

# CONFERENCE PROCEEDINGS

13th Annual International Bata Conference  
for Ph.D. Students and Young Researchers

**DRIVE  
YOUR  
KNOWLEDGE  
BE  
A  
SCIENTIST  
26/4/2017**

 **Tomas Bata University in Zlín**  
Faculty of Management and Economics

**Conference Proceedings**

**DOKBAT**

**13th Annual International Bata Conference  
for Ph.D. Students and Young Researchers**

Copyright © 2017 by authors. All rights reserved.

Edited by: Ing. et Ing. Monika Hýblová

The publication was released within the DOKBAT conference, supported by the IGA project No. SVK/FaME/2017/002.

Many thanks to the reviewers who helped ensure the quality of the papers.

No reproduction, copies or transmissions may be made without written permission from the individual authors.

#### HOW TO CITE:

Surname, First Name. (2017). Title. In *DOKBAT 2017 - 13th Annual International Bata Conference for Ph.D. Students and Young Researchers* (Vol. 13). Zlín: Tomas Bata University in Zlín, Faculty of Management and Economics. Retrieved from <http://dokbat.utb.cz/conference-proceedings/>

ISBN: 978-80-7454-654-9

**Expert guarantor:**

Ing. Jana Matošková, Ph.D.

**Manager and coordinator:**

Ing. Marek Koňářík

**Members of the organizing team:**

Mgr. Iva Honzková

Ing. et Ing. Monika Hýblová

Ing. Viera Pechancová

Ing. Markéta Slovácová

Ing. Lukáš Danko

Ing. Martin Horák

Ing. et Ing. Karel Kolman

**Contact information:**

Ing. Martin Horák

Tomas Bata University in Zlín

Faculty of Management and Economics

Mostní 5139, 760 01 Zlín

Telephone number: +420 728 483 184

E-mail: mhorak@fame.utb.cz

## CONTENT

### **ANTECEDENTS OF EXISTING AND NEW PRODUCTS SELLING: A JOB DEMANDS-RESOURCES (JD-R) CONCEPTUAL MODEL**

Adriana A. Amaya Rivas, Phan Thi Phu Quyen, Jorge Luis Amaya Rivas .....10

### **EXTERNAL DEBT AND CAPITAL FLIGHT: IS HERE A REVOLVING DOOD HYPOTHESIS IN GHANA?**

Ampah Isaac Kwesi, Gabor David Kiss .....21

### **SAVINGS IN POLISH SENIORS' HOUSEHOLDS**

Paulina Anioła-Mikołajczak, Zbigniew Golaś .....36

### **SMART GROWTH CONCEPT: COMPARISON OF EU AND US APPROACH**

Davit Alaverdyan .....46

### **EQUILIBRIUM INTREST RATE BASED ON UTILITY PREFERENCES: THE CASE OF KOSOVO FINANCIAL SYSTEM**

Florin Aliu, Fisnik Aliu .....53

### **SELECTED METHODS OF SUSTAINABILITY OF CUSTOMERS IN E-COMMERCE**

Ottó Bartók .....62

### **FINANCIAL SITUATION AND LIABILITY INSURANCE AS A CRITERION IN SUPPLIER EVALUATION AND SELECTION BY COMPANIES IN THE CZECH REPUBLIC AND GERMANY**

Dagmar Benediktová .....71

### **INTEGRATED SYSTEMS AND METODOLOGIES IN SPANISH FIRMS**

Marta Blasco Torregrosa, Elena Pérez Bernabeu, Víctor Gisbert Soler, María Palacios Guillem .....80

### **APPLICATION OF QUALITY MANAGEMENT SYSTEMS AS A STRATEGIC TOOL IN PERFORMANCE EVALUATION**

Ivana Čandrlić-Dankoš, Anton Devčić, Hrvoje Budić .....90

<b>FAMILY-OWNED WINERIES ONLINE COMMUNICATION WITH THE CUSTOMERS IN HUNGARY</b>	
Gergely Farkas.....	97
<b>CASE STUDY OF COMMUNICATION OF THE PROJECT WATER FOR</b>	
Eva Gartnerová.....	106
<b>HOW THE MANAGEMENT SYSTEMS HAVE BEEN IMPLEMENTED IN SPAIN</b>	
María Palacios Guillem; Elena Perez Bernabeu; Víctor Gisbert Soler and Marta Blasco Torregrosa.....	113
<b>COST STRUCTURE IN SLOVAK STARTUPS BASED ON DEVELOPMENT PHASE</b>	
Ráchel Hagarová.....	127
<b>PERSPECTIVES AND DEVELOPMENT OF THE TOURISM SERVICE IN AZERBAIJAN</b>	
Sabuhi Hasanov .....	136
<b>INTRODUCTION TO MARKETING METRICS AND CHARACTERISTICS OF SELECTED ONLINE MARKETING METRICS</b>	
Vladimír Hojdík.....	144
<b>COMPARISON OF THE SMART CITIES IN THE CZECH REPUBLIC AND FOREIGN COUNTRIES</b>	
Iva Honzková .....	152
<b>INSIGHTS AND PRACTICES FROM BRANDING IN DESTINATION MANAGEMENT</b>	
Monika Hýblová .....	164
<b>EVALUATION OF BUSINESS PERFORMANCE IN SLOVAK REPUBLIC BY ECONOMIC VALUE ADDED</b>	
Monika Jančovičová, Kristína Kováčiková.....	176
<b>SOCIO-ECONOMIC DETERMINANTS OF INTERNACIONAL MIGRATION: EVIDENCE FROM PAKISTAN</b>	
Mohsin Javed, Masood Sarwar Awan .....	182

## **CORPORATE REPUTATION VS. FINANCIAL PERFORMANCE**

**Mária Kozáková .....190**

## **EVALUATION AND EFFICINECY OF ADDITIONAL TRAINING IN CZECH COMPANIES IN THE CONTEXT OF FINANCIAL RESOURCES**

**Ladislav Kudláček .....199**

## **SUSTAINABLE TOURISM DEVELOPMENT - A CASE OF PHU QUOC ISLAND, VIETNAM**

**Vu Minh Hieu, Ngo Minh Vu .....207**

## **CULTURAL TOURISM AND THE TOURISM DEVELOPMENT IN PHU QUOC ISLAND, VIETNAM**

**Vu Minh Hieu, Nguyen Tan Tai.....218**

## **IDENTIFYING MATERIAL ASPECTS AND BOUNDARIES FOR SUSTAINABILITY REPORTING: CASE STUDIES IN CZECH CORPORATIONS**

**Nguyen Thi Thuc Doan .....226**

## **A REVIEW AND CRITIQUE OF RESEARCHES ON KNOWLEDGE MANAGEMENT AND INNOVATION IN ACADEMIA**

**Nguyen Ngoc .....237**

## **INTRODUCTION IN THE EUROPEAN UNION’S SANCTION POLICY AGAINST RUSSIAN FEDERATION**

**Veronika Pastorová .....248**

## **GREEN HUMAN RESOURCE MANAGEMENT, ENVIRONMENTAL AND FINANCIAL PERFORMANCE IN TOURISM FIRMS IN VIETNAM: CONCEPTUAL MODEL**

**Pham Tan Nhat, Zuzana Tuckova .....257**

## **EFFECT OF WEBSITE DESIGN ON POSITIVE ELECTRONIC WORD OF MOUTH INTENTION. THE ROLE MODERATOR OF GENDER**

**Phan Thi Phu Quyen, Michal Pilík .....265**



## **MARKETING COMMUNICATIONS ON B2B MARKETS**

**Lucie Povolná.....274**

## **CONSUMER COMPLAINT BEHAVIOUR, WARRANTY AND WARRANTY CLAIM: BRIEF OVERVIEW**

**Sayanti Shaw.....282**

## **BULL WHIP EFFECT IN THE FMCG INDUSTRY**

**Diána Strommer .....294**

## **MODELS OF SOCIAL HOUSING IN STRATEGIC PLANNING**

**Petr Štěpánek.....304**

## **MODERN STATE OF INSURANCE MARKET IN AZERBAIJAN REPUBLIC**

**Talishinskaya Gunel .....312**

## **ANALYSIS OF THE DEVELOPMENT OF HOTEL SECTOR IN THE REPUBLIC OF KAZAKHSTAN**

**Zuzana Tučková, Dana M. Ussenova.....318**

## **REFORMATION OF THE GERMAN ACCREDITATION SYSTEM - STATUS QUO**

**Susann Wiczorek, Peter Dorčák.....324**

## **THE USE OF FINANCIAL CONTROLLING INSTRUMENTS IN A PARTICULAR COMPANY**

**Jana Zlámalová.....332**

# ANTECEDENTS OF EXISTING AND NEW PRODUCTS SELLING: A JOB DEMANDS-RESOURCES (JD-R) CONCEPTUAL MODEL

*Adriana A. Amaya Rivas, Phan Thi Phu Quyen, Jorge Luis Amaya Rivas*

## Abstract

New product development (NPD) has gained more attention in innovation literature. Due to NPD may determine the unique position that organizations may conquer. However, few studies have examined how salespeople decide to sell existing products and new products. This importance relies on the premise that new products need to be sold by organization's salesforce. The objectives of this study is to (1) to develop a comprehensive and integrative conceptual framework of the antecedents of salesperson existing and new product selling based on the job demands-resources (JD-R). Based on an extensive literature review and the proposed conceptual framework, a self-administered survey will be develop and will be sent to more than 400 salespeople in high-tech's organizations in Taiwan. Then, SPSS and partial least squares (PLS) will be employed to provide a descriptive analysis of the collected data and for further hypotheses testing. Finally, the study will show the expected findings and expected implications for the current literature and for practitioners.

**Keywords:** *product selling performance, job's demands, product complexity, learning orientation, conceptual framework.*

## 1 INTRODUCTION

Nowadays, new product innovation has become one of the most important issue which has gained extensive attention among academic scholars (Page & Schirr, 2008; Min, Kalwani, & Robinson, 2006; Fu, Jones, & Bolander, 2008; Zablah, Franke, Brown, & Bartholomew, 2012). It is important to remark that the introduction of new products is critical to assure firms competitive advantage and survival. According to Cooper (2001) on average, approximately one-third of organization's profits come from new products. Therefore, it is obvious that the profound research related to new product is related. However, also the rate of new product development failure has increased in the past years; this result can be explained by a simple but important axiom: New products may not be sold by themselves. Specifically, sales forces are responsible for enabling the diffusion and trading of the new products (Fu, Richards, Hughes, & Jones, 2010).

We can argue that in some industries the success of the new products depends or is influenced by the degree of efforts that salespeople put on developing new products (Atuahene-Gima, 1997). To serve as a boundary-spanners (Krafft, Albers, & Lal, 2004; Spiro & Weitz, 1990), salespeople play an important function in the building of relationship marketing (Morgan & Hunt, 1994), the success of new products (Ahearne, Rapp, Hughes, & Jindal, 2010), cross-functional product development (Joshi, 2010), new product selling (Zablah et al., 2012). Therefore, many firms have tried to shift more resources to the salespeople's unit (Kotler, 2003; Piercy, Cravens, Lane, & Vorhies, 2006). Moreover, because of the huge investment that organization is doing on the sales force department, it is imperative for managers to manage and to guide in an effective form salespeople's performance (Kraft et al., 2004).

What factors may enhance salesperson's new product selling performance? This question still remains under researched in the new product literature (Fu et al., 2010; Zablah et al., 2012). Moreover, even though the growing importance of the new product selling's field, the current studies do not provide enough insights about how managers may encourage or establish some strategies to impulse equilibrium among the sales of new and existing products (van der Borgh & Schepers, 2014). Indeed there is a vast research directed to recognize the principal factors that may enhance salespeople's performance (Verbeke, Deitz, & Verwaal, 2011). Undoubtedly, for a manager it is necessary to comprehend the factors or mechanisms that are

involved in the salespeople's decision-making. However, despite the fact of the previous researches, it is still a lack of a causal relationship framework that incorporates factors that can enhance new and existing products.

First of all, previous studies have examined several organizational factors such as sales control systems (Ahearne et al., 2010) to analyze sales new product performance. For example, Miao and Evans (2013) investigated the interactive effects of sales control systems of job engagement and job stress. Secondly, on the other hand, previous new product selling studies tended to focus on some specific features of the products such as complexity (Atuahene-Gima & Li, 2006). Another stream of research intended to examine the individual characteristics that influence salesperson's new product performance, for example achievement orientation (Atuahene-Gima & Wei, 2011).

Specifically, most empirical researches have analyzed a single type of factor that may influence on salesperson's new product performance. Although the shed lights that previous studies have provided, it is remarkable to continue the theoretical comprehension of the drivers that enhance salesperson's new product performance (Ahearne et al., 2010). Based on the job demands-resources (JD-R) theory (Bakker & Demerouti, 2007), this study proposes an integrative framework which aims to point out relevance antecedents of new and existing product selling performance.

According to the JD-R theory, job demands and job resources may influence the job outcomes (e.g., performance in selling new product and performance in selling existing products). This influence is through the interaction of the two mechanisms. The first one concentrates on employee job engagement, and the other mechanism concerns job burnout (Baker & Demerouti, 2007). This study proposes customer orientation selling behavior and selling effort as proxies of salespeople's job engagement due to (1) these two kinds exemplify the effort that salespeople put into the selling tasks and (2) customer orientation selling behavior has been considered extremely important in the sales literature due to its influence on sales outcomes (Homburg, Wieseke, & Bornemann, 2009; Brown & Peterson, 1994). Lastly, this study has selected some of the most relevant factors that are consistent with analogous boundary-spanning setting (Zablah et al., 2012) such as goal conflict, role overload and job tension.

As expected result, this study proposes four main contributions: (1) to employ the JD-R model as an integrative framework for research on salesperson's new and existing product performance; (2) to analyze self-regulation training, salespeople's innovativeness, managerial new product selling orientation, managerial existing product orientation, and managerial ambidextrous selling orientation as possible job resources, which may impact on the stress that salespeople can suffer and at the same time may impact on the job engagement; (3) to examine the moderating role of power distance between the relationships of job demands and job resources on job burnout and job engagement; (4) to examine experience as another factor that moderates the effects of job burnout and job engagement on new and existing product selling performance.

## **2 LITERATURE REVIEW**

### **2.1 JD-R Theory**

The JD-R theory proposes four different groups of research constructs (e.g. demands, resources, burnout, and engagement) which lead to some specific outcomes. In an essence, JD-R can be explained by the dual-process theory that is composed by the job demands and job resources which interact to impact on other two processes: job burnout and job engagement (Bakker et al., 2010). Notably, the model asserts that demands are the principal drivers of burnout. Contrary, resources reduce burnout and relieving the pressure of the negative influences of demands. Furthermore, resources act as the main drivers of engagement, but demands reduce engagement (Bakker & Demerouti 2007). Moreover, burnout and engagement will influence negatively and positively on sales performance outcomes, correspondingly. Precisely, this

theoretical lens are prominently useful for understanding the tradeoff between new and existing product selling dilemma.

Currently, a vast research on new product selling has acknowledged several factors such as training, self-efficacy, and competitive intensity. Those factors may fortify or reduce salesperson's willingness to sell new products (Ahearne et al. 2010; Fu, Richards, & Jones 2009). In addition, the proposed factors are based on different theories. The JD-R model offers the opportunity to explain some mechanisms factors that can explain the influence of the demand and resources factors on new and existing products performance. Therefore, the JD-R theory offers a logical causal chain which may permit to organize the different set of factors, resulting from different theories, which have demonstrated to impact not only in the decision of selling existing product but also in the decision of selling new products.

## **2.2 Operationalization of the research constructs**

In accordance with JD-R theory, every employment may possess its own unique requirements which are related with job stress, these variables can be categorized in two broad sets: job demands and job resources (Bakker & Demerouti, 2007). It is clear that due to the different possible settings of the job, the explicit constructs employed in JD-R-based researches can vary depending on the characteristics of the job (Bakker, van Veldhoven, & Xanthopoulou, 2010; Zablah et al., 2012).

Specifically, in this study, applying the terminology of JD-R theory, product complexity can be understood as job demands because it specifies a breadth complex information that salespeople need to process and to explain to the customers (Jones, Brown, Zoltners, & Weitz, 2005; Johnson & Sohi, 2014). Likewise, learning orientation can be perceived as job demands to be executed by salespeople. Learning orientation may require that salespeople possess the capability of discovering how successfully accomplish with sales jobs and how to improve selling skills (Sujan, Weitz & Kumar, 1994). In terms to cope with new and existing products selling, this study considers that learning orientation is an important job demand.

In contrast, self-regulation training can be understood as a job resource because self-regulation training is precisely designed for the organizations to develop on salespeople's efficient self-regulation which implies five techniques such as setting clear, challenging goals for performance outcomes, visualizing obstacle to success; planning how to overcome obstacles, self-monitoring progress, and using self-reinforcement to motivate accomplishments (Gist, Stevens, & Bavetta, 1991). This job resource offers by the organization through the sales managers may facilitate sales force to cope with the job demands. In the same direction, salespeople's innovativeness can be perceived as another job resource that salesperson may hold that will permit them to be flexible and willingness to take new ways of problem solving, to accept new approaches and to be innovative in their selling procedures (Matsuo, 2009; Chen, Peng, & Hung, 2015).

Moreover, managerial new product selling orientation, managerial existing product selling orientation and managerial ambidextrous selling orientation are presented as possible job resources provided by the organizations. These three selling orientations reveal a manager's arrangement of strategic and tactical selling goals that regulate the sales force's work environment (Marinova, Ye, & Singh, 2008; Van de Borg & Schepers, 2014).

## **3 PROPOSED CONCEPTUAL FRAMEWORK**

As depicts in Figure 1, the new and existing selling factors are projected to relate to each other based on JD-R theory. The point that this study wants to emphasize is that numerous demands, resources, burnout, and engagement factors, which differ from salesperson to salesperson and product to product, are connected with new and existing product selling situations. Thus, this study proposes the following propositions:

Proposition 1a, 1b, 1c: Product complexity increases salespersons' goal conflict, role overload, and job tension.

Proposition 2a, 2b, 2c: Learning orientation increases salespersons' goal conflict, role overload, and job tension.

Proposition 3a, 3b, 3c: Self-regulation training decreases salesperson's goal conflict, role overload, and job tension.

Proposition 4a, 4b, 4c: Salespeople's innovativeness decreases salesperson's goal conflict, role overload, and job tension.

Proposition 5a, 5b, 5c: Salespeople's managerial NP selling orientation decreases salesperson's goal conflict, role overload, and job tension.

Proposition 6a, 6b, 6c: Salespeople's managerial EP selling orientation decreases salesperson's goal conflict, role overload, and job tension.

Proposition 7a, 7b: Product complexity decreases salespersons' customer orientation behavior and salespersons' selling effort.

Proposition 8a, 8b: Learning orientation decreases salespersons' customer orientation behavior and salespersons' selling effort.

Proposition 9a, 9b: Goal conflict decreases salespersons' customer orientation behavior and salespersons' selling effort.

Proposition 10a, 10b: Role overload decreases salespersons' customer orientation behavior and salespersons' selling effort.

Proposition 11a, 11b: Job tension decreases salespersons' customer orientation behavior and salespersons' selling effort.

Proposition 12a, 12b: Goal conflict decreases salesperson performance selling new and existing products.

Proposition 13a, 13b: Role overload decreases salesperson performance selling new and existing products.

Proposition 14a, 14b: Job tension decreases salesperson performance selling new and existing products.

Proposition 15a, 15b: Salesperson's customer orientation increases performance selling new and existing **products**.

Proposition 16a, 16b: Salesperson's selling effort increases performance selling new and existing products.

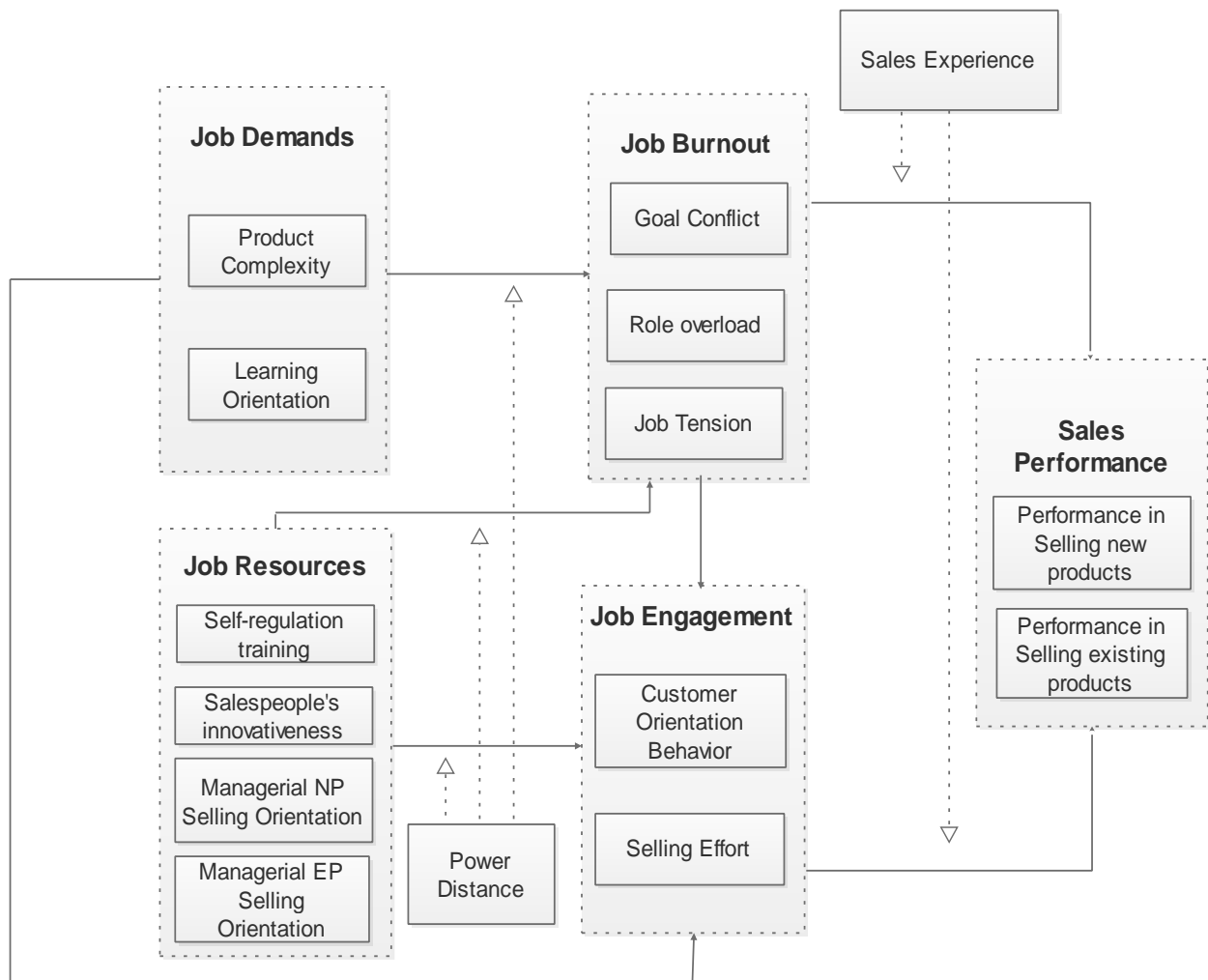


Figure 1. Proposed Conceptual Model

## 4 RESEARCH DESIGN AND METHOD

### 4.1 Research Model

The principal aim of the present study, accordingly, will be to emphasize the demands, burnout, resources, and factor engagement that salespeople may incur that may determine their sales performance (e.g. performance of new products and performance of existing products). This study regards demands from salespeople is crucial to transform salespeople' knowledge and skills as well into the willingness to sell existing products as well as new products. This study will also consider resources as crucial factors that will determine sales performance. Similar to the demands and resources that salespeople may have, this study will propose that salespersons' burnout factors and engagement factors are factors that need to take into consideration to enhance sales performance.

Moreover, this study will propose that there are two moderators involved in this study. First, this study asserts that the relationships between the job resources' factors and the job burnout and job engagement's factors have different magnitudes when there is high or low power distance. Second, this study will propose that the associations between job demands' factors and job burnouts' factors will be moderated by the power distance that exists in the organization. Third, this study proposes the positive effects of job engagements'

factors on sales performance are strengthened when salespeople are more experienced rather than low. Fourth, this study proposes that salespeople experience also serves as a moderator between job burnout's factors and sales performance.

Based on the above literature review, the propositions are developed maybe theoretically correct, but mostly still in lack of empirical validation. Since the development of this model is still on the exploratory stage, this study will take two stages to accomplish. In the first stage, the research will focus on developing and modifying a research framework by investigating the job demands, burnout, resources, and engagement factors through literature review, expert interview, and focus group. In the second stage, the measurement scales of the research constructs will be developed and their reliability and validity will also be evaluated. The research model will be evaluated through questionnaire survey by targeting the samples from salespeople of firms in three science parks of Taiwan. Multivariate data analyses will be employed to empirically validate the developed research hypotheses.

#### **4.2 Research Design and Methodology for the first-stage**

In order to assure the reliability and validity of the research findings, the first-stage study initially will conduct a systematic literature review. Then, two studies will be conducted; study one: qualitative study (in-depth interviews and focus group discussion); and study two: meta-analysis. The most relevant existing literature regarding to the principal factors that comprise job demands, job resources, job burnout and job engagement of new and existing products will be reviewed. Then, it is necessary a deep revision of the theories underlying each of the variables to be used. Based on the exhaustive literature review, this study posits 16 research hypotheses. Grounded theory procedures will be applied to interpret the contents of the in-depth interviews and focus groups discussion, such as open coding, axial coding, and selective coding (Glaser & Strauss, 1967). Next, the content analysis will be carried out to recognize the associations between the proposed research constructs.

#### **4.3 Research Design and Methodology for the second-stage.**

Based on the results that will be obtained from the qualitative study, the research model and the proposed hypotheses will be revised. The proposed hypotheses can be explained through multiple theories, such as JD- R theory, goal theory, role theory. Finally, the study two will encompass a self-administered survey in order to evaluate the research hypotheses based on the information that will be gathered from salespeople.

#### **4.4 Participants and Sampling Plan**

In this study, self-administered survey will be disseminated to Human Resource managers, Salespeople managers of firms competing in high-tech industries in Taiwan. These types of firms are inclined to engage in intense product innovation, thus, it can be assured that they continually launch new products. In order to identify proper participants from the selected firms, this sample will be selected based on the following stages. First, this study will contact the Human Resource managers and salespersons' managers as key informants through e-mail. Then, these managers will recommend salespeople as the candidates of the samples. In order to ensure the collaboration of the respondents, a personalized letter with requests for their participation will be sent from researcher with university-addressed. Also, some follow-up telephone calls will be performed. Respondent anonymity and complete confidentiality will be ensured through employing a link to a separate web site where the respondents can answer the survey.

#### **4.5 Data Analysis Procedures**

In order to test the hypotheses, SPSS 20.0, AMOS 21.0 and SmartPLS will be applied to examine the collected data. A serial of data analysis techniques will be employed.

#### **4.6 Descriptive Statistic Analysis**

Descriptive statistics will be used to explain the characteristics of a collection of data in quantitative terms. Descriptive statistics including frequency, means, and standard deviation of each research variables and cross-tabulation of the demographic variables will be presented. Descriptive statistics will be selected to illustrate the features of the collected data.

#### **4.7 Reliability and Validity Measures**

To ensure instrument validity and dimensionality, several refinement procedures will be employed. First, factor analysis aims to identify the dimensionality of each research construct, ensure the selection of the questionnaire items with high factor loading, and contrast the chosen items with items proposed theoretically. Second, latent roots (Eigenvalues), scree test, and other measure will be computed to confirm the number of dimensions to put into the principal component factor analysis. Following Hair's et al. (2010) guidance, it is important to achieve five threshold criteria. Specifically, factor loading should be greater than 0.6; Eigenvalue  $>1$ , accumulated explained variance  $> 0.6$ , Item-to-total correlation  $>0.5$ , and coefficient alpha ( $\alpha$ )  $> 0.7$ . However, there is a possibility that common method variance still remains in self-reporting scales. In order to assess the potential common method variance the following validity examinations will be conducted.

First, a Harmon one-factor will be adopted which loads all variables into a principal component factor analysis. Second, discriminant validity will be performed thorough the comparison of the square root of the AVE (average variance extracted) with the Pearson correlations among the constructs. Then, all AVE estimates should be greater than the corresponding inter construct square correlation estimates (Hair, et al., 2010). Finally, this study will be examined by adding one latent common market variable (CMV) with the proposed five constructs measurement model to assure that there is no correlation between the new market variable and the other seven constructs (Podsakoff et al., 2003). Finally, this study will employ K-means method to cluster the respondents into 4 groups for each relational moderator in order to evaluate the moderating effects of power distance and experience moderators.

### **5 EXPECTED RESULTS**

The primary aim of this study will be to identify the demands, resources, burnout factors, engagement factors, and consequences on performance in selling new and existing products. It will be expected that salespeople who can access to relevant resources (e.g., self-regulation training, salespeople's innovativeness, managerial NP selling orientation, managerial EP selling orientation, and managerial ambidextrous SO) are likelihood to perceive that devoting effort to sell existing and new products may lead to desired rewards (i.e., rewards, increase in the sales, etc.); as a result, salespeople are likely to spend more time and energy in the new product.

Through this study, it will be expected that salespeople may intend to find a balance between existing and new products and new and old customers. It will be expected that burnout factors result when salespeople perceive that they cannot protect the value job resources from the demands of the jobs. In a NPD context, it is expected that these negative perceptions decrease when salespeople can access to resources than enable them to achieve the demands related to new and existing products. Therefore, it is expected that the availability of resources may diminish the levels of burnout among salespeople.

Based on the JD-R theory, it will be expected that job resources will help salespeople to meet the job demands. In other words, when salespeople need to accomplish high levels of job demands, then job resources tend to decrease, resulting into high levels of burnout and in other negative outcomes. Following Bakker and Demerouti (2007), it will be expected that in a NPD context, certain job demands (e.g. product complexity, learning orientation, and productivity orientation) may increase the stress among salespeople.



Due to the complexity of the product, salespeople may be under high levels of work pressure and customer workloads, increasing their levels of stress.

Due to the proposed job demands in this study, it will be expected that salespeople consider these as challenge (Crawford et al, 2010). Precisely, challenge job demands may provide a positive feelings and increase the participation of the salespeople in the problem solving process. Product complexity, learning orientation, and productivity orientation can be considered as a challenge demands. Salespeople will understand that these challenge demands as an opportunity to increase their growth (Kahn, 1990). Therefore, it will be expected that these positive emotions will increase the levels of motivation and engagement.

## **6 DISCUSSION AND CONCLUSIONS**

This study extends a dual process model, based on JD-R theory, of the drivers of salespersons' existing and new product outcomes. While extant literature only offers partial evidence in support for the model's proposition, the JD-R theory advanced in this study and appropriate includes the proximate and distal determinants (i.e., constructs) of existing and new product selling outcomes examined in prior studies; it also provides a well-established theoretical rationale for the causal associations likely to exist between these drivers.

This study will contribute to the extension of the current literature in the next three ways: First, this study will employ the JD-R model as an integrative framework for research on salesperson's new and existing product performance; so far, this study will consider other job demands constructs (e.g., learning orientation, performance orientation, and product complexity) as potential determinants of job burnout and job engagement. Besides, job demands may directly or indirectly impact on new and existing product selling performance.

Second, this study will pose that self-regulation training, salespeople's innovativeness, managerial new product selling orientation, and managerial existing product orientation, as possible job resources, which may impact on the stress that salespeople can suffer and at the same time may impact on the job engagement. Third, this study will identify goal conflict, role overload, and job tension as three of the most significant factors that may compose the job burnout which mediates the relationship between job demands and new and existing product selling performance. Moreover, job burnout's factors may influence on job engagement's factors.

The interrelationships among job demand's factor, job resource's factors, job burnout's factors, and job engagement's factors are also assessed. Finally, this study will recognize power distance as a factor that moderates the effects of job demands and job resources on job burnout and job engagement. Also, this study suggests experience as another factor that moderates the effects of job burnout and job engagement on new and existing product selling performance.

### **References**

- Ahearne, M., Rapp, A., Hughes, D. E., & Jindal, R. (2010). Managing sales force product perceptions and control systems in the success of new product introductions. *Journal of Marketing Research*, 47(4), 764-776.
- Atuahene-Gima, K., & Wei, Y. S. (2011). The vital role of problem-solving competence in new product success. *Journal of Product Innovation Management*, 28(1), 81-98.
- Atuahene-Gima, K., & Li, H. (2006). The effects of formal controls on supervisee trust in the manager in new product selling: Evidence from young and inexperienced salespeople in China. *Journal of Product Innovation Management*, 23(4), 342-358.

- Atuahene-Gima, K. (1997). Adoption of new products by the sales force: The construct, research propositions, and managerial implications. *Journal of Product Innovation Management*, 14(6), 498-514.
- Bakker, A. B., Boyd, C. M., Dollard, M., Gillespie, N., Winefield, A. H., & Stough, C. (2010). The role of personality in the job demands-resources model: A study of Australian academic staff. *Career Development International*, 15(7), 622-636.
- Bakker, A. B., & Demerouti, E. (2007). The job demands-resources model: State of the art. *Journal of Managerial Psychology*, 22, 309-328.
- Brown, S. P., & Peterson, R. A. (1994). The effect of effort on sales performance and job satisfaction. *The Journal of Marketing*, 58(2), 70-80.
- Chen, A., Peng, N., & Hung, K. P. (2015). Managing salespeople strategically when promoting new products—Incorporating market orientation into a sales management control framework. *Industrial Marketing Management*, 47, 147-155.
- Cooper, R. G. (2001). *Winning at New Products, Accelerating the Process from Idea to Launch*. Cambridge, Perseus.
- Crawford, E., LePine, R. J., & Rich, B. L. (2010). Linking job demands and resources to employee engagement and burnout: A theoretical extension and meta-analytic test. *Journal of Applied Psychology*, 95(5), 834-848.
- Fu, F. Q., Richards, K. A., Hughes, D. E., & Jones, E. (2010). Motivating salespeople to sell new products: The relative influence of attitudes, subjective norms, and self-efficacy. *Journal of Marketing*, 74(6), 61-76.
- Fu, F. Q., Jones, E., & Bolander, W. (2008). Product innovativeness, customer newness, and new product performance: a time-lagged examination of the impact of salesperson selling intentions on new product performance. *Journal of Personal Selling & Sales Management*, 28(4), 351-364.
- Gist, M. E., Stevens, C. K., & Bavetta, A. G. (1991). Effects of self-efficacy and post-training intervention on the acquisition and maintenance of complex interpersonal skills. *Personnel psychology*, 44(4), 837-861.
- Glaser, B. G., & Strauss, A. L. (1967). *Discovery of grounded theory: Strategies for qualitative research*. Chicago: Aldine
- Hair, J., Black, W., Babin, B. J., & Anderson, R. E. (2010). *Multivariate data analysis (7th ed.)*. New Jersey: Prentice Hall.
- Homburg, C., Wieseke, J., & Bornemann, T. (2009). Implementing the marketing concept at the employee-customer interface: the role of customer need knowledge. *Journal of Marketing*, 73(4), 64-81.
- Johnson, J. S., & Sohi, R. S. (2014). The curvilinear and conditional effects of product line breadth on salesperson performance, role stress, and job satisfaction. *Journal of the Academy of Marketing Science*, 42(1), 71-89.
- Jones, E., Brown, S. P., Zoltners, A. A., & Weitz, B. A. (2005). The changing environment of selling and sales management. *Journal of Personal Selling & Sales Management*, 25(2), 105-111.
- Joshi, A. W. (2010). Salesperson influence on product development: insights from a study of small manufacturing organizations. *Journal of Marketing*, 74(1), 94-107.
- Kahn, W. A. (1990). Psychological conditions of personal engagement and disengagement at work. *Academy of Management Journal*, 33, 692-724.
- Kotler, P. (2003). *Marketing management (11th ed.)*. Upper Saddle River: Pearson Education.
- Krafft, M., Albers, S., & Lal, R. (2004). Relative explanatory power of agency theory and transaction cost analysis in German sales forces. *International Journal of Research in Marketing*, 21(3), 265–283.

- Marinova, D., Ye, J., & Singh, J. (2008). Do frontline mechanisms matter? Impact of quality and productivity orientations on unit revenue, efficiency, and customer satisfaction. *Journal of Marketing*, 72(2), 28-45.
- Matsuo, M. (2009). The influence of sales management control on innovativeness of sales departments. *Journal of Personal Selling & Sales Management*, 29(4), 321-331.
- Miao, C. F., & Evans, K. R. (2013). The interactive effects of sales control systems on salesperson performance: a job demands–resources perspective. *Journal of the Academy of Marketing Science*, 41(1), 73-90.
- Min, S., Kalwani, M. U., & Robinson, W. T. (2006). Market pioneer and early follower survival risks: A contingency analysis of really new versus incrementally new product-markets. *Journal of Marketing*, 70(1), 15-33.
- Morgan, R. M., & Hunt, S. D. (1994). The commitment-trust theory of relationship marketing. *The Journal of Marketing*, 58(3), 20-38.
- Page, A. L., & Schirr, G. R. (2008). Growth and development of a body of knowledge: 16 years of new product development research, 1989–2004. *Journal of Product Innovation Management*, 25(3), 233-248.
- Piercy, N. F., Cravens, D. W., Lane, N., & Vorhies, D. W. (2006). Driving organizational citizenship behaviors and salesperson in-role behavior performance: The role of management control and perceived organizational support. *Journal of the Academy of Marketing Science*, 34(2), 244-262.
- Podsakoff, P. M., MacKenzie, S. B., Lee, J. Y., & Podsakoff, N. P. (2003). Common method biases in behavioral research: A critical review of the literature and recommended remedies. *Journal of Applied Psychology*, 88(5), 879-903.
- Spiro, R. L., & Weitz, B. A. (1990). Adaptive selling: Conceptualization, measurement, and nomological validity. *Journal of Marketing Research*, 27(1), 61-69.
- Sujan, H., Weitz, B., and Kumar, N. (1994). Learning orientation, working smart, and effective selling. *Journal of Marketing*, 58(3), 39-52.
- van de Borgh, M., & Schepers, J. J. (2014). Do retailers really profit from ambidextrous managers? The impact of frontline mechanisms on new and existing product selling performance. *Journal of Product Innovation Management*, 31(4), 710-727.
- Verbeke, W., Dietz, B., & Verwaal, E. (2011). Drivers of sales performance: a contemporary meta-analysis. Have salespeople become knowledge brokers?. *Journal of the Academy of Marketing Science*, 39(3), 407-428.
- Zablah, A. R., Franke, G. R., Brown, T. J., & Bartholomew, D. E. (2012). How and when does customer orientation influence frontline employee job outcomes? A meta-analytic evaluation. *Journal of Marketing*, 76(3), 21-40.

**Contact Information**

Adriana A. Amaya Rivas

Ph.D.

Department of International Business Administration, Chinese Culture University

No. 55, Hwa-Kang Rd., Yang-Ming Shan, Taipei, 11114, Taiwan

Corresponding author

[adrianaamayarivas@gmail.com](mailto:adrianaamayarivas@gmail.com)

Phan Thi Phu Quyen

Ph.D. Student

Faculty of Management and Economics, Tomas Bata University in Zlín

T.G Masaryka 5555, 760 01, Zlin - Czech Republic

[phuquyen.due@gmail.com](mailto:phuquyen.due@gmail.com)

Jorge Luis Amaya

Ph.D.

Escuela Superior Politécnica del Litoral, ESPOL, Facultad de Ingeniería Mecánica y Ciencias de la Producción, Campus Gustavo Galindo Km 30.5 Vía Perimetral, P.O. Box 09-01-5863, Guayaquil, Ecuador

[jorge-luis.amaya@espol.edu.ec](mailto:jorge-luis.amaya@espol.edu.ec)

# EXTERNAL DEBT AND CAPITAL FLIGHT: IS HERE A REVOLVING DOOD HYPOTHESIS IN GHANA?

*Ampah Isaac Kwesi, Gabor David Kiss*

## Abstract

Over the past few decades, Ghana in its bid to achieve economic growth and development resorted to external borrowings, propelling her into the status of Heavily Indebted Poor Country, when her debt reached unsustainable levels in the year 2000. Unfortunately, Ghana's economy reported only steady growth with successive periods of high inflation and undesirable balance of payments deficits leading scholars to ask whether external debt really contributes to growth. At the same time, there is now considerable evidence that the build-up in debt was accompanied by increasing capital flight from the country. Employing Autoregressive Distributed Lag (ARDL) model and dataset from 1970 to 2012, this paper investigated the apparent positive relationship between external debts and capital flights in Ghana. The results revealed that capital flight exerted a positive and statistically significant effect on external debt both in the short-run and long-run suggesting that if capital flight remains unchecked, it will continue to lead to massive external debt accumulation in Ghana. The Toda–Yamamoto Approach to Granger causality test also revealed the existence of a debt-fueled capital flight signifying the need for sound domestic debt management to deal with high external borrowing that is causing massive capital flight in the country.

**Keywords:** *Ghana; external debt; capital flight; cointegration; Granger causality; Heavily Indebted Poor Country.*

## 1 INTRODUCTION

Every country around the globe aims at achieving growth and development. Nevertheless, this is only possible if a country has sufficient resources to finance it. In developing countries especially the ones in Sub-Sahara Africa, the resources are not readily available to fund the optimal level of economic growth and development (World Bank, 2009). Basically, for this reason, many developing countries longing for economic growth undoubtedly resort to external financing to bridge the disparity between their savings and investments. Besides, external borrowing is preferable to domestic borrowing because the interest rates normally charged by the international financial institutions like the International Monetary Funds (IMF) and the World Bank is about half to the one charged by the domestic financial institutions (Safdari and Mehrizi, 2011).

However, the massive and continuous accumulation of external debt by Sub-Saharan Africa countries over the past few decades have given rise to concerns about the detrimental effects of such debt on economic growth, principally known as the "debt overhang" effect. The "debt overhang" effect indicates that high level of external borrowing discourage private investment, which adversely affects growth as future higher taxes are expected to repay the debt. Again, fears are often expressed that increasing external debt burdens will threaten financial stability with impacts for the economy, or that increases in debt will create political pressures that will make acceleration of inflation inevitable (Ajayi and Khan, 2000).

Ghana in its bid to achieve economic development resorted to external borrowings over the years, and so face the same question of whether external debt contributes to its economic progress. For instance, from an estimated total of \$6 million at the end of 1960, the external debt of Ghana rose to US\$591 million (114%) in 1972 and then rose further to US\$6 billion in nominal terms at the end of 2000. In the year 1999, when the Heavily-Indebted Poor Countries (HIPC) initiative was introduced by the International Monetary Fund (IMF) and the World Bank, Ghana was judged to be an HIPC country with unsustainable debt reaching over 100% of GDP in 2000 (Institute of Economic Affairs (IEA), 2012). The country subsequently benefited from debt relief under the initiative in 2004 when it met the full debt policy conditions.

Subsequently, in 2006, Ghana, additionally benefitted from the Multilateral Debt Relief Initiative (MDRI), which presented total debt relief owed to the International Development Association (IDA) of the World Bank, the IMF, and the African Development Bank (AfDB). The HIPC and MDRI reliefs triggered a massive reduction in Ghana's debt to approximately 26% of GDP, which was seen as a sustainable level. Subsequent after these reliefs, Ghana's debt has been growing at a rapid pace basically to finance infrastructure and development projects. This has mainly caused the post-HIPC/MDRI debt level to increase, reaching about 67% of GDP in 2014. Warnings are being sounded, including the IMF and other development partners, that the rate of borrowing could return Ghana's debt to unsustainable levels again. Some schools of the thought even argue that Ghana could go back to HIPC status yet again (IEA, 2012).

Furthermore, as the severity of external indebtedness becomes so pronounced, so too is capital flight. The latest estimates of capital flight from Sub-Saharan African countries show that Ghana lost a total of \$12.4 billion between 1970 and 2010 (Boyce and Ndikumana, 2012). This amount exceeds official development aid and Foreign Direct Investment for the same period. Some in the international donor community have regarded this outward movement of capital as compounding the problem of external debt management and have suggested that meaningful discussions of the solutions to external debt will need to wait until the issues of capital flight are dealt with. Indeed, some researchers have suggested that solutions to capital flight be made a precondition to discussions on external debt relief (Eggerstedt, Hall and Wijnbergen, 1994).

Even though, Ghana is one of the heavily-indebted countries where the issue of capital flight has been significant. There is, however, no comprehensive study on the consequences of capital flight on external debt with particular reference to Ghana. The main objective of this study is to examine the long run and short run relationship as well as the level of causality between external debt and capital flight using time series dataset for Ghana from 1970 to 2012. By examining the covariation between external debt and capital flight, the study hopes to provide vital information that would be of help in formulating effective and efficient policies towards minimizing macroeconomic imbalances caused by heavy debt obligation and capital flight in Ghana.

This study is organized into five parts. The first part, which is the introductory chapter, presents a background to the study highlighting the problem statement, the objectives of the study, the scope as well as the organization of the study. The second part presents a review of relevant literature. The third presents the methodological framework and techniques employed in conducting the study. Section four examines and discusses the results, and major findings concerning the literature and the final part present the findings and policy implications of the study.

## **2 LITERATURE REVIEW**

The relationship between external borrowing and capital flight has been well documented in the literature, which recognizes that annual flows of foreign borrowing constitute the most consistent determinant of capital flight. A review of the literature suggests that the simultaneous occurrence of capital flight and foreign debt in a country is theoretically plausible. In the case of Argentina, Dornbusch and de Pablo (1987) noted that commercial banks in New York had lent the government the resources to finance capital flight which returned to the same bank as deposits. In a sample of 30 sub-Saharan countries over the period 1970-96, Ndikumana and Boyce (2003) found that for every dollar of external debt acquired by a country in SSA in a given year, on average, roughly 80 cents leave the country as capital flight. Their results also support the hypothesis by Collier, Hoeffler, and Pattillo (2004) that a one-dollar increase in debt adds an estimated 3.2 cents to annual capital flight in subsequent years. This result leads to the question of why countries borrow heavily while at the same time capital is fleeing abroad. From the literature, there are two main points of view;

- The indirect theory by Morgan Guaranty Company (1986)
- Direct Linkages Theories by Boyce (1992).

## 2.1 Indirect theory

According to Morgan Guaranty Company View (1986), the simultaneous occurrence of external debt accumulation and the outflow of capital from developing countries is not a natural coincidence but rather the track record of bad policies that caused capital flight to rise is the same policies responsible for increases in external debt accumulation. This view of the external debt and capital flight linkage maintains that the relationship between the two may be attributed to poor economic management, policy mistakes, corruption, rent-seeking behavior, weak domestic institutions, and the like. For instance, the Morgan Guaranty Trust Company (1986) contends that indirect factors such as low economic growth, overestimated exchange rates, and poor fiscal management by governments in developing countries is not only causing capital flight but also creating demand for foreign borrowing.

Another contention of the indirect theory by Morgan Guaranty Company (1986) is that capital inflows (especially during surges of capital flows) lead to risky or unsound investment decisions and over-borrowing. When governance structure and mechanisms for administrative controls and prudential regulation are weak or fragile, money borrowed from abroad can end up being pocketed by the domestic elite (and usually transferred into private accounts abroad). Which is spent on conspicuous consumption, or allocated to showcase and unproductive development projects that do not generate foreign exchange to finance external debt servicing? So capital flight and external borrowings are manifestations and responses to unfavorable domestic economic conditions. However, this perspective on the debt-flight association is unable to provide a rationale for the observed year-to-year contemporaneous linkages between debt and capital flight in a country. Indeed, an alternative scenario of the complicated nature of the debt-flight relationship is that lower debt inflows mirror and contribute to deteriorating local economic conditions that result in greater capital flight.

## 2.2 Direct Theory

According to Ajayi (1997), the direct linkages theory contends that external borrowing directly causes capital flight by providing the resources necessary to effect flight. Cuddington (1987) and Henry (1986) showed that in Mexico and Uruguay, capital flight occurred contemporaneously with increased debt inflows, thus attesting to a strong liquidity effect in these countries. According to this theory, external resources acquired as loans can create conditions for capture as “loot” that individuals (often the elite) appropriate as their own. In fact, according to Edser and Bayer (2006), the (captured) funds may not even enter the country at all. Instead, only accounting entries are entered in the respective accounts of the financial institutions. Boyce (1992) further distinguishes four possible equal links between external debt and capital flight.

The first is the **debt-driven capital flight**. According to Boyce (2012), in a debt-driven capital flight, residents of a country are motivated to move their assets to foreign countries due to excessive external borrowing by the domestic government. The outflow of capital is, therefore, in response to fear of the economic consequences of heavy external indebtedness. The effects of debt-driven capital flight include; expectations of exchange rate devaluation and crowding out effect on domestic capital, avoidance of expropriation risk and the imposition of high taxes, among other distortions. In a debt crisis, the domestic investors may expect to pay higher taxes to the government to meet debt service obligations. So the desire to avoid such taxes in the future causes capital flight is. The second is **Debt-fueled capital flight**. In a debt-fueled capital flight, the capital borrowed provides both the motive and the resources for capital flight. This form of capital flight is motivated by the inflow of foreign capital in the form of loans, which are then siphoned away by corrupt leaders (Ajayi, 1997). There are two processes through which money is siphoned abroad. Firstly, the domestic government could acquire foreign capital (foreign exchange) by external borrowing and then sell the currency to domestic residents who transfer it abroad either by legal or illegal means. Secondly, the government can on-lend funds to private borrowers through a national bank, and the

borrowers, in turn, transfer part or all of the capital abroad. In this case, external borrowing provides the necessary fuel for capital flight (Ajayi, 1997).

The **Flight-driven External Borrowing** is a situation where after the capital flight, which dries up domestic resources, a gap between savings and investment rises, so the government borrows more resources from external sources to fill the resource gap created in the domestic economy. This situation occurs due to the resource scarcity in the domestic economy, both the public and private sectors seek for a replacement of the lost resources by acquiring more loans from external creditors. The external creditor's willingness to meet this demand can be attributed to different risks and returns facing residents and non-resident capital. "The systemic differences in the risk-adjusted financial returns to domestic and external capital could also arise from disparities in taxation, interest rate ceilings and risk-pooling capabilities" (Lessard and Williamson, 1987). Finally, the **Flight-fueled External Borrowing** occurs when the domestic currency siphoned out of the country through capital flight re-enters in the form of foreign currency that finances external loans to the same residents who transferred the capital. In other words, the domestic capital is converted to foreign exchange and deposited in foreign banks, and the depositor then takes a loan from the same bank in which the deposit may serve as collateral. This phenomenon is also known as round-tripping or back-to-back loans (Boyce, 1992).

At the empirical level, Saxema & Shanker (2016) examined the dynamics of external debt and capital flight in the India's economy; they authors used Two Staged Least Square (2SLS) method to investigate the relationship during the period 1990-2012. The result of the study indicates a positive relationship between external debt and capital Flight in India.

Usai & Zuze (2016), provided a similar analysis in Zimbabwe using the Vector Autoregression. The main objective of their study was to establish the direction of causality between capital flight and external debt for the period 1980-2010 in the essence of the revolving door hypothesis. Their study employed the Granger causality test to investigate this relationship. The pairwise Granger causality test revealed the existence of a uni-directional relationship running from external debt to capital flight. Their result indicates that for Zimbabwe, external debt has had an influence on capital flight and not the other way round.

Hassan and Abu Bakar (2016), also examine the impact of external debt on the growth and development of capital formation in Nigeria. Time series data was used for a period from 1980 to 2013, employing the Autoregressive Distributed Lag (ARDL) modeling. The result of stationarity tests showed that the variables are both I(0) and I(1) necessitating the use of the ARDL. The ARDL estimation also revealed the presence of long run relationship amongst the variables. However, the study showed that the variables were related independently in the long-run. The result also indicated a negative and statistically significant association between external debt and capital formation while savings came out as the only variable with a bidirectional causal relationship amongst the variables. The interest rate was also statistically significant even though it was weak. The other variables were found to be of unidirectional causal effects.

Boyce and Ndikumana (2014) also examine the impacts of capital flight with linkages with external borrowing in Sub-Saharan Africa. The results of the study established that Sub-Saharan Africa is a net creditor to the rest of the world because the private external assets exported exceed its external public liabilities. This finding suggests the existence of debt-fueled capital flight. The results also show a debt overhang effect, as increases in the debt stock spur additional capital flight in later years and underscore the of natural resource-rich countries. The studies also emphasize the significant role of government institutions and structures in alleviating the dangers of capital flight, while political uncertainty is found to be key a determinant of capital flight.

In a nutshell, the relationship between capital flight and external debt have been the focus of many types of research and policymakers. Under conventional expectations, the bi-directional relationship between capital flight and external debt which is also known as the revolving door hypothesis seems to be a more common research finding. However, there is no discussion or empirical study on the relationship



between external debt and capital flight in the Ghanaian context. The researchers feel the need to fill this void by empirically examining the relationship between this variable from 1970 to 2012.

### 3 METHODOLOGY

#### 3.1 Empirical Model Specification

Based on the framework illustrated in the review, the study adopted the method used by Saxema (2016) for the Indian economy, Ajilore (2014) for the Nigerian economy and Demir (2004) for the Turkey's economy to mimic the bi-directional causality between the main variables of the study. The model, therefore, can be specified as:

$$InEXT_t = \alpha_1 + \beta_1 CF_t + \beta_2 InGDP_t + \beta_3 POLITY_t + \beta_4 INF_t + \beta_5 FD_t + \varepsilon_t \dots \dots \dots (1)$$

$$CF_t = \alpha_1 + \partial_1 InEXT_t + \partial_2 \ln GDP_t + \partial_3 POLITY_t + \partial_4 INF_t + \varepsilon_t \dots \dots \dots (2)$$

Where *EXT* is total external debt, *CF* is capital flight, *GDP* is the real gross domestic product, *FD* is financial development, *INF* is inflation and *Polity* represent political stability. Also, the coefficients,  $\beta_1, \beta_2, \dots, \beta_5$ , as well as  $\partial_1, \partial_2, \dots, \partial_4$  are the output elasticities of the factor inputs.  $\varepsilon_t$  is the stochastic error term and  $\alpha_0$  is the constant term.

The variable description and measurement, as well as their source, are presented in Table 1. The datasets used in the study spans from 1970 to 2012. This is because, after independence, Ghana started espousing capital and accumulating external debt in the early 1970s.

Table 1: Variables in the model: Definitions and Sources

Variable	Definition	Source
External Debt (EXT)	Total external debt in a million US dollars.	World Development Indicators (2016 online database)
Capital Flight (CF)	Capital flight expressed as the ratio of GDP	Database of Ndikumana & Boyce (2012)
Gross Domestic Product (GDP)	Real Gross Domestic Product	WDI (2016 online database)
Political Stability (POLITY)	Political Stability is measured by the country's elections competitiveness and openness, the nature of political involvement in general, and the degree of checks on administrative authority. The estimate gives the country's score on the aggregate indicator, in units of a standard normal distribution, i.e. ranging from -10 to +10.	Polity 2 data series from Polity IV database
Inflation (INF)	Inflation rate is the growth rate of the CPI index	WDI (2016 online database)
Financial Development (FD)	Money supply as a percentage of GDP	WDI (2016 online database)

Source: Authors Own Construction.

### 3.2 Estimation Procedure

#### Cointegration test

The existence of the long run equilibrium relationship between external debt and capital flight can be investigated by using several methods. The most commonly used methods include Engle and Granger test, fully modified OLS procedure (FMOLS) of Phillips and Hansen's, maximum likelihood based on Johansen and Johansen-Juselius tests. All these methods require that the variables in the system are integrated of order one,  $I(1)$ . Further, these methods are considered as weak as these methods do not provide robust results for small samples or structural breaks. In fact, these methods are still employed by many researchers who strongly argue that they are the most accurate methods to apply on  $I(1)$  variables. However, researchers like Hakkio and Rush (1991) find some disadvantages with the above techniques. They argued that two common misconceptions exist in these standard Cointegration techniques. First, long-run relationships exist only in the context of cointegration of integrated variables of the same order. Second, standard methods of estimation and inference (e.g. F-test) will render inconsistent and inefficient parameters in a cointegrating relationship. Due to these problems, a recently developed autoregressive distributed lag (ARDL) approach to cointegration has become significant in recent years. The ARDL modeling approach was initially introduced by Pesaran and Shin (1999) and further extended by Pesaran et al. (2001). This approach has several econometric advantages in comparison to other cointegration methods. One major advantage of ARDL approach is that it can be applied irrespective of the degree of integration whether  $I(1)$  or  $I(0)$ . Secondly, ARDL approach provides robust results in small sample sizes, and estimates of the long-run coefficients are well consistent in small sample sizes (Pesaran & Shin 1999). Furthermore, a dynamic error correction Term (ECT) can be derived from ARDL that incorporates the short-run with the long-run estimates without losing long run information. Given the above advantages, we use ARDL approach for cointegration analysis and the resulting ECT.

By means of the ARDL method for cointegration, the following restricted (conditional) version of the ARDL model is estimated to test the long-run relationship between external debt and capital flight. This framework is implemented by modeling equation (2) as a conditional ARDL, as:

$$\begin{aligned} \Delta \ln EXT_t = & \beta_0 + \beta_1 CF_{t-1} + \beta_2 \ln GDP_{t-1} + \beta_3 POLITY_{t-1} + \beta_4 INF_{t-1} + \beta_5 FD_{t-1} + \sum_{i=1}^p \alpha_1 \Delta \ln EXT_{t-i} + \\ & \sum_{i=1}^p \alpha_2 \Delta CF_{t-i} + \sum_{i=1}^p \alpha_3 \Delta \ln GDP_{t-i} + \sum_{i=1}^p \alpha_4 \Delta POLITY_{t-i} + \sum_{i=1}^p \alpha_5 \Delta INF_{t-i} + \sum_{i=1}^p \alpha_6 \Delta FD_{t-i} + v_t \end{aligned} \quad (3)$$

Where  $\Delta$  denotes the first difference operator,  $P$  is the lag order selected by Akaike's Information Criterion (AIC),  $\beta_0$  is the drift parameter while  $v_t$  is white noise error term which is  $\sim N(0, \delta^2)$ . The parameters  $\alpha_i$  are the short-run parameters and  $\beta_i$  are the long-run multipliers. All the variables are defined as before.

#### Long-run and short-run relationships

Given that cointegration has been established from the ARDL model, the next step is to estimate the long-run and error correction estimates of the ARDL and their asymptotic standard errors. The long run is estimated by:

$$\ln EXT_t = \mu_0 + \sum_{i=0}^p \beta_1 CF_{t-i} + \sum_{i=0}^p \beta_2 \ln GDP_{t-i} + \sum_{i=0}^p \beta_3 \ln POLITY_{t-i} + \sum_{i=0}^p \beta_4 INF_{t-i} + \sum_{i=0}^p \beta_5 FD_{t-i} + v_t \quad (4)$$

This is followed by the estimation of the short-run parameters of the variables with the error correction representation of the ARDL model. By applying the error correction version of ARDL, the speed

of adjustment to equilibrium is determined. When there is a long-run relationship between the variables, then the unrestricted ARDL error correction representation is estimated as:

$$\Delta \ln EXT_t = \phi_0 + \sum_{i=0}^p \delta_1 \Delta CF_{t-i} + \sum_{i=0}^p \delta_2 \Delta \ln GDP_{t-i} + \sum_{i=0}^p \delta_3 \Delta \ln POLITY_{t-i} + \sum_{i=0}^p \delta_4 INF_{t-i} + \sum_{i=0}^p \delta_5 FD_{t-i} + \gamma ECT_{t-1} + \Omega_t \quad (5)$$

Where  $\gamma$  is the speed of adjustment of the parameter from the short-run to long-run equilibrium following a shock to the system and  $ECT_{t-1}$  is the residuals obtained from equations (4). The coefficient of the lagged error correction term  $\gamma$  is expected to be negative and statistically significant to confirm the existence of a cointegrating relationship among the variables in the model. The value of the coefficient,  $\gamma$ , which signifies the speed of convergence to the equilibrium process, usually ranges from -1 and 0. -1 signifies perfect and instantaneous convergence while 0 means no convergence after a shock in the process.

In addition, Pesaran and Pesaran (1997) argued that it is extremely important to ascertain the constancy of the long-run multipliers by testing the above error-correction model for the stability of its parameters. The commonly used tests for this purpose are the cumulative sum (CUSUM) and the cumulative sum of squares (CUSUMQ), both of which have been introduced by Brown et al. (1975).

## 4 EMPIRICAL RESULTS

Table 2 presents the descriptive statistics of the variables used in the study. From the table, the total number of observations used was 43, and it was found that all the variables have positive means. Further examination of the table reveals that all the variables are slightly negatively skewed except inflation and real GDP. The deviation of the variables from their means as shown by the standard deviation gives an indication of wide growth rate (fluctuation) of these variables over the study period. The Jarque-Bera statistic also shows that the null hypothesis that the series are drawn from a normally distributed random process cannot be rejected except external debt and financial development. This is shown by their probability values.

Table 2: Summary Statistics of the variable

	LNEXT	CF	LNGDP	POLITY	INF	FD
Mean	9.474410	3.959575	9.806741	6.162791	31.63969	22.62380
Median	9.572204	7.633468	9.735963	7.000000	24.56542	22.66524
Maximum	10.09917	9.985304	10.62263	8.000000	122.8745	34.10831
Minimum	8.728203	-8.958086	9.324754	0.000000	3.030303	11.30499
Std. Dev.	0.398414	7.193499	0.340513	2.126144	28.84950	6.272417
Skewness	-0.475995	-1.104768	1.001649	-1.478655	1.958858	-0.011674
Kurtosis	1.978936	2.258661	3.270420	3.885123	6.355115	1.984831
Jarque-Bera	3.491699	9.731676	7.321340	17.07301	47.66781	1.847412
Probability	0.174497	0.007705	0.025715	0.000196	0.000000	0.397045
Sum	407.3996	170.2617	421.6899	265.0000	1360.507	972.8234
Sum Sq. Dev.	6.666822	2173.350	4.869874	189.8605	34956.33	1652.415
Observations	43	43	43	43	43	43

Although the ARDL cointegration approach does not require unit root tests, nevertheless we need to conduct this test to ensure that none of the variables are the integrated of order 2, thus, I (2), because, in the case of I (2) variables, ARDL procedures makes no sense. If a variable is found to be I(2), then the computed F-statistics, as produced by Pesaran et al. (2001) and Narayan (2005) can no longer be valid. The results

of the Augmented Dickey-Fuller test as shown in Table 3 indicate that all the variables are non-stationary at their levels except capital flight and polity. However, all of the variables are stationary in the first difference at the 1% level of significance. This implies that all other variables are integrated of order one or I(1). Since the variables are shown to be either I(0) or I(1), we can proceed to test for cointegration using the ARDL approach to cointegration.

Table 3. Results of Unit Root Test: ADF Test

Levels		First Difference				
Var.	ADF-Statistic	Lag	Var.	ADF-Statistic	Lag	OI
LNEXT	-0.974585 (0.7537)	1	DLNEXT	-6.396770(0.0006) ***	0	I(1)
CF	-7.826107(0.0000) ***	0	DCF	-6.198752(0.0000) ***	0	I(0)
LNGDP	-1.002320(0.9959)	0	DLNGDP	-5.232315(0.0001) ***	0	I(1)
POLITY	-3.309668(0.0207) **	0	DPOLITY	-8.427628(0.0000) ***	0	I(0)
INF	-2.475187(0.1288)	1	DINF	-11.40022(0.0000) ***	0	I(1)
FD	-1.240119 (0.6481)	0	DFD	-6.12630(0.0000) ***	0	I(1)

Source: Authors Own Construction

The results of the bound test procedure for cointegration analysis between external debt and its determinant are presented in Table 4. As shown in Table 4, the joint null hypothesis of lagged level variables (that is, variable addition test) of the coefficients being zero (no cointegration) is rejected at 1 percent significance level. This is because the calculated F-statistic value of 5.104335 exceeds the upper bound critical value of 4.15 at 99%. This means that there exist a long run relationship between external debt and capital flight.

Table 4: Results of Bounds Tests for the Existence of Cointegration

	10% Sign. Level		5% Sign. Level		2.5% Sign. Level		1% Sign. Level	
	I(0)	I(1)	I(0)	I(1)	I(0)	I(1)	I(0)	I(1)
K								
5	2.08	3	2.39	3.38	2.7	3.73	3.06	4.15
F-statistic	5.104335							

Source: Authors Own Construction

As shown in Table 5, the results indicate theoretically correct and prior expected signs for almost all of the explanatory variables. Capital flight expressed as a ratio of GDP, real GDP, political stability, inflation and financial development all have the expected sign and exert a statistically significant effect on external debt in the long-run. The constant is also negative and statistically significant too. The positive and statistically significant coefficient of the capital flight means that increases in capital flight have the potential of stimulating external debt in Ghana at the aggregate level over the study period. This result concurs with the

findings of Saxema (2016) for the Indian economy. Ndikumana & Boyce (2014) also found a similar result for Sub-Saharan Africa.

Table 5: Estimated Long-Run Coefficients using the ARDL Approach

Variable	Coefficient	Std. Error	t-Statistic	Prob.	
CF	0.075848	0.026967	2.812602	0.0090	***
LNGDP	1.227552	0.260778	4.707270	0.0001	***
POLITY	-0.066100	0.029944	-2.20748	0.0360	**
INF	0.006712	0.003531	1.900671	0.0681	*
FD	-0.031654	0.013404	-2.361444	0.0257	**
C	-1.78978	2.437822	-0.725639	0.4743	

Source: Authors Own Construction

Note: \*\*\* denote significance at 1%, \*\* denote significance at 5% and \* denote significance at 10%

The error correction model that calculates the error correction term for the adjustment to short run equilibrium in equation 1 when there is any disequilibrium in the system as a result of a shock is given as:

$$\text{Cointeq} = \text{LNEXT} - (0.0758 * \text{LNCF} + 1.2276 * \text{LNGDP} - 0.0661 * \text{POLITY} + 0.0067 * \text{INF} - 0.0317 * \text{FD} - 1.7690)$$

Once the long-run relationships among the variables have been established within the ARDL framework, the study further estimates their short-run relationships. According to Engle and Granger (1987), when variables are cointegrated, their dynamic relationship can be specified by an error correction representation in which an error correction term (ECT) computed from the long-run equation must be incorporated to capture both the short-run and long-run relationships. From the result in Table 6, it is again evident that the results of the short-run dynamic coefficients on capital flight, Polity, financial development, and inflation have the expected positive and negative signs respectively as in the long-run and exert statistically significant coefficients on external debt. The Gross Domestic Product, though is positive in the long-run, it is not statistically significant coefficients on external debt. The coefficient of the error correction term is negative as expected. Additionally, the value of the external debt lagged one period on current values of external debt in the short-run is negative and statistically significant at 10 percent significant level. The implication is that current values of external debt are negatively affected by their previous year's values.

Table 6: Estimated Short-Run Error Correction Model using the ARDL Approach

Variable	Coefficient	Std. Error	t-Statistic	Prob.	
D(LNEXT(-1))	-0.276514	0.152967	-1.80775	0.0818	*
D(CF)	0.003578	0.00097	3.687917	0.001	***
D(LNGDP)	0.151367	0.118911	1.272944	0.2139	
D(POLITY)	-0.008464	0.004405	-1.921702	0.0653	*
D(INF)	0.000925	0.000285	3.243912	0.0031	***
D(FD)	-0.012195	0.003363	-3.626229	0.0012	***
ECT(-1)	-0.149519	0.023607	-6.333583	0.0000	***

Source: Authors Own Construction

Note: \*\*\* denote significance at 1%, \*\* denote significance at 5% and \* denote significance at 10%

Also, the coefficient of the lagged error correction term (ECT<sub>t-1</sub>) is negative and highly significant at 1 percent significance level. This confirms the existence of the cointegration relationship among the

variables in the model yet again. The ECT stands for the rate of adjustment to restore equilibrium in the dynamic model following a disturbance. The coefficient of the error correction term is 0.1495. This means that the deviation from the long-term growth rate in GDP is corrected by approximately 15 % each year due to adjustment from the short-run towards the long-run. In other words, the significant error correction term suggests that more than 15 percent of disequilibrium in the previous year is corrected in the current year.

Hansen (1992) warned that the estimated parameters of a time series data might vary over time. As a result, it is crucial to conduct parameter tests since model misspecification may arise as a result of unstable parameters and thus has the tendency of biasing the results. In order to check for the estimated variable in the ARDL model, the significance of the variables and other diagnostic and structural stability tests of the model are considered. Table 7 shows the results for the model Diagnostics and Goodness of Fit.

Table 7: Model Diagnostics and Stability Tests

R-Squared ( $R^2$ )	0.986493	Adjusted R Squared	0.980491
S.E. of Regression	0.049857	F-stat. F(9, 28)	164.3359[.000]
Mean of Dependent Var.	9.528813	S.D. of Dependent Var	.356944
Residual Sum of Squares	0.067113	Equation Log-likelihood	71.04747
DW-statistic	2.179113		
<hr/>			
<b>Diagnostics</b>		<b>LM Version</b>	<b>F Version</b>
Serial Correlation $\chi^2_{\text{Auto}} (1)$		1.5249[.217]	91977[.348]
Functional Form $\chi^2_{\text{Reset}} (1)$		.18930[.664]	.11014[.743]
Normality $\chi^2_{\text{Norm}} (2)$		3.0777[.215]	
Hetero $\chi^2_{\text{white}} (1)$		1.8177[.178]	1.8085[.187]

Source: Authors Own Construction

The diagnostic test shows that there is no evidence of autocorrelation and the test proved that the error is normally distributed. Additionally, the model passes the white test for heteroskedasticity as well as the RESET test for correct specification of the model. A DW-statistic of 2.179113 indicates that there is no strong serial correlation in the residuals. The overall regression is also significant at 1 percent as can be seen from the R-squared and the F-statistic in Table 5 above. The R-squared value of 0.986493 indicates that about 99 percent of the change in the dependent variable (LY) is explained by changes in the independent variables. Also, an F-statistic value of 164.3359 suggests the joint significance of the determinants in the ECT.

The plots of the cumulative sum of recursive residuals (CUSUM) and the cumulative sum of squares of recursive residuals (CUSUMSQ) stability tests as depicted in Figures below indicate that all the coefficients of the estimated model are stable over the study period since they are within the 5 percent critical bounds.

Figure1: Plots of the cumulative sum of recursive residuals (CUSUM)

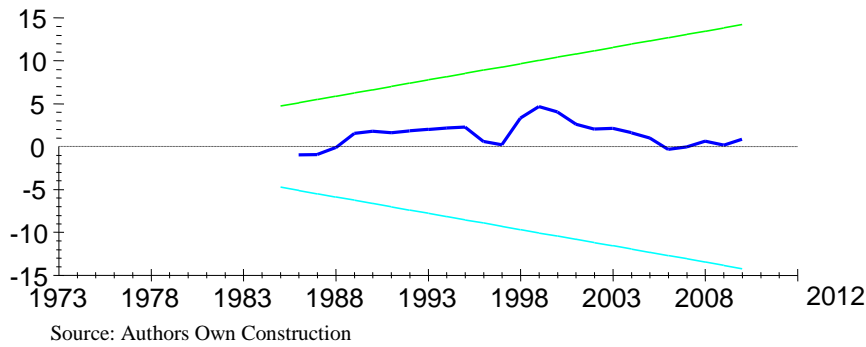
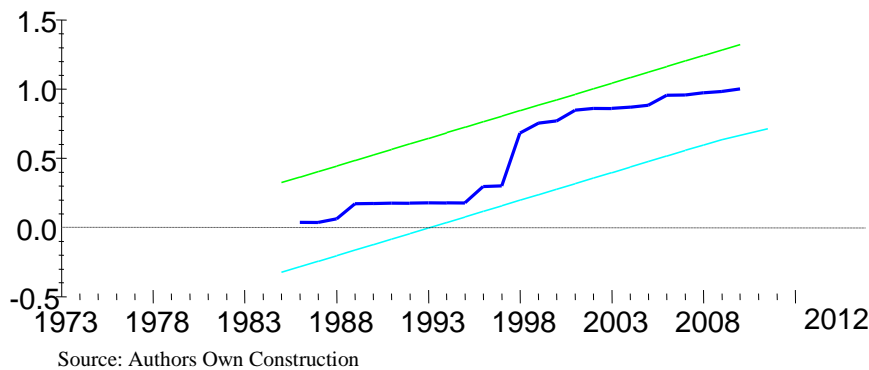


Figure2: Plots of the cumulative sum of square of recursive residuals (CUSUM)



To establish the predictability of capital flight on external debt, Granger causality test was applied to measure the linear causation among these variables. The usual Granger causality test proposed by Granger (1969) has been found to have plausible shortcomings of specification bias and spurious regression. Engel and Granger (1987) defined X and Y as being cointegrated if the linear combination of X and Y is stationary, but each variable is not continually stationary. Therefore, Engel and Granger (1987) pointed out that when variables are non-stationary at the same level, then the usual Granger causal test will be invalid. To mitigate these problems, Toda and Yamamoto (1995) and Dolado and Lutkepohl (1996) based on augmented VAR modeling, introduced a modified Wald test statistic. This procedure has been found to be superior to the usual Granger causality tests because it can be estimated irrespective of whether the series is I(2), I(1) or I(0). Table 8 present the result of the Toda-Yamamoto Granger causality test.

Table 8: Toda-Yamamoto Causality Test

Null Hypothesis	Obs	F-Statistic	Prob.
EXT does not Granger Cause CF	33	14.99797	0.0410
CF does not Granger Cause EXT		9.562798	0.3870

Source: Computed by the authors using Eviews 9.

The Toda-Yamamoto Causality Test causality test results in Table 8 indicate that the null hypothesis of capital flight does not Granger cause capital flight is not rejected implying that capital flight does not Granger cause external debt. However, the null hypothesis that external debt does not Granger cause capital flight is rejected, implying external debt indeed Granger causes capital flight. This means that there exists a uni-directional causality running from external debt to capital flight indicating the existence of a debt-



fueled capital flight. These results show that, if unchecked, the external debt will continue to cause massive capital flight hence leaving the country with a resource deficit.

## 5 CONCLUSION AND POLICY IMPLICATIONS OF THE STUDY

This paper examined the relationship between capital flight and economic growth in Ghana employing the autoregressive distributed lag (ARDL) approach to cointegration for the period 1970 to 2012.

The empirical evidence presented in this paper suggests that there is both short-run and long-run relationship between external debt and capital flight in Ghana signifying that increases in capital flight lead to increase in external debt and that if the capital flight is unchecked, it will continue to cause a substantial amount of external debt. However, the Granger causality test results revealed a unidirectional causality running from external debt to capital flight. This implies that large capital flight in Ghana to a large extent is financed by external borrowing, a phenomenon known as debt-fueled capital flight. This result implies that creditors knowingly or unknowingly financed the export of private capital rather than investment. Such lending is often motivated by political and strategic considerations. Again, it could also imply a lack of diligence on the part of creditors before the loans were approved. A policy implication for external debt management is to insist that foreign creditors be made to bear the consequences of irresponsible or politically motivated lending while government should accept the liability of those portions of the debt incurred by past government that was used to finance development projects and programs.

In addition to greater accountability on the creditor side, it is equally important that Ghana as a country should establish mechanisms of transparency and accountability with respect to decision-making processes regarding external debt management. It is important that the government guarantee that any external loans acquired are invested into productive projects that give higher returns on investment. If these loans are invested into such productive projects, it enhances the country's debt serving capacity thereby reducing the incidence of falling into a debt crisis. Furthermore, the government also needs to timely pay its outstanding obligations to avoid a debt trap which can also spill over into a debt crisis. These measures can thus reduce capital flight since the debt-driven capital flight is exacerbated when conditions for debt crises exists.

This result also suggests an additional rationale for the annulment of debts since the continuous accumulation of external debt may signal increased risks, to which private capital owners may respond by pulling out their capital. The government needs to discuss with International Financial Institutions, the World Bank and other bilateral loan providers for the possible debt annulment or debt rescheduling.

### References

- Ajayi, S. I. (1997). An analysis of external debt and capital flight in the severely indebted low-income countries in the Sub-Sahara Africa," IMF, *Working Paper* WP/97/68.
- Ajayi, S. I., & Khan, M. S. (2000). *External debt and capital flight in Sub-Saharan Africa*. International Monetary Fund.
- Ajilore O.T (2014). External debt and capital flight: Is there a revolving door hypothesis. *South African Journal of Economic and Management Sciences*, 5(2), 211-224
- Boyce, J. K. (1992). The revolving door? External debt-capital flight: A Philippine case study. *Journal of World Development*, 20(3), 335-349.
- Collier, P., Hoeffler, A., & Pattillo, C. (2001). Flight capital as a portfolio choice. *World Bank Economic Review*, 15(1), 55-80.
- Cuddington, J. (1987). Macroeconomic determinants of capital flight. In Donald Lessard and John Williamson (ed.). *Capital Flight and Third World Debt*. *Institute for International Economics*, Washington, DC: 85-96.

- Demir, F. (2004). A failure story: Politics and financial liberalization in Turkey, revisiting the revolving door hypothesis. *World Development Bank*, 32(5): 851-869.
- Dooley, M. P. (1988). Capital flight: A response to differential financial risks. *IMF Staff Papers*, 35(3) 422-436.
- Dornbusch, R. and de Pablo (1987), Comment in Lessard, D. R. and Williamson, J. (ed.s) (1987), "Capital flight and third world debt," *Washington Institute for International Economics*.
- Eggerstedt, H., Hall, R. B., & Wijnbergen, S. V, (1994). Measuring Capital Flight: A Case Study of Mexico, *World Development*, 23, 211-232.
- Engle, R. F., & Granger, C. J. (1987). Cointegration and error-correction representation, estimation, and testing. *Econometrica*, 55(2), 251-278.
- Frimpong, J. M., & Oteng-Abayie, E. F. (2006). The impact of external debt on economic growth in Ghana: A cointegration analysis, *Journal of Science and Technology*, 26(3), 121- 130.
- Hakkio, Craig S. & Rush, Mark, (1991). Cointegration: how short is the long run? *Journal of International Money and Finance*, 10(4), 571-581.
- Hansen, B. E. (1992). Tests for parameter stability in regressions with I(1) Processes. *Journal of Business and Economic Statistics*, 10(3), 321-335.
- Institute of Economic Affairs (2012), Ghana's Debt Profile and sustainability, A Public Policy Institute, Ghana.
- Lessard, D.R. & Williamson J. (1987), Capital Flight and Third World Debt, *Washington Institute for International Economics*.
- Morgan Guaranty Trust Company (1986) "LDC Capital Flight" *World Financial Market*, (2), 13-16.
- Ndikumana, L. & J.K. Boyce (2011). Capital flight from Sub-Saharan African countries: linkages with external borrowing and policy options. *International Review of Applied Economics* 25(2), 149–70.
- Ndikumana, L., & Boyce, J. K. (2003). Public debts and private assets: Explaining capital flight from Sub-Saharan African Countries. *World Development*, 31(1), 107-130.
- Pesaran, M. H., & Pesaran, B. (1997). *Working with micro fit 4.0: Interactive econometric analysis*. Oxford: Oxford University Press.
- Pesaran, M. H., & Shin, Y. (1999). An autoregressive distributed lag modeling approach to cointegration analysis. In S. Strom, (Eds.), *Econometrics and economic theory in the 20th century (Chapter 11)*. The Ragnar Frisch centennial symposium, Cambridge: Cambridge university press.
- Pesaran, M. H., Shin, Y., & Smith, R. J. (2001). Bounds testing approach to the analysis of level relationships. *Journal of Applied Econometrics*, 16(3), 289-326.
- Safdari, M., & Mehrizi, M. A. (2011). External debt and economic growth in Iran. *Journal of Economics and International Finance*, 3(5), 322-327.
- Sazema S.P. (2016), Dynamics of external debt and capital flight in India. *International Journal of Management & Development*, 3(2), 49-62.
- Summers, L. (1986). *Debt Problems and Macroeconomic Policies*. (NBER Working Paper No. 2061), Federal Reserve Bank of Kansas City. Retrieved July 2015, from <http://www.nber.org/papers/w2061.pdf>
- World Bank (2009), Global Development Finance 2009, Washington D.C.

**Contact information:**

Isaac Kwesi Ampah

University of Szeged

Dugonics tér 13., Szeged

+36 70 563 1772

[ampah.isaac@eco.u-szeged.hu](mailto:ampah.isaac@eco.u-szeged.hu)

Gabor David Kiss

University of Szeged

Dugonics tér 13., Szeged

+36-62-544-632

[kiss.gabor.david@eco.u-szeged.hu](mailto:kiss.gabor.david@eco.u-szeged.hu)

# SAVINGS IN POLISH SENIORS' HOUSEHOLDS

*Paulina Anioła-Mikołajczak, Zbigniew Gołaś*

## **Abstract**

The main objective of the paper is the analysis of saving portfolio of the households of Polish seniors over 50 years old. To achieve this aim, the classification of Polish seniors' households based on the composition of their saving portfolio was conducted. The data used in the analysis comes from the Social Diagnosis. By using cluster analysis 4 types of older people's households were distinguished: saving in cash (46%), saving in banks and avoiding cash (26%), saving in banks and in cash (25%), diversified (3%). Households of older people in Poland use mainly safe savings products, that do not require much involvement. Almost half of surveyed households of seniors accumulates they savings only in the form of cash.

*Keywords: households of seniors, savings, saving portfolio, cluster analysis*

## **1. INTRODUCTION**

Demographic changes such as aging, life extension, the decline in population growth, translates into the fact that seniors are becoming important player on the market, including the market for banking and financial services (Czerwiński 2016, Kłobukowska 2016, Zalega 2016). Olejnik (2014) and Zalega (2016) emphasize the growing potential of the older people's segment, which until now was considered as unattractive. Kłobukowska (2016) as the strong side this consumer group shows fixed, regular cash flow, loyalty and conscientiousness in payments. Also Olejnik (2014) highlights the importance of regular, but small income of seniors. Zalega (2016) draws attention to the changing lifestyles of older people, including the way how they spend free time. The stereotypical image of the poor and lonely elderly people is slowly replaced by the image of active people with the hedonistic approach to life (Zalega 2016).

It should be noted that the segment of seniors is not a homogenous group, which was evidenced by the results of previous studies. Czerwiński (2016) observes that age, income, level of education are the main factors determining the use of financial services by Polish seniors. The analysis of Olejnik (2014) show, that besides these three factors, the use of financial services by Polish seniors is also determined by the place of residence and health.

Grzelak-Kostulska (2016) emphasizes that the level of education of seniors largely determines their overall activity, and the ability to adopt new attitudes, behaviors, and patterns. She also noted that the level of education of seniors aged 65 and more, in recent years has increased significantly. In the years 2002-2011 the percentage of people over 65 with higher education increased from 6,2% to 9,5%. At the same time decreased the percentage of older people with no education (from 12,5% to 5%).

Another aspect that should be taken into account in analyzing segment of seniors is greater aversion to risk among older people, which is reflected in the fact that this segment prefers safe financial products (Bakshi and Chen 1994, Wójcik 2007, Clark and Strauss 2008, Collard 2009, Rytelewska and Kłopocka 2010, Czerwiński 2016). Extensive research on risk aversion among the elderly conducted Bejtelsmit and Bernasek (2001). They indicate that the financial portfolio of elderly (over 65) was much poorer in assets with a high degree of risk, in comparison with a portfolio of younger people. They also noted that financial portfolios of affluent households consist of more risky financial instruments than portfolio of less wealthy households. Similar conclusions were reached by Morin and Suarez (1983), who observed that beyond age, another important factor influencing the increase in risk aversion is the level of wealth. Among the less affluent investors aversion to risk increases with age, while in the case of wealthy investors, can be seen opposite tendency. Increasing propensity to risk in wealthier households is also confirmed by studies Clark and Strauss (2008) and Collard (2009).

## **2. THE RESEARCH MATERIAL AND METHODS**

This study based on the data from over 8000 Polish households run by people over 50, surveyed by Social Diagnosis project in 2015. The Social Diagnosis is a comprehensive survey of the conditions and life quality of Poles in their own assessment. It is conducted by the Council for Social Monitoring periodically since 2000. It covers both the economic aspects of households (eg, affluence, income situation, way of managing income) and non-economic aspects (eg, education, lifestyle, health, satisfaction with various aspects of life).

The segment of seniors' household is not a homogeneous group. The diversification of households is influenced by economic, social and psychological factors of closer and further environment in which they exist. The typology of a population allows to show these inhomogeneities in the multidimensional space defined by a number of features simultaneously. The main task of typology is to distinguish and describe the types in such way, to expose their characteristic features (Smyczek 2001).

In order to distinguish the types of Polish senior households based on their saving portfolio, a multidimensional clustering method was applied. The aim of clustering methods is to divide a multi-dimensional set of observations into homogeneous subsets, based on a set of characteristics that describe them (Poczta-Wajda 2010). The study used a non-hierarchical cluster analysis method (k-means method), in which the number of clusters is determined a priori. The clusters are formed in such a way, that the objects placed within a given cluster are as similar to each other as possible, and the objects form different clusters are as much different from each other as possible. The aim of the method is to form homogeneous groups, minimizing the variance in clusters and maximizing the variance among them (Stanisz 2007).

The method of cluster analysis was used to study the composition of saving portfolio of seniors' households. This study allows to obtain valuable information about the different types of financial strategies of seniors' households in Poland. The basic criterion for the classification using cluster analysis were different financial products. Cluster analysis was conducted on the basis of 15 variables representing different forms of saving: bank deposits in zlotys, bank currency deposits, individual pension funds, investment funds, bonds, Employee Pension Fund, securities listed on the stock exchange, shares and stocks in companies not listed on the stock exchange, investments in property, investments in material goods other than real property, cash, insurance policy, long-term savings programmes, savings account, personal current account.

The fact of declaring (yes-no) by a household the listed above forms of saving, was basis for identification and naming the clusters, that they represent. Since the number of clusters is not known, and the variables used in analysis (form of saving) are qualitative, the best method of grouping is the method of k-means, contained in a module of Statistica Data Mining. In addition, the application in this case V-fold cross-validation, enables to find the optimal number of clusters, which, according to Sagan (2010) is from three to six. The obtained results were the basis for profiling the individual clusters (types of savings strategies of households). The profiling of types was conducted by cross-tabulation using contingency tables, which show the simultaneous distribution of several features.

## **3. THE CLASSIFICATION OF SENIORS' HOUSEHOLDS BASED ON THE COMPOSITION OF THEIR SAVING PORTFOLIO**

Using the cluster analysis method, four types of households run by persons over 50 were distinguished based on the composition of their savings portfolio: (table 1):

diversified (3%),

saving in banks and in cash (25%),

- saving in banks and avoiding cash (26%)
- saving in cash (46%).

Table 1. Indicators of classification, Source: Own calculation based on: Social Diagnosis Database, www.diagnoza.com

Forms of saving	Cluster 1: Diversified	Cluster 2: Saving in banks and in cash	Cluster 3: Saving in banks and avoiding cash	Cluster 4: Saving in cash
bank deposits in PLN	85,4	80,0	89,8	12,0
bank deposits in foreign currencies	24,0	5,5	3,7	1,0
bonds	22,9	2,9	2,9	1,2
investment funds	60,4	4,9	4,0	1,8
Individual Pension Fund	70,8	2,6	3,1	1,4
Employee Pension Fund	13,5	1,7	1,9	0,6
securities listed on the stock exchange	11,5	3,0	1,9	0,7
shares and stocks in companies not listed on the stock exchange	7,3	2,1	1,8	0,5
investments in property	24,0	2,6	1,8	0,8
investments in material goods other than real property	15,6	1,2	0,3	0,5
cash	69,8	66,9	0,0	91,9
insurance policy	94,8	16,5	11,7	8,0
long-term savings programmes	28,1	8,0	2,2	0,8
savings account	70,8	78,1	0,0	7,2
personal current account	81,3	85,3	53,5	22,3
<b>Number of cases</b>	<b>96</b>	<b>841</b>	<b>892</b>	<b>1545</b>
<b>(%)</b>	<b>2,8</b>	<b>24,9</b>	<b>26,4</b>	<b>45,8</b>

Tables 2 and 3 provides basic information about the distinguished clusters of seniors' household. Their analysis provides the basis for a detailed description types of Polish seniors' households based on their saving portfolio.

Table 2. Households' behaviors and financial problems by clusters, Own calculation based on: Social Diagnosis Database, www.diagnoza.com

Specification		Cluster 1: Diversified	Cluster 2: Saving in banks and in cash	Cluster 3: Saving in banks and avoiding cash	Cluster 4: Saving in cash
Using the bank services	yes	99,0	99,5	98,9	77,5
Savings value	up to monthly household income	3,2	6,6	11,7	28,0
	above monthly – to 3months household income	14,7	19,9	31,5	35,1
	above 3 months to half year household income	10,5	28,1	22,2	17,4
	above half year – to yearly household income	21,1	23,0	15,8	7,0
	above yearly to 3 years household income	21,1	7,1	4,7	1,8
	Above 3 years household income	12,6	3,1	3,5	1,0
	Hard to say	16,8	12,3	10,6	9,6
Household have credit or loan	yes	33,7	18,7	16,3	18,6
Household have mortgage	yes	43,8	19,8	16,7	10,0
The value of debt	up to monthly household income	9,7	18,4	26,2	24,3
	above monthly – to 3months household income	9,7	23,7	19,2	26,5
	above 3 months to half year household income	9,7	16,5	19,2	14,3
	above half year – to yearly household income	19,4	10,5	10,6	10,3
	above yearly to 3 years household income	25,8	11,8	9,2	5,5
	Above 3 years household income	6,5	7,9	7,1	9,9
	Hard to say	19,4	11,2	8,5	9,2
Makeing ends meet	with great difficulty	1,1	1,5	3,0	6,2
	with difficulty	5,4	7,6	9,9	13,2
	with some difficulty	14,0	33,3	36,2	42,3
	rather easily	41,9	44,2	39,4	32,1
	easily	37,6	13,5	11,6	6,2
Income sotuation	get worse	15,6	15,0	16,9	18,2
	get better	19,8	14,5	10,3	11,9
	no changed	64,6	70,4	72,8	69,9

### Cluster 1: Diversified

This is the smallest group of all distinguished types of households. It consist of only 96 households, which constitutes less than 3% of the surveyed population of seniors. This group has the most diversied saving portfolio. *Diversified* their funds invest primarily in insurance policies (95%), bank deposits in PLN (85%), personal current accounts (81%), savings accounts(71%) in the Individual Pension Fund (71%), cash ( 70%)

and investment funds (60%). Approximately every fourth household of seniors from this cluster also invest savings in long-term savings programmes (28%), bank deposits in foreign currencies (24%), investments in property (24%) and bonds (23%).

Households from this cluster are characterized by very high value of savings. In every third household from this cluster it exceeds the annual income of the household, and in every tenth (13%) household the savings exceeds the 3-year household income. Moreover, this cluster is characterized by a very low percentage of households (3%) with the lowest savings, ie. less than the monthly income of the household.

*Diversified* households are indebted relatively most frequently. As many as every third household declares to repay credits or loans, and more than 40% repay mortgage. This translates into high value of indebtedness – in more than half of households debt exceeds the semi-annual household income, and in every third household debt exceed an annual income. Only in every tenth household from this cluster, the value debt is lower than the monthly income of the household.

Households from this cluster positively evaluate their income situation. Almost 80% of them declare that the current income is enough to make ends meet, while to 38% of households making ends meet come easily. Every fifth household claims that compared to two years ago, the income situation of the household get better.

The households representing *Diversified* cluster are characterized by the following socio-economic features:

domination of employees households (42%), more than the average households of self-employed (17%), lack of households living on unearned sources,

relatively high percentage of marriages with children,

relatively more often the household is run by man (74%),

low age of the head of household. Almost half of the households are run by persons aged 50-59,

the place of living is usually very big (27%) or big city (18%),

the high level of education of the head of household head. domination of households run by people with higher education (58%),

relatively low percentage of single households (12%),

very high level of income - almost 4000 PLN per month.



Table 3. Socio-economic features of households by clusters, Own calculation based on: Social Diagnosis Database, diagnoza.com

Specification		Cluster 1: Diversified	Cluster 2: Saving in banks and in cash	Cluster 3: Saving in banks and avoiding cash	Cluster 4: Saving in cash
Socio-economic group	employees	42,1	39,7	30,6	25,5
	farmers	3,2	5,5	3,6	5,3
	self-employed	16,8	6,3	4,9	3,5
	retire	35,8	45,2	54,8	56,9
	pensioner	2,1	2,3	4,9	6,7
	living on unearned sources	0,0	1,0	1,2	2,0
Biological type of family	marriage without children	41,1	38,8	39,3	34,2
	marriage with one child	17,9	16,1	13,8	12,6
	marriage with two children	8,4	8,4	5,4	7,4
	marriage with 3+ children	3,2	3,3	1,5	3,0
	single parent family	9,5	8,0	7,0	8,2
	multifamily	6,3	9,3	6,4	8,2
	single non-familial	12,6	15,3	25,8	25,5
	Multiple non-familial	1,1	0,7	0,8	1,0
Sex	man	74,0	70,0	62,6	65,5
	woman	26,0	30,0	37,4	34,5
Age	50-59	47,9	39,2	29,3	29,2
	60-69	32,3	35,4	39,7	33,3
	70-79	10,4	16,2	20,7	22,0
	80 i więcej	9,4	9,2	10,3	15,5
Place of living	city with population over 500 thousand inhabitants and more	27,1	10,5	11,7	6,1
	city with population 200-500 thousand inhabitants	17,7	14,0	13,0	6,9
	city with population 100-200 thousand inhabitants.	7,3	8,1	9,8	6,1
	city with population 20-100 thousand inhabitants	17,7	21,3	22,6	22,5
	city with population less than 20 thousand inhabitants.	11,5	14,7	13,1	14,5
	village	18,8	31,4	29,8	43,9
Level of education	primary school and lower	2,1	9,6	9,7	24,9
	vocational/junior high school	8,3	25,8	23,6	32,9
	secondary	31,3	30,4	36,6	27,9
	higher	58,3	34,2	30,1	14,3
Marital status	single	11,5	5,0	7,2	4,9
	married	68,8	73,7	64,9	62,7
	widower	14,6	15,2	21,7	26,6
	divorced	4,2	5,4	5,7	5,0
	legal separation	0,0	0,1	0,1	0,1

	de facto separation	1,0	0,6	0,3	0,6
Income		3958	2479	2159	1755

### Cluster 2: Saving in banks and in cash

About ¼ of analyzed households of persons above 50 represent the cluster Saving in banks and in cash. This type of households invest savings mainly in bank – on personal current accounts (85%), bank deposits in zlotys (80%), savings account (78%) and also in cash (67%). Other saving products have marginal importance for the representatives of this cluster.

In this cluster the value of savings is relatively higher than in clusters: three and four, represented by almost ¾ of analyzed population of seniors above 50. Almost half of the households represented cluster 2 have savings equaled from 3 months to yearly household income.

Saving in banks and in cash are indebted on the average level. About every fifth household declared to use credits or loans (19%) and mortgage (20%).

The income situation in these households is rather stable. The representatives of this cluster have no major problems with meeting their needs and making ends meet come them rather easily.

The households representing Saving in banks and in cash cluster are characterized by the following socio-economic features:

domination of employees households (39%), relatively high comparing to other clusters percentage of households of farmers (6%),

relatively high percentage of marriages with children,

relatively low age of the head of household, ¾ of households are run by persons above 69,

relatively high level of education of the head of household. every third household is run by persons with higher education (34%),

dominate households of married people (74%),

average level of income (2479 PLN).

### Cluster 3: Saving in banks and avoiding cash

One fourth of analyzed households of people aged 50 and more, were classified to the cluster Saving in banks and avoiding cash. The saving portfolio of representatives of this cluster is dominated by bank deposits in zlotys (90%) and personal current accounts (54%). The characteristic feature of this cluster is the fact, that any of the household save money neither in form of cash nor on saving accounts.

The value of saving in this cluster is relatively low. More than 40% of households declare that their savings do not exceed three months income.

Households are indebted to the average level, and the value of credits and loans is rather small. In every fourth household representing this cluster, the value of debt does not exceed the monthly income of the household.

Also the financial situation of Saving in banks and avoiding cash is average. Half of the households do not show major difficulties with meeting needs from current income, but every third household has some difficulties in this area, and almost 13% of households declare difficulty or great difficulty with making ends meet with.

The households representing *Saving in banks banks and avoiding cash* cluster are characterized by the following socio-economic features:

dominate the households of retired (55%),

- relatively high percentage of single non-familial households (26%),
- relatively most often comparing to other clusters, the household is run by woman (37%),

dominate the households run by persons with secondary education (37%),

average level of income (2159 PLN).

#### Cluster 4: Saving in cash

The last and most numerous cluster, is represented by almost half the analyzed population of seniors over 50 (46%). The saving portfolio of this group of households is dominated by cash (92%). Only every fifth representative of this cluster declare to have a personal current account (22%). Preference to accumulate money in form of cash may be due to the low number of banking services users in this cluster. More than 1/5 of the representatives of this focus does not use any bank service.

The value of saving is the lowest among all clusters. More than ¼ of households (28%) have savings not exceeding their monthly income. In every third household (35%) the value of savings amounts from monthly to three months income.

*Saving in cash* are indebted to the average level (19% repay some credit or loan), but they relatively least likely use mortgage - only every tenth representative of this cluster declare to repay mortgage. For half of the households representing this cluster, the debt does not exceed the three-month income. However, it should be noted that among *Saving in cash* there is also a relatively high proportion of households (10%) in which the value of loans exceed a 3-year income.

*Saving in cash* rather negatively evaluate their income situation. More than 60% of the households declare problems with making ends meet. Almost every fifth household thinks that its income situation has worsened in the last two years, and one in ten households acknowledges that income is not sufficient to cover current needs.

The households representing *Saving in cash* cluster are characterized by the following socio-economic features:

dominate households of retired (57%), relatively the highest percentage of pensioners' households (7%),

Relatively high percentage of single non-familial households (26%),

the relatively high age of the head of household, the highest percentage of households led by people aged 70-79 years (21%) and above 80 (16%),

the place of living is usually village (44%), relatively the smallest percentage of households living in a big cities (6%),

low level of education of the head of household. every fourth household is run by persons with primary education or lower,

relatively the highest percentage of households run by widowers (27%),

the lowest level of income among all clusters (1755 PLN).

## 4 SUMMARY

Segment of households run by seniors over 50 is a heterogeneous group, so it should not be treated in the same way. Banking and financial institutions should try to adopt their products, taking into account the needs and preferences of older people and differentiate it depending on the specific socio-economic features, such as age, education level or level of wealth.

The results of cluster analysis justify the perception of saving behaviors of households of people over 50 through the prism of the four clusters, which are distinguished on the basis of the composition of the savings portfolio: *Saving in cash* (46%), *Saving the bank and avoiding cash* (26%), *Saving in bank and cash* (25%), *Diversified* (3%).

The segment of older people usually use simple, safe and passive forms of saving. Much less popular are more complex products, with a greater degree of risk and requiring activity in the financial market. In the saving portfolio of more affluent and better educated households the occurrence of savings products with a higher degree of risk is a bit more common.

Key factors diversifying the saving portfolio of seniors are: age, the level of income and level of education. Taking into account the demographic changes, such as an increase in the percentage of seniors with higher education, which translates into higher income, it can be assumed that the next generation of seniors will be more active on the market of financial products. Higher level of income and education translates into a reduction of risk aversion, which may contribute to the growth of interest in alternative, more aggressive ways of investing free funds.

## References

- Bakshi G.S. & Chen Z., (1994). Baby boom, population aging, and capital markets. *Journal of Business*, 67(2), 165-202.
- Bejtelsmit V.L. & Bernasek A., (2001). Risk preferences and the investment decisions of the older Americans. AARP Public Policy Institute.
- Clark, G. & Strauss, K., (2008). Individual pension-related risk propensities: the effects of socio-demographic characteristics and a spousal pension entitlement on risk attitudes. *Ageing and society*, 28, 847-874.
- Collard S., (2009). Individual investment behaviour: a brief review of research. Personal Finance Research Centre, Bristol.
- Czerwiński B., (2016). Zachowania seniorów z Polski Północnej na rynku usług finansowych w świetle wyników badań. *Handel Wewnętrzny*, 3(362), 76-87.
- Diagnoza społeczna: zintegrowana baza danych. [www.diagnoza.com](http://www.diagnoza.com), data pobrania: 2.06.2016r.).
- Grzelak-Kostulska E., (2016). Seniorzy w Polsce w świetle procesów modernizacyjnych. Wydawnictwo Naukowe Uniwersytetu Mikołaja Kopernika, Toruń.
- Kłobukowska J., (2016). Pozycja i ochrona seniorów na rynku bankowości detalicznej w perspektywie zrównoważonych finansów. *Finanse i prawo finansowe*, vol 3, nr 1, 71-82.
- Morin R.A. & Suarez A.F. (1983), Risk aversion revisited, *The Journal of Finance*, 38. 1201–1216.
- Olejniki I., (2014). Zachowania finansowe osób w wieku emerytalnym – integracja metod ilościowych i jakościowych. *Handel Wewnętrzny*, 1(348), 46-56.
- Poczta-Wajda A., (2010). Nowoczesne techniki analityczne w kształceniu na studiach ekonomicznych. Część pierwsza. Wydawnictwo Uniwersytetu Ekonomicznego w Poznaniu, Poznań.
- Rytelewska G. & Kłopocka A., (2010). Wpływ czynników demograficznych na poziom i strukturę oszczędności gospodarstw domowych w Polsce. *Bank i Kredyt* 41/1, 57-80.
- Sagan A., (2010). Metody statystyczne w marketingu i badaniach rynku. Kraków 4-5 marca 2010 – materiały szkoleniowe StatSoft w ramach kursu obsługi programu Statistica.

Smyczek S., (2001). Zachowania konsumentów na rynku usług bankowych. Wydawnictwo Akademii Ekonomicznej w Katowicach, Katowice.

Stanisz A., (2007). Przystępny kurs statystyki z zastosowaniem STATISTICA PL na przykładach z medycyny. Tom 3. Analizy wielowymiarowe. StatSoft, Kraków.

Wójcik E., (2007). Polskie gospodarstwa domowe na rynku oszczędności. Bank i Kredyt, 07, 55-66.

Zalega T., (2016). Incomes and savings of Polish seniors in view of research outcomes. Problemy Zarządzania, vol.14, nr 2(59), t.1:135-155.

### **Contact information**

Paulina Anioła-Mikołajczak, Ph.D.

Poznan University of Life Sciences, Faculty of Economics and Social Sciences

Address: Wojska Polskiego 28, 60-637 Poznań, POLAND

E-mail: [aniola@up.poznan.pl](mailto:aniola@up.poznan.pl)

# SMART GROWTH CONCEPT: COMPARISON OF EU AND US APPROACH

*Davit Alaverdyan*

## **Abstract**

The importance of newly created approaches that leads to sustainability in our communities and economies cannot be overemphasized in today's fast growing world. Smart growth has appeared in the reality of Unites States to solve the problems of urban sprawls. Thus having a strategy which will create communities with diverse housing and transportation options, will create better links with neighbourhoods, and will promote community engagement. However, in Europe it appeared as a part of Europe 2020 strategy, where it has a goal to bring more effective investments in education, research and innovation. A systematic review was applied in the paper. It was employed the collection of research papers about smart growth as a public policy, as a means of sustainable development, as an asset of an effective growth and as a new concept in European Union.

It was revealed that in both continents the concept is getting more popularity by policy makers and it is strongly linked with sustainable development.

**Keywords:** *Smart Growth, Development, Sustainability*

## **1 INTRODUCTION**

Smart growth was launched from a community of environmentalists, citizen groups, transportation planners, and policy makers in (Geller, 2003). It came to reality to reflect rising concerns with specific problems caused by the existing pattern of urban development. In the name of smart growth, for example, the American Planning Association seeks to enhance the efficacy of planning; the U.S. Environmental Protection Agency (EPA) seeks to protect environmental quality and the Urban Land Institute seeks to facilitate large-scale development and the National Association of Home Builders seeks to remove land use restrictions. (Gerrit, 2002). In European Union, smart growth has less to do with planning and more to do with policies for innovation, research and education (Lucia et al, 2015). Moreover, several studies from Asian countries show that the concept closely relates with the effective planning of the cities and the proper usage of the resources (Wann-Ming, 2015; Rento et al, 2015)

Emerging in the 1990s in United States of America, the concept represents an approach to urban design that promotes compact development and aims to reduce development in environmentally and culturally sensitive areas by limiting the expansion of communities into outlying areas and redirecting private investment to urban areas (Burchell, 2000). It offers a convincing vision of how to revitalize urban areas and ensure economic competitiveness and improved environmental quality. In most urban areas around the world, conventional low-density development pattern has been successful in causing transportation problems, environmental degradation, and have led to the loss of farmlands, natural areas and open spaces. It is this nuisance that has called for innovative thinking and action across the world and generally been referred to as "Smart Growth" (Katz, 2002). The idea of smart growth recommends a reasonably planned growth in order to restrict sprawl at the edge, to protect open space against further urban development and use space more effectively.

As basic principles count among other things the determination of urban growth boundaries, focussing of the growth onto corridors of transportation lines, re-development and re-use of the central core, infilling in the core instead of organizing development on the open field, procurement of new lifestyles in the individual communes with the idea of urban functions in walking distances, and the introduction of regional governmental, infrastructural and economic coalitions among different spatial levels of cooperation (Gerhard, 2005). Towards addressing excessive suburban expansion, the concept of smart growth has

emerged as one of the popular movements to fight against suburbanization in many countries, cities and towns around the world (Burchell, 2000). The planning principles of smart growth are still relatively new and even the term “smart growth” is a highly visible concept in public policy debates. It is touted as a framework for helping communities achieve a better, more equitable and affordable built environment (Wann-Ming W, 2015).

Further, smart growth allows for the development of the local economy through increased productivity, property values, business activity, and tax revenue. These are largely evident in the benefits and savings that result from efficient public services and infrastructure provision, agglomeration efficiencies, and improved accessibility which reduce costs of transportation and decrease per capita land consumption. Elsewhere, it is also held that smart growth policies are oppressive, restrict property owners’ rights and freedoms, and constitute “social engineering” through the imposition of needless regulations (Williamson, 2010)

The article brings together different meanings and definitions of smart growth currently used in USA and in European Union (EU). It shows how different organisations and companies use it for different purposes to achieve their goals. It shows how the concept is getting wide spread use in different sectors, by having different ideology and approaches. Moreover, it shows the main principles of the concept and the concept as a means of sustainability.

## **2 THE SCOPE OF THE PAPER AND METHODS**

Paper is created using qualitative methods. Review of the literature was applied where smart growth acts as a means of planning, sustainability and a symbol of a growth to show the different faces, implementation and area of the coverage of the concept. A systematic review was applied in the paper. It was employed the collection of research papers about smart growth as a public policy, as a means of sustainable development, as an asset of an effective growth and as a new concept in European Union. The paper will serve as a base to understand the concept, summarize the advantages and use in further researches with the purpose of applying in other sectors.

## **3 SMART GROWTH IN USA**

Currently there is no single definition of smart growth that satisfies everyone, and many people have their own (Miller and Hoel, 2002). Different environmental organizations, government agencies, and interest groups define smart growth in their own ways to achieve their particular missions and goals. Then end result is the use of a common label for approaches that are not fully consistent and may even be contradictory (Ye et al, 2005). The concept is varying from continent to continent and it serves to different goals.

Turner (2007) states that smart growth is one of the efforts of controlling the natural resources consumption. In a collective description, smart growth aims to make a compact city, not create a city development in a sprawl condition. However, there is a difference between smart growth and smart city. If smart growth plays a role as " pot" of physical nature of urban areas, the smart city plays a part as "content" of urban areas. The first is an enhancement of technology development and the second is drawing of people's needs (Angelidou, 2015).

Mandpe and Meyer (2005) noted that, beyond the categories of resource preservation and community development, most dimensions of smart growth definition are urban focused. Many of the needs of rural communities seem to be left out of the standard definitions of smart growth and the array of policies to advance better planning. Barbara McCann, the Executive Director of Smart Growth America, states that smart growth includes many different things. It is not only just transportation but also a mindset towards creating a more holistic community (Geller, 2003).

Harris (2012) also refers smart growth to urban planning and transportation. According to him it is an approach that concentrates growth in compact walkable urban centres to avoid sprawl. It can be applied to solve planning and design problems (e.g., mixed-use infill development), to accelerate land use efficiency, and to manage growth (e.g., human population control). It also advocates compact, transit-oriented, walkable, bicycle-friendly land use (e.g., neighbourhood schools, complete streets), and mixed-use development with a range of housing choices. Moreover, to implement the smart growth concept in urban planning, a private engagement is required to reduce wasteful public subsidies sprawling development (Glendening, 1997). Similar definition is given by Smart Growth America that defines the concept as building urban, suburban and rural communities with housing and transportation choices near jobs, shops and schools. This definition not only emphasizes the promotion of local economies but also the creation of neighborhoods that are safe, beautiful and within easy reach to shops and other institutions (Ishak et al 2016). Furthermore, according to Freeman et al (2004) the typical smart growth strategy focuses on (1) creating some kind of urban growth boundary that limits outward expansion of growth, and (2) encouraging new development in infill-locations in already urbanized areas" locations which have been passed over in an earlier wave of growth or which are meanwhile abandoned to "accommodate more intense, newer development.

In contrast the U.S. Department of Agriculture (USDA), seems to have little concern for urban forms except for their effect on rural settlements and land uses. The USDA Economic Research Service provided a definition of smart growth, describing it as “a catch-all phrase to describe a number of land use policies to influence the pattern and density of new development, which designated areas (cities and older suburbs) through incentives and design incentives, without actually prohibiting development outside them or threatening individual property rights” (USDA 2001).

Some scholars believe that smart growth does not contain the nature of the growth principles. According to Hayward (2000) it is similar to cyclical processes of concentration and de-concentration, of structuring and re-structuring to adjust changing challenges. In this view, it can be stated that smart growth " turn out to be just a reprise of urban re- newel" (and not a concept to deal with growth. Also, National Association of Home Builders (2012) explains it from a developers' perspective. The organization defines smart growth as “development that provides a wide range of different housing choices.” That is, it is defined as the development that provides: (1) a firm, comprehensive, open and locally-based planning, (2) a more effective, innovative and market-sensitive way of utilizing land areas, and (3) housing units according to economic and population projections. In contrast, Knaap et al (2009), the state’s smart growth legislation is dedicated to restricting sprawl through neighborhood restoration and revitalization and the direction of growth towards existing developed areas. In order to discourage outlying developments and to protect farmlands, open spaces and natural resources.

The U.S. Environmental Protection Agency (EPA) had defined smart growth from the viewpoint of sustainable development. According to the it is development that serves the economy, the community, and the environment (EPA, 2002). Also Rento et al (2015) stated that smart growth is closely related with the components of sustainable development. According to authors smart growth is a healthy development in economic, environmental and social.

While some of the arguments against smart growth are undoubtedly legitimate, they are scarcely able to provide enough justifications that warrant the nullification of the smart growth philosophy. Rather, they offer useful insights into strategies that should be adopted to improve the social, economic and environmental effectiveness of smart growth policies. In simple terms, the relationship between smart growth and sustainable development is perhaps reflected in the fact that, both are concerned about the degradation of the environment and resource exhaustion and that one concept is essentially the approach to reaching the other (Ishak, 2016).



### **3.1 Smart growth principles and sustainability**

Ishak 2016 et al is linking sustainability dimensions, sustainable indicators, sustainable urban development goals and smart growth principles. By showing that the smart growth principles are the big part to reach sustainable development or to complete the policies which will lead to have 3Es (environment, economy and equity). In their case studies published in 'An Approach to Assess the Effectiveness of Smart Growth in Achieving Sustainable Development' authors stated that there is no universal approach to smart growth. Notwithstanding the variations in the way their respective smart growth policies have been designed and implemented, they each have made conscious efforts to pursue a number of policies that encourage mixed-use and high-density development, the protection of open spaces and natural areas and transit-oriented development. Porter (2002) added that the aims of sustainable development are evident in the principles of smart growth. The Municipal Research and Services Center (MRSC) also see the two concepts to be used interchangeably. Specifically, they define smart growth to be development that is community-oriented and sustainable, economically viable and environmentally sensitive (EPA, 2015).

Gerhard (2005) states that 3Es are the base of the smart growth and states that better opportunities, better access, higher financial and energy savings, lower fiscal disparities, better preservation of agricultural green field urban field clear edge, urban growth boundaries land are expected to guarantee the hoped for effects of smart growth. The outcome will be (1) denser subdivisions, (2) urban infill housing, infrastructure and employment, (3) higher density mixed use, (4) sub-centralization, neighborhood and identity development and (5) integrated diverse housing, servicing, shopping and urban life style.

While the operationalization of sustainable development in planning could be looked at in many diverse ways, attempts to integrate sustainable development into urban planning have largely been linked to the concept of smart growth. While the relationship between the two concepts remains debatable, some writers maintain that smart growth is similar to sustainable development (Porter, 2002). In its extensively cited publication, "Getting to Smart Growth", the Smart Growth Network (2016) outlines ten principles of smart growth, which include: (a) mixed-use development; (b) compact development/building design; (c) range of housing choices and opportunities; (d) creation of neighborhoods that are walkable; (e) fostering of unique and attractive communities with a strong sense of place; (f) the preservation of farmlands, open spaces, natural beauty and important environmental areas; (g) intensifying and directing development towards existing communities; (h) provision of a variety of transportation options; (i) making development decisions predictable, cost-effective and fair; and (j) encouraging community and stakeholder participation in development decisions. However, Gerhard (2005) sees it as a planning concept with the bottom up approach nature, smart growth or any kinds of planning concept have to be carefully adjusted to regional conditions and need. It should be a bottom up concept where trust plays the decisive role. A monitoring system should escort the initiated processes to tune the system at any time.

Litman (2003) argues that smart growth community residents typically own between 10 and 30 percent fewer vehicles and drive between 20 and 40 percent fewer annual miles than in sprawling, auto-dependent communities. The implementation of smart growth policies reduces automobile dependency and helps urbanites avoid the high cost of fuel, insurance premiums and parking. It is particularly helpful to the economically, physically and socially underprivileged people who tend to be limited in their ability to drive and reduces the portion of household budgets devoted to transportation (Rodier et al, 2009).

Finally, as the only national organization devoted to supporting, researching, promoting and providing leadership for smart growth coalitions in the United States, Smart Growth America has the following federal policy priorities: (1) support stronger, more economically competitive communities; (2) ensure a more accountable and safer transportation system; (3) improve programs that waste taxpayer dollars and encourage costly development; (4) create opportunity in underserved communities; (5) protect water; and (6) revitalize communities (Ishak 2016 et al).

## 4 SMART GROWTH IN EU

In 2010 launched ten-year jobs and growth Europe 2020 strategy. It was launched to create the conditions for smart, sustainable and inclusive growth. Five headline targets have been agreed for the EU to achieve by the end of 2020. These cover employments; research and development, climate/energy, education, social inclusion and poverty reduction.

EU defined smart growth by improving the EU's performance in:

Education (encouraging people to learn, study and update their skills)

Research/innovation (creating new products/services that generate growth and jobs and help address social challenges)

Digital society (using information and communication technologies) (European Commission, 2010).

According to Lacia et al (2015) EU has not adopted the US way of defining smart growth is probably due to that the problem of urban sprawl is a typical US problem. This is in general not the case for European cities and the EU therefore focuses on issues that are more pressing for the growth of European economies. These include lagging behind in terms of productivity, innovation input and output, and growth. The authors of the paper state that the concepts that underlie the Europe 2020 growth strategy are foremost policy-oriented concepts and the discussion of how they should be applied and understood in a regional context is far from settled. In their paper they argue that there are still several outstanding issues related to the different conceptual aspects of growth defining the Europe 2020 strategy, their mutual interactions in terms of policy objectives, and how they can be applied and measured in a European regional context. More specifically, they argue that it is unclear how such smart growth policies are supposed to be translated to fit a diverse set of rural regions.

According to European Commission (2010) Europe 2020 should be accomplished through Regional Policy and its funding, mainly with the European Regional Development Fund (ERDF). The annex to this communication suggests ways of building on regional diversity and ensuring an efficient use of scarce resources by exploiting synergies between funding sources and between the research and innovation systems in different regions. The Annex 1 by the European Commission states the following: Actions to attain the smart growth objectives of EU 2020 through regional policy and its funding.

The main aim of the Action 1 is to develop smart specialisation strategies, which will aim resource concentration on the most promising areas of comparative advantage, e.g. on clusters, existing sectors and cross-sectoral activities, eco-innovation, high value-added markets or specific research areas. With the help of Action 2, Commission will make more extensive use of financial engineering instruments in support of innovation, including soft loans, guarantees and venture capital, according to the type and size of firm and risk involved. The expansion of lending and equity financing for innovation through existing instruments, including the European Investment Bank (EIB) group, and particularly to SMEs should be a policy priority. Action 3 will pursue the possibility to finance interregional cooperation to promote research and innovation under the Convergence and Regional Competitiveness Objectives and better access to international research and innovation networks. While Action 4 is for ensuring coherence between supply push and demand pull research and innovation policy, by making use of the opportunities offered by public procurement co-financed by the ERDF to increase the innovation content of products, processes and services. Action 5 will use international peer review by independent experts for research projects more systematically to enhance the effectiveness of support. Implementing Action 6 will be considered the use of the ERDF for financing suitable shortlisted Research Framework Program 7 (FP7) and Community Innovation Program (CIP) projects and exploiting the possibilities for improving regional innovation policy through the peer learning offered by FP7, CIP and INTERREG IV C platforms and networks with Action 7.

## 5 CONCLUSION

Originated by the transportation and community planners in 1970s in US smart growth concept started getting into policy agendas from 1990s. One of the main ideas of the concept was to exclude the sprawls in US cities and make the cities more compact, environmentally, vehicle and pedestrian friendly. However, the concept became very diverse and till now there is no fixed definition. Companies or different national and local organisations are using it differently to reach their goals. One organization connects it with sustainable development and resource preservation, another connects with urban planning etc. Several studies from Asian countries has shown that the concept is mainly used to establish effective transportation systems in big cities. In contrast, it has different ideology in EU, where it is connected with innovation, education and technological advancement. Moreover, for the EU the concept is very new and there is a lack of literature related to smart growth.

### References

- Angelidou, M. (2014). Smart city policies: A spatial approach. *Cities*, 41. DOI: 10.1016/j.cities.2014.06.007, 3–11.
- Burchell, R.W., Listokin, D. & Galley, C.C. (2000) Smart growth: More than a ghost of urban policy past, less than a bold new horizon. *House. Policy Debate*, 11, 821–879.
- Environmental Protection Agency (EPA) (2015). Parking Spaces/Community Places: Finding the Balance through Smart Growth Solutions. Retrieved from: <http://pipta.org/wp-content/uploads/2014/04/SmartGrowth-Parking-Solutions.pdf>
- Environmental Protection Agency (EPA). 2002. National award for smart growth achievement 2002 winners. Washington, DC: U.S. Environmental Protection Agency. Publication EPA 231-F-02-002.
- European Commission (EC). (2010) Europe 2020: A European Strategy for Smart, Sustainable and Inclusive Growth. European Commission, Brussels. Retrived from: [http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/index\\_en.htm](http://ec.europa.eu/europe2020/europe-2020-in-a-nutshell/index_en.htm)
- Freeman, B., P. Shigley & Fulton W. (2004). The Pros and Cons of "Smart Growth". Retrived from: [www.facsnet.org/tools/env\\_luse/natl1smart.php3](http://www.facsnet.org/tools/env_luse/natl1smart.php3)
- Geller, A. L. (2003). Smart growth: a prescription for liveable cities. *American Journal of Public Health*, 93(9), 1410-1415. PMID: PMC1447984.
- Gerhard O. B. (2005). Smart Growth a concept for the urban future or just a tricky fraud? *Metar Manuskripte Zur Empirischen, Theoretischen und Angewandten Regionalforschung*. Freie Universitat Berlin Institut fur Geographische Wissenschaften Malteserstr ISSN: 0170-6268, 74-100
- Gerrit K. (2002). Talking Smart in the United States. Paper prepared for the International Meeting on Multiple Intensive Land Use. Gouda, The Netherlands, pp 3.
- Glendening, P. (1997). A new smart growth culture for Maryland. Retrieved from: [www.op.state.md.us/smartgrowth](http://www.op.state.md.us/smartgrowth).
- Harris, G. A. (2012). Implementing smart growth approaches in southwest Atlanta neighbourhoods. Retrieved from: <http://www.smartgrowth.org>.
- Hayward, S. (2000). Smart Growth Lessons from Portland. Retrieved from: [www.pacificresearch.org](http://www.pacificresearch.org)  
<http://www.aarp.org/content/dam/aarp/livable/communities/act/planning/getting-to-smart-growth100-policies-for-implementation-aarp.pdf>.
- Ishak M., Habib M. A. & Yusuf A. A. (2016) An Approach to Assess the Effectiveness of Smart Growth in Achieving Sustainable Development. *Journal Sustainability*. Number 8, 397. DOI:10.3390/su8040397.

- Katz, B. (2002) *Smart Growth: The Future of the American Metropolis?* CASE Parer 58; Centre for Analysis of social Exclusion, London School of Economics: London, UK,
- Knaap, G.J. & Lewis, R. (2009) Maryland case study. In *Smart Growth Policies: An Evaluation of Programs and Outcomes*; Ingram, G.K., Carbonell, A., Hong, Y.-H., Flint, & Eds. A. Lincoln Institute of Land Policy: Cambridge, MA, USA. 166–175.
- Litman, T. (2003) *Evaluating Criticism of Smart Growth*; Victoria Transport Policy Institute: Victoria, BC, Canada,
- Lucia N., Pia N., Hans W. & Sofia Wixe. (2015). What is smart rural development? *Journal of Rural Studies* 40, DOI:10.1016/j.jrurstud.2015.06.006, 90-101.
- Miller, J. S., & Hoel, L. A. (2002). The “smart growth” debate: best practices for urban transportation planning. *Socio-Economic Planning Sciences*, 36(1), 1-24.
- National Association of Home Builders (NAHB). (2012). *Smarter growth policy statement: Building better places to live, work and play*. Retrieved from: <http://www.nahb.org/generic.aspx?genericContentIDj6380&fromGSAj1>.
- Porter, D. (2002). *Making Smart Growth Work*; Urban Land Institute: Washington, DC, USA.
- Retno S., Sugiono S., Imam B., & Brotosunaryo P.M. (2015). Smart growth, smart city and density: in search of the appropriate indicator for residential density in Indonesia. *Social and Behavioral Sciences*, Elsevier. *Procedia*, 194 – 201.
- Rodier, C.J., Abraham, J.E., Dix, B.N., & Hunt, J.D. (2009). *Equity Analysis of Land Use and Transport Plans Using an Integrated Spatial Model*. Innovative Mobility Research University of California, Berkeley. Retrieved from: <http://ultrans.its.ucdavis.edu/files/pecas/Rodier%20-%20Equity%20Analysis%20of%20Land%20Use%20&%20Tansportation%20Plans%20Using%20Integrate%20Spatial%20Model%20-%202009.pdf>
- Smart Growth Network. (2016). *Getting to Smart Growth: 100 Policies for Implementation*. Retrieved from:
- Turner, M. A. (2007). A simple theory of smart growth and sprawl. *Journal of Urban Economics*, 61, 21–44. doi:10.1016/j.jue.2006.05.004.
- Wann-Ming W. (2015). Smart growth and transit-oriented development planning in site selection for a new metro transit station in Taipei, Taiwan. Elsevier Ltd. *Habitat International* 47, 158-168.
- Williamson, T. (2010). *Sprawl, Justice, and Citizenship: The Civic Costs of the American Way of Life*; Oxford University Press: Oxford, UK.
- Ye, L, Mandpe, S., & Meyer, P. B. (2005). What is “smart growth” really? *Journal of Planning Literature*, 19(3), 301-315. DOI: 10.1177/0885412204271668.

### **Contact information**

Davit Alaverdyan

Tomas Bata University in Zlin., Faculty of Management and Economics

T.G. Masaryka 5555, 76001, Zlin

+420774138276

[alaverdyand@fame.utb.cz](mailto:alaverdyand@fame.utb.cz)

# EQUILIBRIUM INTEREST RATE BASED ON UTILITY PREFERENCES: THE CASE OF KOSOVO FINANCIAL SYSTEM

*Florin Aliu, Fisnik Aliu*

## **Abstract**

There is a broad perception that interest rates in the Kosovo banking industry do not reflect underlying settings of the economy. The paper aims to find out the tendency of the interest rate equilibrium in the Kosovo financial system. The paper captures interest rate equilibrium standing on the risk preferences of the Kosovo inhabitants. Interaction of financial institutions such as: Kosovo Pension Fund, banks, Kosovo treasury, non-financial institutions, Kosovo companies and all other economic agents realizing monetary transactions allow functionalization on the bond market. The bond market is inexistent in Kosovo; all the equilibrium outcomes are based on presumption that economic agents are driven from their rational instinct. Based on the questionnaires conducted with 230 respondents within the Kosovo territory, Kosovo inhabitants are risk averse on their nature. In addition, most of the respondents declared that they are not satisfied with the interest rates in the banking industry. Standing on the questioner's outcomes, equilibrium in the Kosovo financial system would be reached at the level of 5.49%.

*Keywords: Market equilibrium, Kosovo financial system, risk preferences, banking industry*

## **1 INTRODUCTION**

It is proven that competition among economic agents is the key driver of innovation, productivity and better living standards. Since the capitalist system was established, competition was standing as the backbone of prosperity. Countries with well-established market institutions recognized in advance that markets would fail to deliver the intended outcomes in the absence of proper regulation. Invisible hand of Adam Smith proved that companies in a competitive environment deliver better economic conditions for the whole society, while failing in many economic dimensions for the emerging economies (Stiglitz, 2002). The banking industry in Kosovo is a crucial element in feeding business ideas and economic life of the country. Banks comprise the major share within the financial system. According to the Central Bank of Kosovo, concentration was very high within the industry since free market concepts were established within the banking industry (CBK, 2016). Many countries established stock and bond market as a substitute for the banking industry. The countries of eastern and central Europe followed the streams of a market economy through recognizing that markets might fail to deliver the outcomes intended (market failure). Czech Republic fashioned the stock and bond market via privatization of state owned enterprises, where the voucher scheme was the corn stone of the whole process (Pajuste. 2002). Hungary, Poland and Slovenia opened their stock markets in 1991, Slovakia in 1993 while Rumania and Latvia in 1995. Poland was characterized with the highest capitalization, followed by Hungary and Czech Republic. Low levels of capitalization were influenced by country size, low economic development and not a strong regulatory framework. Establishment of the bond and stock market in the countries of central and eastern Europe was supported from the inherited institutional framework. Kosovo has started forming institutions from the ground base since 1999, which is an extra difficulty in making bond market viable. Strong institutional frameworks are crucial contributions in raising investors' confidence. Hakansson (1999), considers that bond market has a robust influence on the banking industry. There are no scientific evidences that proves which is the optimal capital structure of the economic entities (Graham, 2002; Modigliani and Miller, 1958; Myers, 1998; Leland, 1998; Wald, 1999). It is proven that diversification has delivered better economic outcomes, not just in terms of assets (investments), but also in terms of debts. The debt structure of Kosovo company's stance only on one credit line (banking industry), which does not allow arranging their debt in ideal format. Well-developed bond market generates less room for the crisis to have a spillover effect on the whole economy and especially in the banking industry (Hakansson, 1999). Bond market creates space

for the vast number of financial analysts, rating agencies and derivative instruments that enable risk to be more visible in the system (Hakansson, 1999). The country with a largest share of financing business activities through the bond market is U.S. with 50% of total financing (Rajan and Zingales 1995, Sapsford 1997, Pomerleano 1998, McGee 1998). Banks are very autocratic in their lending's, since lending decisions are made mostly from the major banks. Bond investors are more capable of assessing risk than the banking industry (Siconolfi, Raghavan, and Pacelle 1998). Enormous concentration of the money in the banking industry generates supplementary risk when banks are opposed to the bankruptcy. Recent financial crises (2008) displayed that banks are too big to fail and too interconnected to fail, while government intervention was required. Diversifying investments within the financial system (banks, the bond market and stock market), does not allow banks to get engaged in risky activities beside their traditional operations. The presence of the bond market allows superior diversification not just of the assets, but also the better arrangement of the capital structure. The bond market is a major investment element within pension funds' portfolios and other long term investment funds. Raising participants in the bond market require profound familiarity with the way bond market operates. Hakansson (1999), considers that opportunities to invest in long term financial securities generates better financial standing in terms of capital structure. My work differentiates itself, since it extends the scope of the companies that are able to issue contractual obligations in the bond market. It is the first work which attempts to find the total interest rate equilibrium in the financial system. The most important element of the well-functioning of the bond market is the financial reporting system. Reliable reporting on the financial statements offer higher confidence on the borrowers to invest in bonds while reflecting on lower interest rates. One of the key ingredients in the transmission mechanism of the bond issuance is related to the financial analysts and rating agencies that enables better information on the borrowers and lenders (Hite et al. 1997; Ederington et al. 1998). My work extends the scope of inclusion in the bond market, through allowing all sorts of firms to reach access to it. Different people and various investors stand on different risk preferences, assisting to grasp diverse risk balances on the financial system. Presenting junk bonds in the bond market requires strong credit analysts to define their prices, denomination and interest rates. Some investors retain their bonds till maturity while the others tend to trade during this process which is named as private placement (Emerick and White, 1992). The manner individuals make choices affects how markets operate, how policies are conducted by the government and fashions the economic principles of the country. The other obstacle in the overall process of the bond market establishment are the issues related to the company bankruptcy. According to the World Bank, Kosovo stands below the regional average concerning the contract enforcement by the judicial system (Doing Business Report, 2011). Contrast enforcement reflects the time lag of executing the contract via judicial system. Lack of effective liquidation device is one of the reasons of lateness in dealing with non-performing loans in Japan (Whitman, 1998). In addition, the well-developed bond market is a Pareto improvement for the whole financial system (Hakansson 1982, 1992). The bond market would have been a crucial substitute for high interest rates that were exposed to businesses and families in Kosovo since the initial process of transformation (Aliu, 2015). My previous work only introduced the schematic diagram of involving whole businesses in the bond market (Aliu, 2016). However, the results of the work show financial interest rate equilibrium reached on Kosovo financial system based on the risk preferences of the Kosovo inhabitants. Questionnaires' were constructed to see the risk preferences that Kosovo inhabitants prefer. Based on their preferences, equilibrium was reached standing on the responses from the questionnaires.

The remaining parts are structured as follows: The first part contains an introduction and short literature review. The second part covers the theoretical background concerning risk preferences. Methodology stands on the third part while graphical representation linked with equilibrium in the financial system is in the fourth part. Conclusion together with recommendations are enclosed in the fifth part.

## **2 THEORITICAL BECKGROUND**

People are opposed to a different set of choices. Our work lies within two crucial theories that build demand curve, such as: preferences, utility functions and choices. The utility function is a mathematical

representation of preferences. The choices are constrained under the capability of individuals to pay for preferences. People might prefer one thing from the other for different motives. If one person prefers asset A than Asset B, it means that asset A has higher utility (Halvarian. 2010). Our work does not consider the financial position of the interviewed individuals, since it is based on the “if” presumption. Demand comes from utility maximization. Utility maximization is compounded from two components, such as: preferences people have and budget constraint. People tend to make choices which lead them on the way to utility maximization. In order to satisfy preferences, there are some assumptions that must be reached, such as: completeness, transitivity, non-satiation. Completeness means that you can't be indifferent among two financial assets, you must prefer one or the other. Transitivity, means that if you prefer bonds of Company A instead of Company B, and bonds of Company B instead bonds of Company C. Then you prefer bonds of Company A than bonds of Company C. Non-satiation assumption bring insights that more is always better. Our work is explained with the preferences under four options, such as: Bank deposits with 2% interest rate, Company A with a 5% interest rate, Company B with 8% interest rate and Company C with a 10% interest rate. Risk averse people experience diminishing marginal utility. Risk neutral individuals has constant marginal utility. Risk lovers have increasing marginal utility. The utility function is expressed as follows

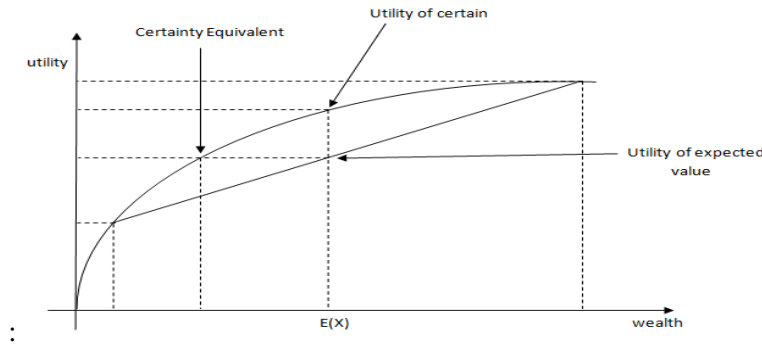


Figure Nr 1. Utility function of risk averse individuals.

The diagram expresses choices among two goods, or among one good and “all other goods”. Consumer theory is built under certain assumptions. You cannot want Asset (A) > Asset (B) and at the same time want Asset (B) > Asset (A), since you will have to choose one or the other. Preferences are represented through indifference curves. Indifference curves show only how indifferent is consumer within two different assets, but they do not show which one is better or worse. Indifference curves represent the tendency that more is better. Standing on the logic of our work, bonds with higher interest rates and lower risk stand on higher indifference curves.

$$\text{Expected Utility} = \sum_{i=1}^n p_i U(x_i) \quad (1)$$

While the first derivate of the utility functions for risk averse people, is as follows:

$$U''(X) < 0, \text{ strictly concave } U(X) \Rightarrow \text{Risk Averse} \quad (2)$$

Since indifference curves are optional choices between two goods. In our work choices are offered through the questioner between two financial investments with different levels of return, but with the same level of risk. Company A offered 5% return on investments in bonds, while banks offer 2% return. Since risk averse people pretend to get no risk on their investment, while trying to optimize their returns. According to the consumer theory, risk averse people would choose investments on the Company A, while would ignore investing in bank deposits. Risk neutral people are considered investing in Company B. They are not concerned for their risk level; they only want a certain level of return for any risk level. Where the second derivate of utility function equals to zero:

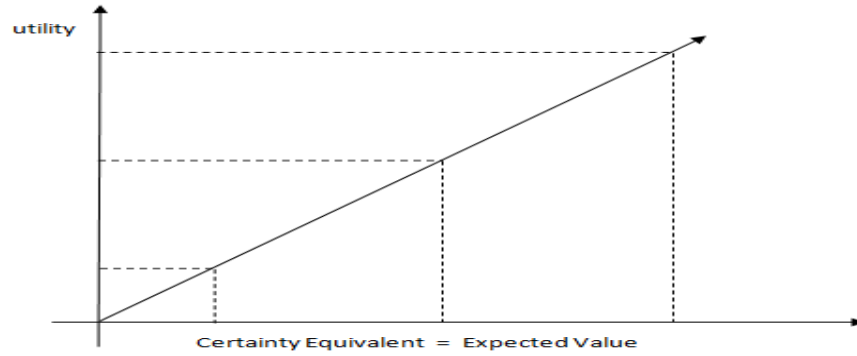


Figure Nr.2 Risk neutrals utility function

$$U''(X) = 0, \text{ linear } U(X) \Rightarrow \text{Risk Neutral} \quad (3)$$

Risk lovers are people who are used to live with the risk. They are gamblers, which want higher return while they are opposed to higher risk level on their investments. Risk lovers have increasing marginal utility. The formula of utility function for risk lovers is as follows:

$$U''(X) > 0, \text{ strictly convex } U(X) \Rightarrow \text{Risk Lover} \quad (4)$$

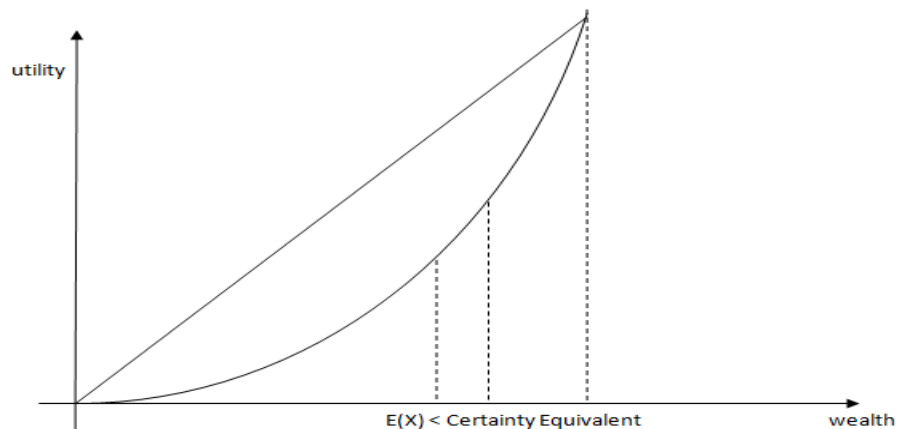


Figure. Nr 3. Risk lover's utility function.

### 3 METHODOLOGY

The work captures the equilibrium of the financial system in Kosovo, through schematic diagram. The study contains not only diagram representation, but also results obtained from questionnaires' with Kosovo inhabitants. The sample used is a random sample with 230 respondents. Respondents of the questionnaires' were selected in three different cities of Kosovo: Prishtina, Gjilane and Prizren. In Prishtina were randomly selected 130 respondents, Gjilane 50 respondents and in Prizren 50 respondents. Beside respondents and theoretical diagram, mathematical approach was used to reach the equilibrium in the financial system. The questioner was built in Albanian language, since this is the first official language in Kosovo.



## 4 RESULTS AND DISCUSSIONS

Answers on the questionnaires stand within the range of risk preferences, such as: risk averse, risk lover or risk neutral. The region of risk preferences where respondents will stand, supports new interest rate equilibrium in the Kosovo financial system. Questioner confirms that Kosovo inhabitants are risk averse in their nature. They prefer no risk on their investment even though the returns are lower, which perform the equilibrium in the lower bound.

First question: Are you satisfied with the interest rates in the banking industry?

Satisfied

More or less satisfied

Not satisfied

The response from three different cities were diverse. In Prishtina, which is the capital city of Kosovo, 90% of the respondents answered that they are unsatisfied with the interest rates from the banking industry, while 8% were more or less satisfied and 2% were satisfied. Results show that Kosovo inhabitants are looking for new forms with less costs to finance their daily economic operations. It is quite clear that the answers would flow in this direction, since for 17 years' banks that operate in Kosovo were keeping interest rates in lending activities very high (reaching 14%) while in deposits quite low around 2% (CBK, 2014). The answers of this question confirm the need for introduction of the bond market.

Second question: if you have 10000 euro, where you would invest those moneys if both investments contain no risk?

Bank deposits with return on investment of 2%

Company A with return on investment of 5% interest rate

Answers on this question confirmed that respondents want higher returns for no risk on their investment. This confirms that in the case of the bond market existence, they would prefer investments in bond market rather than the banking industry. These movements are confirmed under the assumption that respondents have full information on the form bond market operates.

Third question: If you have 10000 euro, where would you invest your money if three companies contain different level of risk, also different level of returns?

Company A, return on investment of 5% (risk free investment)

Company B, return on investment of 8% (average risk on investment)

Company C, return on investment of 10% (too much risk on the investment)

Answers on this question approve that Kosovo inhabitants are risk averse on their nature. 85% of the respondents choose company A, while 13% choose company B and 2% company C. Opposed to three different risk levels and three different levels of returns, they preferred less risk even though the returns are lower. Choosing Company A might be a consequence of different factors, such as: economic situation of the country, historical context during the communist system, the risk nature of the people etc.

The diagram (1) demonstrates that financial market equilibrium would be reached when all actors in the system will be involved. The diagram is detached in two main parts, demand for money, which contains: three companies with different risk levels, the government of Kosovo, banks and microfinance institutions. Supply side contains economic agents that have money but they don't know where to invest, such as: Kosovo businesses, Kosovo inhabitants, Kosovo Pension Fund, Kosovo diaspora, domestic and foreign economic agents. Company A, B and C is assumed to have the same performance and leverage ratios such as: debt, equity, profits, turnover etc. in order to simplify the explanation. Differences in the interest rates that appear among three companies are a consequence that their financial statements are audited from three

different audit companies. Company A is audited from big five well known audit companies and interest rate on bonds is 5%. Company B is audited from domestic audit companies while interest rate imposed on it is 8%. Company C is not audited and the interest rate is 10% of the bonds issued. Company A has the same performance, leverage, liquidity ratios like Company B and Company C. Three companies have the same financial ratios, in order to simplify the assumption. Company A is audited from big five and interest rate imposed on it is lower than other companies. Company B, is audited from domestic companies and it is supposed that is more easy to corrupt domestic audit companies than international ones. Company B is paying a higher interest rate than Company A, but lower than Company C which is not audited. Our schematic diagram differentiates itself from the previous wisdom concerning the bond markets since it enables all companies to be listed, not only those audited from big five. Since people might have different risk preferences, basket of different financial securities enables choosing among different risk-reward tradeoffs.

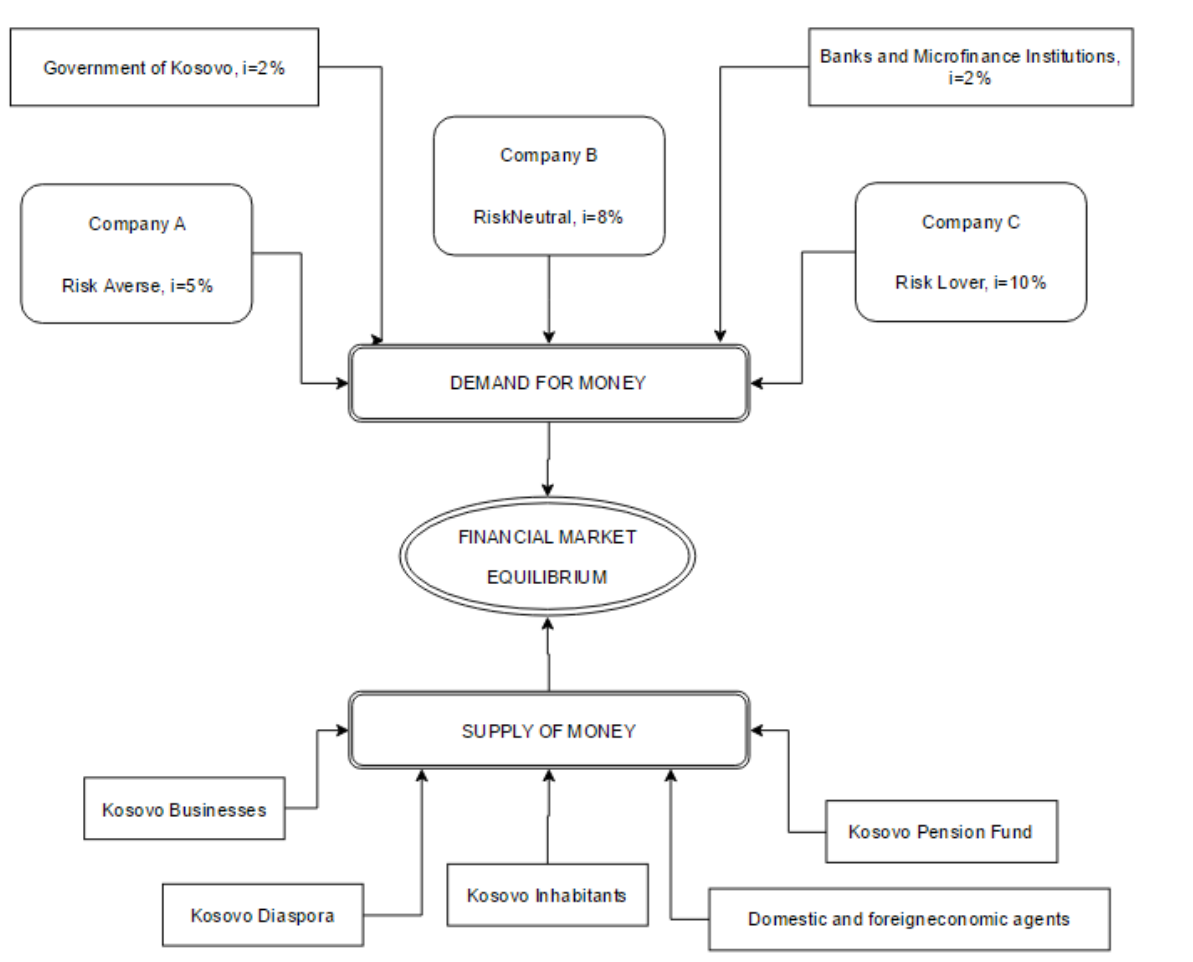


Figure 1. Financial market equilibrium in Kosovo financial system. Source: Authors own theoretical design.

Since respondents are not satisfied with current interest rates imposed from the banking industry. Introducing bond market would create new opportunities not only for better diversification of their balance sheet, but also obtaining funds with lower interest rates. Standing on my proposed diagram, where 85% of respondents are risk averse, 13% risk neutral and 2% risk lover. Equilibrium interest rate under this schematic diagram would be reached at the level of 5.49%. This will push banks to lower interest rates on lending activities close to this margin while to raise interest rates on deposits, in order not to lose their clients both on the lending side and deposit side.

*weighted average interest rate in Kosovo financial system*

$$= [(0.85 * 0.05) + (0.13 * 0.08) + (0.02 * 0.10)] = 0.0425 + 0.0104 + 0.002 \\ = 0.0549$$

Economics is not what people say, but what they do. Economic history proved that there is a misalignment within what individuals declare in questionnaires' and what they do in reality. The results of our questioner stand behind this paradigm.

## 5 CONCLUSION

Financial system and in particular banking industry is the vital development device of the Kosovo prosperity. Fixing banking industry through establishing bond market, would be a new alternative source of financing business ideas and economic needs. Europe is more oriented on the banking industry on injecting economy with money, while US and England because of the capitalist arrangement they mounted more hinge is concentrated on the capital markets (bond and stock markets). Recent financial and economic emergency in Europe and US, exhibited that structural restructuring in the real economy does not bring results projected without healthy financial industry. On good and bad economic times, banks are the lender of last resort for the economy. Creating substitute mechanism (stock and bond market) that feeds the economy with liquidity, empowers optional sources of lending and expand the variety of financial assets in the economy. The results of our work confirm that there is a need for the new alternative source of injecting the Kosovo economy with liquidity. Kosovo inhabitants based on questionnaires' are not satisfied with interest rates enforced by the banking industry, since higher interest rates deepens problems allied with household and business investments. Under the assumption that respondents have full information on the practices and procedures how the bond market operates, Kosovo inhabitants are risk averse in their nature. Based on the interaction between risk averse, risk lovers and risk neutral people, interest rate on the Kosovo financial system equilibrates in the rate of 5.5%. It is proven that in Kosovo, regulators are weak to control market anomalies. Higher interest rate spread in the Kosovo banking industry did not justify the risk level that the Kosovo economy contains. Regulators during the Kosovo economic transition were not proficient to identify if there exist cooperative agreements among banks in the industry. Standing on these limitations, the bond market would be a natural substitute for the banking industry to lower interest rates. Kosovo has a short institutionalized economic history to guard markets from irregularities. Since the declaration of independence in 2008 market regulators were fragile to create healthy and competitive environment in the banking industry.

### Acknowledgement

We are very grateful for the support provided by the Internal Grant Agency of Tomas Bata University in Zlin IGA/FaME/2016/018.

### References

- Aliu, F. (2015). Understanding the current state of the financial system in Kosovo and its implications for human security. Center for research documentation and publication, Policy Brief. [Online]. Available at: <http://cn4hs.org/wp-content/uploads/2015/12/FINALPOLICY-BRIEF-ENGLISH-DEC.18-2015.pd>
- Aliu, F., & Nadirov, O. (2016). Kosovo Banking Paradox. Academic Journal of Economic Studies, 2(4), 11-22.
- CBK (2004-2014). Central Bank of Kosovo, Annual reports.[online]. Available at: <http://bqk-kos.org/index.php?m=tandid=57>

Doing Business Report—"South East Europe Doing Business"—page 33, 32, Available from: <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Subnational-Reports/DB11-SubSouth-East-Europe.pdf>

Ederington, Louis H. and Jeremy C. Goh, "Bond Rating Agencies and Stock Analysis: Who Knows What When?," *Journal of Financial and Quantitative Analysis*, December 1998, 569-585

Emerick, Dennis and William White, "The Case for Private Placements: How Sophisticated Investors Add Value to Corporate Debt Issuers," *Journal of Applied Corporate Finance*, Fall 1992, 83-91.

Graham, J. R., & Harvey, C. R. (2001). The theory and practice of corporate finance: Evidence from the field. *Journal of financial economics*, 60(2), 187-243.

Hakansson, N. H. (1999). The Role of a Corporate Bond Market in an Economy--and in Avoiding Crises.

Hakansson, Nils H., "Changes in the Financial Market: Welfare and Price Effects and the Basic Theorems of Value Conservation," *The Journal of Finance*, September 1982, 977-1004

Hite, Gailen and Arthur Warga, "The Effect of Bond-Rating Changes on Bond Price Performance," *Financial Analysts Journal*, May/June 1997, 35-51.

Leland, Hayne E., "Agency Costs, Risk Management, and Capital Structure," *The Journal of Finance*, August 1998, 1213-1243.

Modigliani, Franco and Merton Miller, "The Cost of Capital, Corporation Finance and the Theory of Investment," *American Economic Review*, 1958, 267-297.

Myers, S.C. (2001), "Capital structure", *Journal of Economics Perspectives*, Vol. 15, pp. 81-102.

McGee, Suzanne, "Corporate Bonds Set to Blossom in a New Europe," *The Wall Street Journal*, July 22, 1998

Pajuste, A. (2002). Corporate governance and stock market performance in Central and Eastern Europe: A study of nine countries, 1994-2001.

Pomerleano, Michael, "The East Asia Crisis and Corporate Finances— The Untold Micro Story," *World Bank Working Paper*, August 6, 1998.

Rajan, Raghuram G. and Luigi Zingales, "What Do We Know about Capital Structure? Some Evidence from International Data," *The Journal of Finance*, December 1995, 1421-1460.

Stiglitz, J. E. (2002). *Globalization and its Discontents* (Vol. 500). Norton: New York.

Sapsford, Jathon, "Japanese Growth Model Hits a Wall in Asia," *The Wall Street Journal*, October 16, 1997.

Siconolfi, Michael, Anita Raghavan, and Mitchell Pacelle, "How the Salesmanship and Brainpower Failed At Long-Term Capital," *The Wall Street Journal*, November 16, 1998

Varian, H. R., & Repcheck, J. (2010). *Intermediate microeconomics: a modern approach* (Vol. 6). New York: WW Norton & Company.

Wald, J, K, 1999, 'How firm characteristics affect capital structure: An international comparison', *Journal of Financial Research*, vol. 22, pp. 161-87

Whitman, Martin J., "Japan Should Write A New Chapter," *Barron's*, October 19, 1998.

**Contact information**

Florin Aliu

Tomas Bata University in Zlin

Mostní 5139, 760 01 Zlin

Email: [aliu@fame.utb.cz](mailto:aliu@fame.utb.cz)

Fisnik Aliu

University of Prishtina

Bregu I Diellit 2, Sali Nivica nr 38

Email: [fisnik.a@hotmail.com](mailto:fisnik.a@hotmail.com)

# SELECTED METHODS OF SUSTAINABILITY OF CUSTOMERS IN E-COMMERCE

*Ottó Bartók*

## **Abstract**

The article discusses the sustainability of customers in e-commerce in the B2C relationship. Looks at the issue from a position of small or medium providers of goods in e-commerce section. Identifies major differences compared to the classic sale of goods and also defines critical approaches. This article tries to find out synergistic methods for the long-term sustainability of the customer in comparison with different methods. All these methods are evaluated based on the effect on final profit and the rate of return of individual customers for the year term. In conclusion of this article is the procedural scheme for the small and medium firm which should help increase the sustainability of customers in e-commerce. As important as the processing scheme is to increase customer loyalty. One option is to offer gifts and personal phone calls to increasing customers' loyalty. The consequence of these measures is an increase of 10.5% in comparison to the return of individual customers gained from basic data.

**Keywords:** CRM, B2C, leading relationships with customers, e-commerce, eCRM

## **1 INTRODUCTION**

“Customers may forget what you said, but they'll never forget how you made them feel.”

Author: Unknown

Customer relationship management (CRM) is the way how to lead interaction with current customers and potential future customers.

There are many different definitions of CRM. For example, Bose gives this definition of CRM: CRM is an integration of technologies and business processes used to satisfy the needs of a customer during any given interaction. More specifically, CRM involves acquisitions analysis and use of knowledge about customers in order to sell more goods or services and to do it more efficiently” (Bose, 2002)

Another definition gives Kotler and Keller. They are defining CRM “as the process of carefully managing detailed information about individual customers and all customers “touch points” to maximise loyalty”. These customer touch points are defined as anything and any occasion that customer approaches the brand or product.” (Kotler and Keller, 2011)

CRM is about an understanding of customer's requirement and who is able to understand has got the advantage on the market. That idea is defined by Baran as „emphasize that in order to achieve better development and implementation of an effective CRM it is important to understand the relationship between satisfaction, loyalty, and profits. Furthermore, the main objective of an effective CRM is satisfying customers, creating customer loyalty and creating a relationship between the business and its customers.“ (Baran et al 2008)

All authors of definitions are agreeing in two main mentions:

take care about a relationship with customers, and their loyalty.

The main goal of CRM we can see in many ways, but in general the purpose of the CRM is keeping our customers, identification essential processes and offer them added value which they expect.



Figure 1 - Main goals of CRM in B2C. Source: Author's works

At first the business needs to build customer loyalty, and then transform the loyalty into dependency. Customer loyalty is not easy to build. Loyalty is progressive, like a ladder. (Brown 1991)

The main difference between CRM in e-commerce with B2C is that customers who came to shop are unknown for us. We can aim to each segment of our potential future customers by using ads such as Google Ads or Social Network Ads Manager. The social commerce is new phenomenon that needs to be better understood. (Huang & Benyoucef, 2013)

Social commerce is one of mode for building brand name or rise numbers of customers. Also, many of small and medium-large firms which are using e-commerce for making business have a chat support for to get closer to customers and make some social connect with them. These technologies are based on Web 2.0 which will be evolved into Web 3.0 in the future. (Newman, Chang, Walters, & Wills, 2016) But on the other hand case study conducted in India identified that information support has the strongest influence on an individual's intention to use social commerce website. (Lal, 2017)

But there is no any closer interaction like a while, shopping in a market at the corner of our street. Which shows a reason, why conventional CRM has been modified to Electronic Customer Relationship Management (eCRM), came into being along with the ice, which makes multiple electronic channels available to customers. It is not merely an extension of the traditional CRM, but shifting focus from mass customer to one customer, that is, customer Centricity, managing customer relationship on a one-to-one basis. (Mougayer, 1997)

eCRM has different ways to approach the customer over conventional CRM. These differences should be summarized into a few points by (Satish, & Strickland, 2004)

all of the traditional methods are used in addition to the internet,

designed for front-end applications,

the customers' browsers are a gate to eCRM

highly individualized and personalized views based on purchases and preferences

the system is designed around the customer's need

Another research deals with sustained competition advance on e-commerce markets. The main competitive advantage can be achieved by effectively use the network technology especially IT and suitable software.

(Chen & Zhang, 2015) Using new innovations in e-commerce has positive impact brand equity and should improve customer loyalty. (Atashfaraz & Abadi, 2016)

### **1.1 eCRM in e-commerce on Czech market**

Small and medium firms spend about 15% of their marketing costs to promotion for new customers at the price comparator Google Merchant, Zbozi.cz, and Heureka.cz. These numbers are different for each category. For example, e-shop with electronics could spend 35% of marketing costs to find the new customer. This is a reason why it's necessary to keep new customers because we give a lot of money to attract new customers.

On the Czech market are 36,000 retailers using e-shop (B2C) for business. The estimated turnover approaching 6.63 billion dollars in 2016. The most common e-commerce customers are men (56%) and woman (43%). The typical customer is men 24 - 26 years' old who is looking for electronic and pays on average 60 dollars for his order. Also, 83% of people in the Czech Republic have ever been used e-commerce for order goods or service.

49% of all customers have favourite e-shop and 24% of customers are regularly using the same e-shop. They are the most loyal for this category: PC, food & drink, films, games, and office equipment. 15% of customers prefer specialized e-shop then shopping gallery.<sup>1</sup>

## **2 SUSTAINABILITY OF CUSTOMER IN E-COMMERCE ON CZECH MARKET**

As said above the difference between CRM and eCRM in e-commerce can be found in social interaction with customers. The research question could be: Can personal contact be substituted by another method in e-commerce? Personal contact always makes a bond with the shop as a result of social interaction. Sustainability of customer in e-commerce relates to customer loyalty to the firm.

These shops using similar e-commerce solution (FastCentrik, Webareal, Prestashop) but categories of sales were different. Contain food & drink, kids' clothes, electronics and office supplies. All of them are located in Czechia and aiming at Czech customers. The basic data were passed from the largest provider of e-commerce in the country.

Effect of customer's loyalty is a measured rate of return of customers. That all is evaluated into process graph. The general approach how to raise customers' loyalty builds the strong brand. This approach is not possible for the small or medium shop using e-commerce. They cannot afford to spend a lot of money to build a brand. Marketing costs account about 7% of total costs. Is it enough? In comparing with bigger firms, it is not, but if we allocated these expenses well it's possible to raise loyalty sufficiently.

Social commerce is one of mode for building brand name or rise numbers of customers. Also, many of small and medium-large firms which are using e-commerce for doing business have a chat support. In the main reason to get closer to customers and does socially connect with them.

The ways how to lead sustainability of customers in e-commerce are divided into three methods:

social contact with customers by phone after they made an order or while they are making an order, present for customers, which didn't advertise on the page, but it's possible to buy separately, improve process of CRM evolved into eCRM.

---

<sup>1</sup> *E-business case study* [online]. In: . p. 89 [cit. 2017-01-05]. Retrieved from: <https://www.heurekashopping.cz/resources/attachments/p0/3/e-business-forumkompletnistudie.pdf>



Questionnaire survey found that 71% of respondents is subscribed to the newsletter and 86% of them use these offers to buy goods. Women are using special offers, more often than men. The price, coupon uses only 30% respondents for next purchase.

Quantitative research was based on survey. The survey has 15 close questions with 2 open questions. The survey was sent to 1.457 e-mail addresses and 547 surveys came back filled. From 547 respondents was chosen 67 to focus group, that encouragement survey. The calls have structured form. The email addresses were received from 7 e-shops. Each e-shop has the average annual turnover \$ 127.000.

Table 1 - Compare woman and man in main questions. Source: Author's work.

	Man	Woman
Using price cupoun	27%	32%
Have a favorite shop	59%	51%
Are planning their purchase	73%	81%
Are loyal for their shop	26%	22%
Are subscribed for NWL	74%	68%

Men come back because they felt satisfied with last purchase, we're glad about communication also a quality of goods were fine. On the other hand, women come back in a reason of they felt satisfied with last purchase, we're pleased with the quality of goods and the price was favourable.

Loathly was measured as:

Figure 2 – Loathly index. Source: Author's work.

$$\left(\frac{TRP}{TOP}\right) \cdot 100$$

Where is:

TRP – total number of orders from same customer within one year

TOP – total number of orders from all customers within one year

General loyalty for individual categories of e-shops are (the percentage of consumers that are returned within one year):

kids' clothes: 16%

electronic: 24%

food & drink 30%:

office accessories: 32%

Identified customer loyalty before implementation (the percentage of consumers that are returned within one year)

kids' clothes: 16%

electronic: 24%

food & drink 24%:

office accessories: 22%

### 3 RESULTS

What we must do to make customers back? In summary, improve the satisfaction from their purchase, the quality of goods must be excellent. Few of customers, especially in the electronic category are looking for lower price. Last but not least is service and communication with customers and last one delivery. These all think we have to do well to do well in order to achieve long-term sustainability of the customer.

The main problem is communication with customers. If the customer places an order it is good to call and give them any advice or recommendations about the goods. Also, we can offer them to other services. The telephone contact increases the confidence of 81% customers. This is the same social contact as for conventional purchase in the “stone” shop. The total costs of this service are small, but the time required on it is a bit higher. With this method 33% of customers place an order at the same store again because of the helpful approach affected as a result of the call. Most suitable hours for this call are 8-9 hour and 14-16 hour. This call is preferred by 84% of customers before contacting via e-mail.

Another possible approach is giving gifts to each customer-differentiated according to the order price value. Of those surveyed, 94% of customers were satisfied and surprised from a present. 63% of customers stated that they will place an order in the future. Indeed, 38% of them created another order.

Table 2 - The level of satisfaction in connection with the loyalty. Source: Author's work.

Customer spent money		Value* of present in \$														Optimum
		0	0,1	0,2	0,4	0,6	0,8	1,2	2,0	2,8	3,9	5,1	7,1	9,1	11	
\$ 7,88	\$ 19,69	--	-	*	**	**	*	-*	-*	-*	-*	-*	-*	-*	-*	\$ 0,39
\$ 19,69	\$ 39,39	--	-	*	**	**	**	**	*	-*	-*	-*	-*	-*	-*	\$ 0,70
\$ 39,39	\$ 118,16	--	--	-	-	*	**	**	**	*	-*	-*	-*	-*	-*	\$ 1,49
\$ 118,16	\$ 196,93	--	--	--	-	-	*	**	**	**	*	-*	-*	-*	-*	\$ 1,97
\$ 196,93	\$ 393,86	--	--	--	--	-	-	*	**	**	**	*	-*	-*	-*	\$ 2,46
\$ 393,86	\$ 787,71	--	--	--	--	--	-	-	*	**	**	**	*	-*	-*	\$ 5,02
\$ 787,71	\$ 1 575,42	--	--	--	--	--	--	--	-	-	*	**	**	**	-*	\$ 6,07
Satisfaction of customers that they described.																

\*in cost price

\*\* calculated by using the exchange 25.39 CZK

-- (very unsatisfied feeling), - (unsatisfied feeling), \* (satisfied feeling), \*\* (very satisfied feeling), - \* (limit reached, satisfied is not rising more but only cost of present)

Table 2 shows the rate of loyalty with the optimum price of the present. It is important that the customer receives gifts unannounced. Customers must be surprised from a gifts. All these presents we can sell in our shops as normal goods it may be sold at a higher price. For example, the customer buy TV and we give him set of towels for electronic in a total cost of \$ 1 but in the shop could be bought for \$ 6.

The dependence between two variables is determined by the correlation coefficient. As is shown in Graph 1.

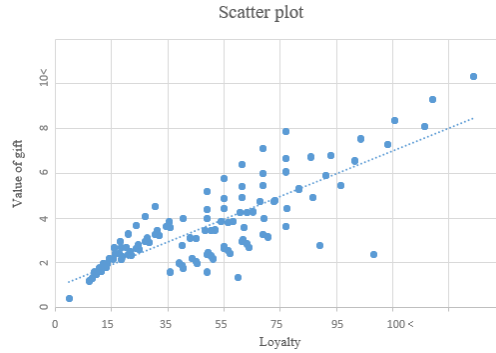


Figure 3 - Scatter plot (VG and LO). Source: Author's work.

Based on the correlation plot, it may be assumed that the rate of VG and LO has a positive linear bond. The correlation coefficient shows the bond strength.

Table 3 - Correlation coefficient. Source: Author's work.

Name	Sample mean	Standard deviation	Variance
VG	0,922	0,466	0,682853
LO	55,310	29,574	5,438243

Correlation coefficient $r$
0,79632

95% intervals for correlation coefficient is (0,6677; 0,9744). There is 95% of probability for strong or very strong correlation between VG and LO.

It is interesting that during the six months after the introduction of the gifts in e-shops, visits from new customers rose. An example of one of the shops with foods & drink is shown in Graph 1. In comparing 2016 and 2015 year.

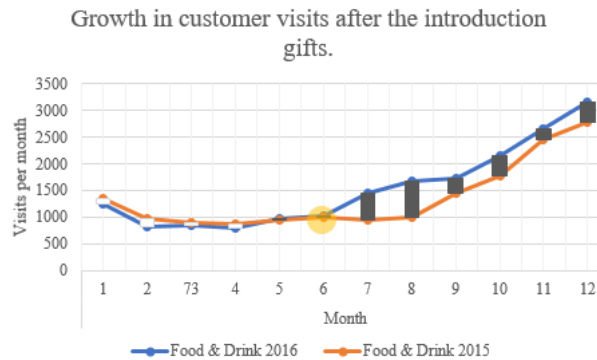


Figure 4 - Growth in customer visits after the introduction gifts. Source: Author's work.

The average cost per customer for their gift was \$ 2,42 for each shop, but the average profit from customers' orders was \$ 18,42 compared to last year's \$ 12,47. Costs for gifts offset higher profits as a result of new customers and higher customer loyalty. Gifts increased customers' loyalty, together with communication helped the return of 35% customers, which is 10.5% higher than the base diameter and 13% higher than was previously.

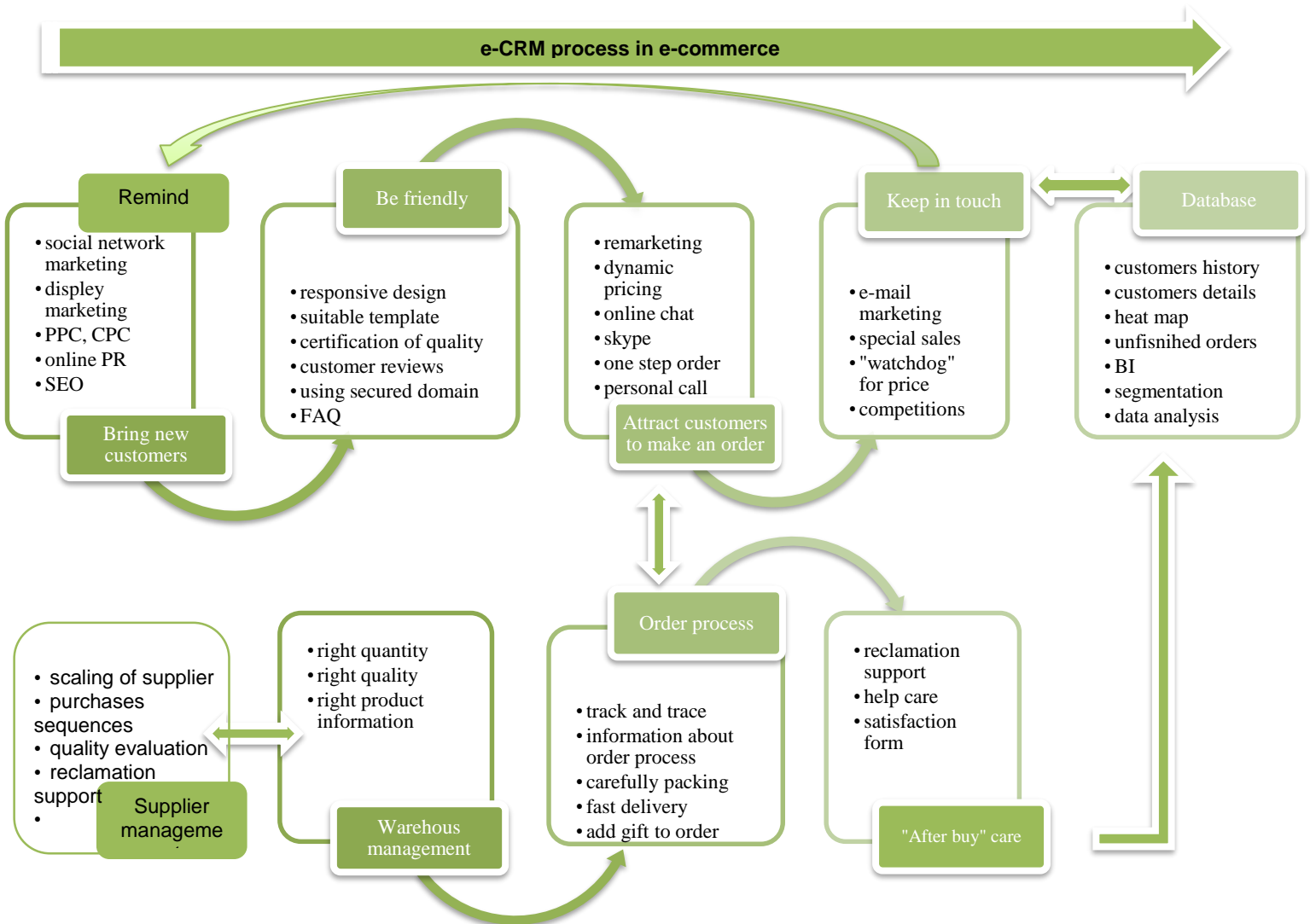


Figure 5 - CRM process B2C in e-commerce. Source: Author's work.

The important factor is to foster customer loyalty and procedurally. Figure 5 shows the basic process which helps to support, loyalty and customer relationship. It is necessary to build relationships downstream of the goods, but also against it.

As can be seen above, good marketing is equally important as order process. We have to build a database with all details about customers but suppliers too. This process with improved communication and gifts for customers should help raise profits and increase the number of new customers and their loyalty to shop. Increasing of loyalty depends on many factors. And our purpose is being ready to face these factors

## 4 CONCLUSION

The influence of gifts and communication on customer loyalty is evident. Based on correlation with strong and very strong correlation in loyalty and gifts. The cost of gifts does not exceed the total gain. The return of individual customers surpassed the general average for this category. However, it is necessary to manage customer relationships not only with the marketing strategy, but the processes need to be guided too. General process relationship management can be easily applied to small and medium businesses with B2C

relationships and thus achieve higher profits from each customer. For larger companies, it's not possible to quickly and efficiently implement various steps due to their large organizational structure.

Research has also shown the importance of managing the relationship with suppliers. The small and medium businesses are essential for negotiation with suppliers. Each of the monitored shops in e-commerce had a problem with supplier. Most of them were incomplete delivery and late delivery. Improved communication and gifts can be an additional tool how to improve customer loyalty.

## References

Atashfaraz, M., & Abadi, M. H. (2016). Impact of E-Service Innovation on Brand Equality and Customer Loyalty in Samsung International Corporation. *Procedia Economics and Finance*, 36, 327-335. doi:10.1016/s2212-5671(16)30044-2

Baran, R. J., Galka R. J. & Strunk D. P. (2008). *Principles of customer relationship management*. Student ed. Mason, Ohio: Thomson/South-Western, ISBN 9780324322385.

Bose, R. *Customer relationship management: key components for IT success* Industrial, Management & Data Systems, 2002, Vol. 102 ISSN 0263-5577.

Chaffey, D. E (2007). *Business and e-commerce management: strategy, implementation and practice*. 3rd ed. Harlow [etc.]: Prentice Hall/Financial Times,. ISBN 9780273707523.

Chandra, Satish, & Ted J. Strickland (2004) Technological differences between CRM and eCRM, *Issues in Information Systems*, 5 (2), 412. [cit. 2017-01-10]. Retrieved from [http://www.iacis.org/iis/2004\\_iis/PDFfiles/ChandraStrickland.pdf](http://www.iacis.org/iis/2004_iis/PDFfiles/ChandraStrickland.pdf).

Chen, Q., & Zhang, N. (2015). Does E-Commerce Provide a Sustained Competitive Advantage? An Investigation of Survival and Sustainability in Growth-Oriented Enterprises. *Sustainability*, 7(2), 1411-1428. doi:10.3390/su7021411

CHong, W. K., Bian D. & Zhang. (2015). E-marketing services and e-marketing performance: the roles of innovation, knowledge complexity and environmental turbulence in influencing the relationship. *Journal of Marketing Management* [online]. 32(1-2), 149-178 [cit. 2017-01-10]. DOI: 10.1080/0267257X.2015.1102758. ISSN 0267-257x. Retrieved from: <http://www.tandfonline.com/doi/full/10.1080/0267257X.2015.1102758>.

E-business case study [online]. In: . p. 89 [cit. 2017-01-05]. Retrieved from: <https://www.heurekashopping.cz/resources/attachments/p0/3/e-business-forumkompletnistudie.pdf>.

Huang, Z., & Benyoucef, M. (2013). From e-commerce to social commerce: A close look at design features. *Electronic Commerce Research and Applications*, 12(4), 246-259. doi://dx.doi.org/10.1016/j.elerap.2012.12.003

Kotler, P., & Keller, L. K. (2012). *Marketing management*. 14th [ed.]. Upper Saddle River, N.J.: Prentice Hall, ISBN 0132102927.

Lal, P. (2017). Analyzing determinants influencing an individual's intention to use social commerce website. *Future Business Journal*, 3(1), 70-85. doi://dx.doi.org/10.1016/j.fbj.2017.02.001

Newman, R., Chang, V., Walters, R. J., & Wills, G. B. (2016). Web 2.0—The past and the future. *International Journal of Information Management*, 36(4), 591-598. doi://dx.doi.org/10.1016/j.ijinfomgt.2016.03.010

Nguyen, B. X., Sinkin L. & Ana Isabel. CANHOTO. *The dark side of CRM: customers, relationships and management*. Routledge 2015. ISBN 978-1138803329.

Shoniregun, C.A., Omoegun A., Brown-West D. & Logvynovskiy O.. Can eCRM and trust improve eC customer base? In: *Proceedings. IEEE International Conference on e-Commerce Technology*, 2004. CEC

2004 [online]. IEEE, 2004, s. 303-310 [cit. 2017-01-16]. DOI: 10.1109/ICECT.2004.1319748. ISBN 0-7695-2098-7. Retrieved from: <http://ieeexplore.ieee.org/document/1319748/>.

**Contact information**

Ing. Ottó Bartók

Tomas Bata University in Zlín, Faculty of Management and Economics

Mostní 5139 760 01 Zlín

+420 603 944 894

[bartokotta@gmail.com](mailto:bartokotta@gmail.com)

# **FINANCIAL SITUATION AND LIABILITY INSURANCE AS A CRITERION IN SUPPLIER EVALUATION AND SELECTION BY COMPANIES IN THE CZECH REPUBLIC AND GERMANY**

*Dagmar Benediktová*

*Keywords: Supplier, supplier evaluation, evaluation criterion, financial results, insurance*

## **1 INTRODUCTION**

The paper addresses financial situation and liability insurance in the evaluation and selection of suppliers by companies. The topic is based on own research conducted among Czech and German companies, which addresses in more detail the supplier evaluation methods used by industrial companies and examines individual evaluation criteria that are used by these companies in the two countries. While conducting the research, a number of interesting facts were found out that deserve a more detailed analysis. One such fact is whether and to what extent customers evaluate and select their suppliers with regard to their financial situation and liability insurance.

Supplier evaluation and selection criteria may vary significantly – each customer prefers somewhat different criteria, depending on the industry in which it operates, its priorities, its customers' requirements etc. On the other hand, it is indisputable that a supplier's poor financial situation or the fact that the supplier does not have liability insurance may have a significant impact on the customer and the customer's clients. For example, a poor-performing company may end up insolvent, which may temporarily jeopardise the customer's production until a new supplier is found. Likewise, there may be delays in deliveries because the supplier does not have sufficient funds e.g. to purchase materials that are required in order to produce the product to be delivered. There are a variety of problems that may arise, and businesses are usually more or less aware of that.

In this context, the aim of the present paper is to determine the extent to which the financial situation of companies and their liability insurance are used by Czech and German customers as supplier evaluation criteria and to determine the most common ways in which customers verify this information and how it differs in Czech Republic and Germany.

## **2 THEORETICAL BASIS**

Supplier selection is one of the main factors essential for a good purchase. During selection, the company must be confident that the supplier meets its requirements. Even the best business plan may fail if the selected supplier is incompetent (Šlapota, 2005).

Given that industrial companies are characterised by close links between suppliers and customers, supplier selection and evaluation is a very important step for every industrial company. Supplier evaluation also serves as a source of information for the strategic management of customer-supplier relationships (Dambowy, 2012).

A company should evaluate the following two groups of suppliers (Berning, 1996):

Potential suppliers and current suppliers – here it is necessary to look into the purchasing market, analyse and collect information about suppliers, recalculate risks associated with deliveries from the supplier, the quality of supplier-customer services, supply chain management, and studies are also often used.

Subsequently, the procedure for individual (specific) suppliers is as follows: a supplier audit is conducted, evaluation parameters are set, supplier performance is analysed using performance indicators – the methods used include for example matrix evaluation methods, evaluation of financial ratios, or the complex evaluation tools within the Supplier Evaluation System (SES).

Supplier selection and evaluation criteria can be divided into three groups that also reflect the importance of each criterion (Vašítková, 2014):

Product and associated services: the ability to deliver products in the quantity and at the quality required, product reliability, service level, technical assistance, consulting services, product packaging, guarantee and reliability, accompanying documentation, simplicity.

Price and contract terms: the actual price, discounts, rebates, potential ability to receive compensation for damages, payment and delivery terms, ability to adapt to changing conditions.

Supplier, good-will and contract performance: innovative technical abilities and conditions, management, the company's reputation, image, financial situation, reliability, willingness to compromise, quality of communication, corporate culture and morality, labour relations, the company's location and logistic conditions, references from other customers.

The potential ability to receive compensation for damages, which typically includes the issue of compensation for damages from insurance that had been taken out for that purpose, is therefore included in the second group of criteria, while the actual financial situation is included in the third group of supplier selection and evaluation criteria, yet it is indisputable that these are criteria that need to be taken into account.

With regard to supplier evaluation as such, while supplier evaluation takes place as part of supplier selection, the purchasing department is also tasked with carrying out on-going inspection of existing suppliers and determining their compatibility with pre-determined criteria. A positive evaluation of an existing supplier is needed for the customer's decision to continue cooperation or to modify or even terminate the business relationship (Nenadál, 2006).

On the part of the customer, the very basis of supplier evaluation consists in laying down certain criteria that are based on some basic indicators. It is only after a these indicators have been specified into specific criteria that the actual evaluation process can take place. Basic indicators are understood as a set of supplier services that include in particular the delivery period (time), delivery reliability, delivery flexibility and delivery quality, but they may also include the financial health of the supplier, liability insurance, or generally the ability to claim compensation for damages if incurred, and so on. (Pfefferli, 2002).

In other words, in the context of supplier selection and evaluation, the supplier's financial situation and the question of whether the supplier is insured against liability for damages are often seen as possible, yet not necessary evaluation criteria. It is therefore up to each company – customer to decide whether it will use these facts as evaluation criteria.

In relation to the actual research of this paper, similar studies comparing the financial situation and liability insurance as the assessment criteria in different countries could not be found (in Czech nor English language), so it can be considered that this study is a unique research.

### **3 RESEARCH AND METHODOLOGY**

The actual research was conducted using a quantitative survey, which consisted of a semi-structured questionnaire. A questionnaire is classified as a subjective research method. This means that respondents have the ability to modify their answers in various ways (i.e. they can provide true as well as false statements). Therefore – given that companies respect their trade secrets or refuse to disclose certain information and, in turn, some individual results may be distorted – it was necessary to involve an adequate



number of respondents in order to achieve sufficiently conclusive results, despite the potential distortion on the part of some companies (Reichl, 2009). For the same reasons, all respondents were kept anonymous, and while the researcher knew to whom a questionnaire had been sent and who had responded to it, the actual evaluation does not include any names of respondents or any highly specific information that might make it possible for respondents to be identified.

The research was conducted in a period starting in July 2016, when a pilot study was carried out in which selected companies were approached with a request to fill in the questionnaire and also to help identify those passages of the text that were difficult to understand or that needed to be further explained in the questionnaire. In August 2016, the questionnaire was revised based on the results of the pilot study and, in the period from September 2016 to December 2016, the questionnaire was distributed to Czech and German industrial companies and answers to questions were collected. The original language of the survey was Czech, then it was translated to German, the main language of the survey is Czech.

The companies were approached through a targeted selection that was made primarily on the basis of the author's professional contacts, because it could be expected that companies with which the author was in regular contact in her job, would be less concerned to provide sensitive information about their supplier evaluation and would be more willing to participate in implementing the research. While, on the one hand, targeted selection *reduces the representativeness of the research sample, on the other hand, the research was gathering internal and sensitive information that would not have been provided by companies than had been selected entirely at random. However, the validity of such research is considerably greater than in the case of a survey* where the questionnaire is sent out to a large number of companies and responses are only received from a small percentage of respondents. Overall, 221 companies were approached for the purpose of completing the questionnaire, 194 of which responded to the questionnaire. Unfortunately, it was later necessary to exclude 13 questionnaires due to incomplete answers. The resulting sample thus comprised 181 respondents from the Czech Republic and Germany. The differences between the samples from the two countries were examined using the binomial test of equality of relative frequencies.

#### 4 RESULT OF THE RESEARCH

The research sample consisted of 181 companies that responded to the questionnaire. Overall, 46 questionnaires were completed by German companies and 135 questionnaires by Czech companies. All of these were industrial companies, mainly in the automotive industry (71 companies, of which 50 Czech and 21 German), the industry producing plastic parts for the automotive industry (16 companies, 10 Czech and 6 German) and the glass industry (7 companies, 6 Czech and 1 German). In other industries (chemical industry, engineering industry, but also need the clothing industry) there were 54 companies, of which 43 Czech and 11 German. With respect to the automotive and plastic parts industries, it was not uncommon for the companies to operate in both of these industries and to identify both categories in the questionnaire (33 companies, of which 26 were from the Czech Republic and 7 from Germany). In the following table, such companies are indicated separately. Table 1 presents the structure of the industries in which the companies operated according to the country where the research was conducted.

Table 1: Number of respondents by industry in each country

	Automotive	Glass industry	Plastic parts	Other industry	Automotive and plastic parts
Czech Republic	50	6	10	43	26
Germany	21	1	6	11	7
Total	71	7	16	54	33

Source: own research

Another characteristic feature of the companies, which was important for the following comparison and was therefore also determined, was their categorisation as micro, small, medium and large enterprises – in line with Commission Regulation No 800/2008, companies with fewer than 10 employees and an annual turnover of up to EUR 2 million are categorised as micro enterprises, companies with 10–49 employees and an annual turnover of EUR 2–10 million are categorised as small enterprises, companies with 50–249 employees and an annual turnover of EUR 10–50 million are categorised as medium enterprises, and companies with more than 250 employees and an annual turnover of more than EUR 50 million are categorised as large enterprises (Srpová and Řehoř, 2010).

In both the Czech Republic and Germany, a large part of the companies were classified as medium and large enterprises, which was primarily due to the fact that a large portion of the research sample consisted of companies operating in the automotive industry, where it is usually not possible to operate at the level of a micro enterprise. The results are clearly presented in Table 2 where, as before, the companies are also divided according to the country in which they operate. Within the 181 companies, there were only 3 micro enterprises (all from the Czech Republic), only 15 small enterprises (of which 9 from the Czech Republic and 6 from Germany), 57 medium-sized enterprises (of which 39 in the Czech Republic and 18 in Germany) and 106 large companies (of which 84 in the Czech Republic and 22 in Germany). Table 2 shows the results for the Czech Republic and Germany in absolute numbers as well as the overall results, while Chart 1 present the same results for all of the companies in the research (regardless of whether they are based in the Czech Republic or Germany) as percentages.

Table 2: Structure of respondents by company size, in each country

	Micro enterprise	Small enterprise	Medium-sized enterprise	Large enterprise
Czech Republic	3	9	39	84
Germany	0	6	18	22
Total	3	15	57	106

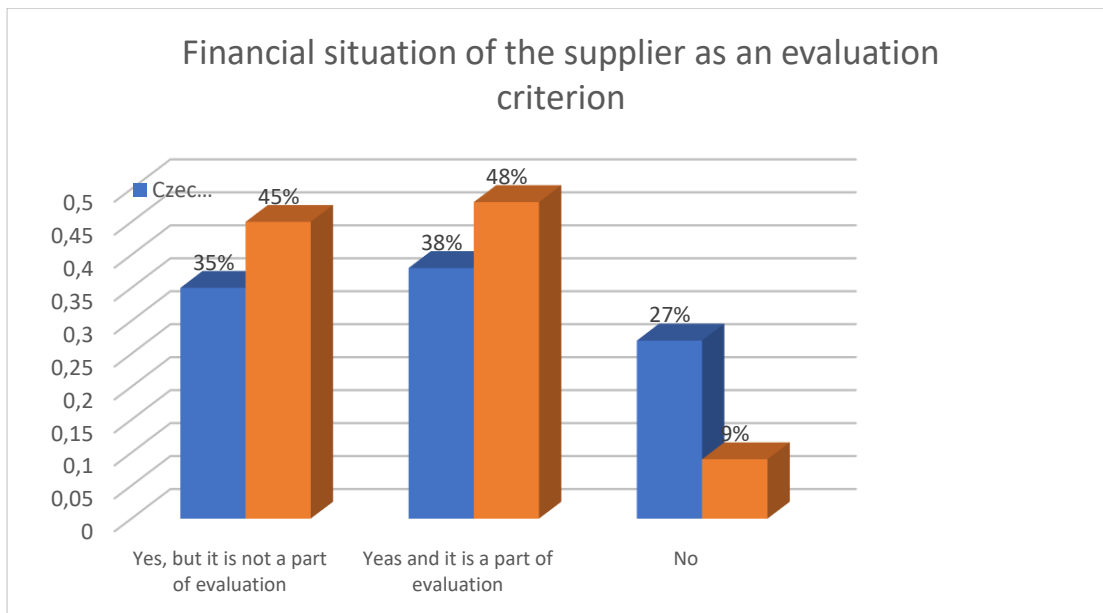
Source: own research

The next part of the questionnaire examined how – as part of supplier selection and evaluation – the companies’ approached suppliers’ financial situation, whether and how they verified it, and how they approached suppliers’ liability insurance. The results are as follows:

*Question: As part of supplier selection and evaluation, are you interested in your suppliers’ financial situation?*

The question examined not only whether the industrial company was interested in the supplier’s financial standing, but also whether this aspect was specifically taken into account in supplier evaluation, i.e. whether it was an evaluation criterion. It was found that only 4 of the German companies did not determine the supplier’s financial standing (i.e. 9% of German companies), while in the Czech Republic this was 36 companies (i.e. 27% of Czech companies). It was also found that 22 respondents in Germany (i.e. 48%) not only determined the supplier’s financial standing but also took it into account in supplier evaluation and selection, while in the Czech Republic 51 respondents did the same (i.e. only 38% of the companies). In addition, it was found that 20 respondents in Germany (i.e. 43% of the companies) determined the financial standing but did not take it into account in supplier evaluation, while in the Czech Republic 48 respondents opted for this answer (corresponding to 38% of the companies). The results are presented in Chart 1.

Figure 1: Financial situation of the supplier as an evaluation criterion



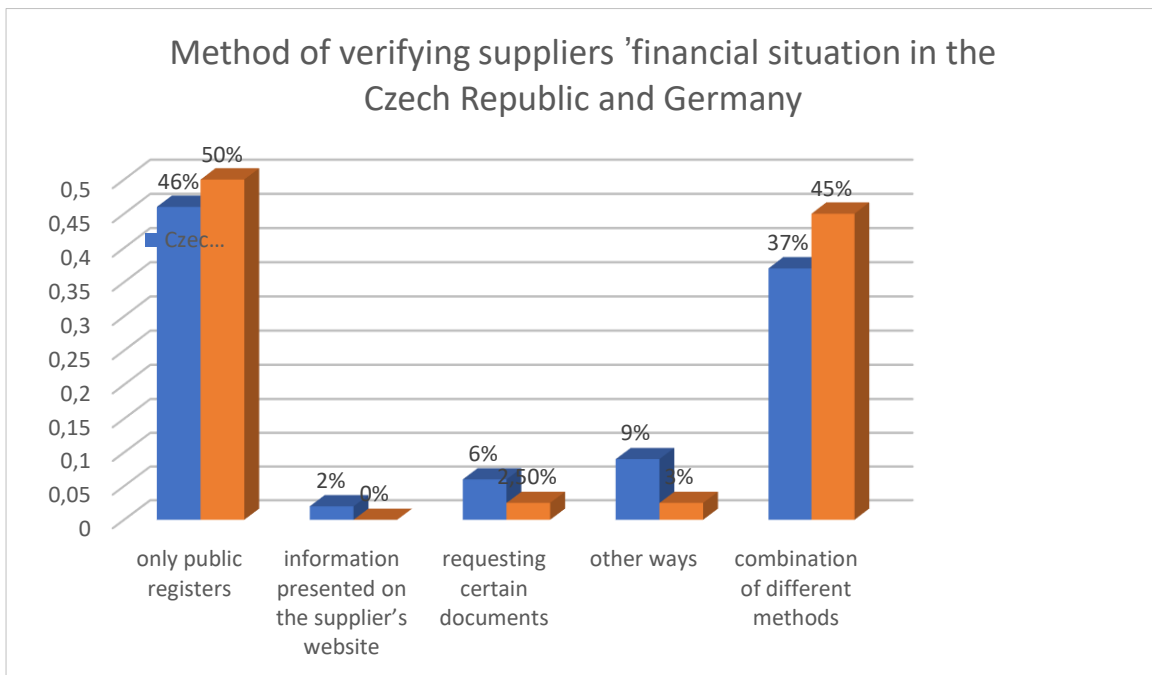
Source: own research

*Question: If you answered “yes” to the question above, how do you vet suppliers in terms of their financial situation?*

The next question followed up on the previous one and was only answered by those respondents who had answered the previous question by indicating that they determined suppliers’ financial situation. That is also why the total number of companies that answered this question is lower, because it is based only on 99 Czech companies and 42 German companies. From the responses to this question, it was determined that 45 companies in the Czech Republic (46% of the respondents who checked suppliers’ financial situation) only relied on public registers, such as the insolvency register or the commercial register, while in Germany this was 21 respondents (i.e. exactly 50% of those who checked suppliers’ financial situation).

In the Czech Republic, 37 respondents (i.e. 37% of the companies) used a combination of different methods – i.e. access to public registers, suppliers’ websites, requests for various documents from suppliers, as well as other methods used at their discretion and based on their needs – to verify suppliers’ financial situation, while in Germany this option was indicated by 19 respondents (i.e. 45% of the companies). A total of 9 respondents (i.e. 9%) from the Czech Republic indicated that they used other ways to verify suppliers’ financial situation, in Germany only one respondent (i.e. 2.5%) selected this option. 6 respondents in the Czech Republic (i.e. 6%) and 1 respondent in Germany (i.e. 2.5%) verified suppliers’ financial situation only through requesting certain documents. Only two respondents (i.e. 2% of the companies) in the Czech Republic rely solely on information presented on the supplier’s website, while none of the companies in Germany selected this option. The results are clearly presented in Chart 2.

Figure 2: Method of verifying suppliers’ financial situation in the Czech Republic and Germany

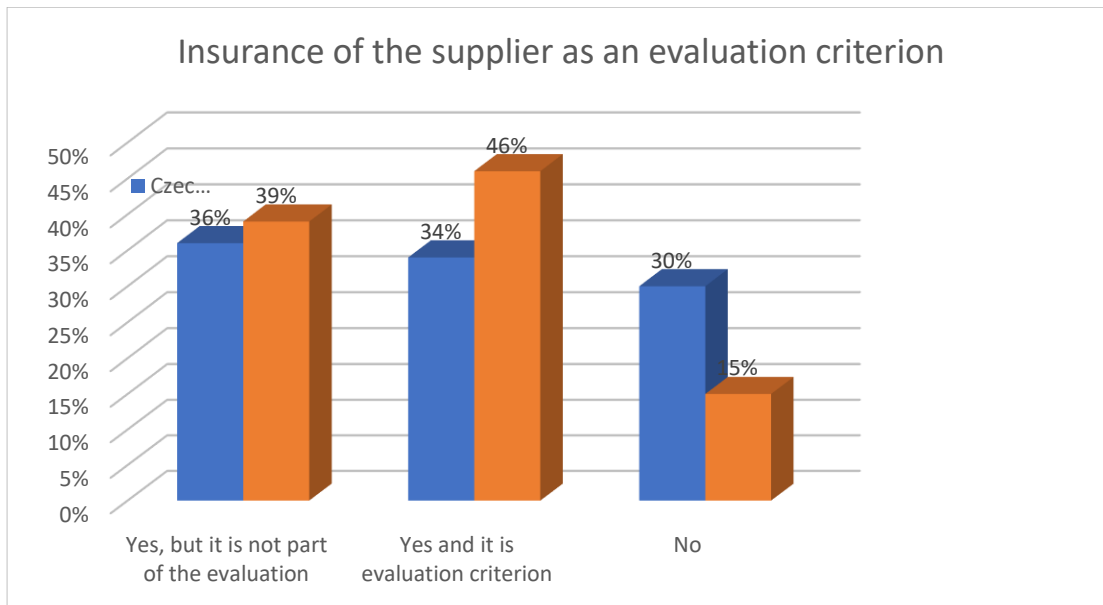


Source: own research

Question: As part of supplier selection and evaluation, are you interested in whether the supplier is insured in order to cover the cost of damages or other liability (personal injury etc.)?

**The third question, which was significantly correlated to the previous two, determined whether industrial companies were interested in whether their supplier was insured especially for any damage caused, but also for other cases such as an injury in connection with a delivery etc. It was found that 40 Czech respondents (i.e. 30% of the companies) and 7 German respondents (i.e. 15% of German companies) did not determine at all whether the supplier was insured for liability for damages and other unforeseen events. 49 Czech respondents (i.e. 36% of the companies) and 18 German companies (i.e. 39% of German companies) determined the information but did not take it into account in evaluation. 46 respondents (i.e. 34% of companies) in the Czech Republic and 21 respondents (i.e. 46% of the companies) in Germany determined this information and took it into account in supplier selection and evaluation. The results are clearly presented in Chart 3.**

Figure 3: Insurance of the supplier as an evaluation criterion



Source: own research

## 5 DISCUSSION

The results of the questionnaire survey indicate that certain differences between Czech and German industrial companies can be identified in terms of verifying suppliers' financial situation and taking it into account in supplier selection and evaluation, and the same applies to suppliers' insurance and its impact on supplier evaluation. The main motivation for comparison between the Czech Republic and Germany is their intense business relationship, both for suppliers from the Czech Republic and customers in the Czech Republic, it is interesting to know how the rating in the Czech Republic and Germany varies, and, if so, to follow up on business relations

For example, at a significance level of  $\alpha = 5\%$  it is possible to identify a significant difference consisting in the fact that 9% of companies in Germany were not interested at all in suppliers' financial situation, while in the Czech Republic this was 27% of the companies ( $p\text{-value} = 0.0112$ ). While there was a difference between the number of companies that not only determined the financial situation but also considered it a form of evaluation, as this applied to 38% of the respondents in the Czech Republic and 48% of the respondents in Germany, the difference was not statistically significant ( $p\text{-value} = 0.2297$ ). In Germany, there were also a larger number of companies that at least determined suppliers' financial situation and, even though they did not consider it an evaluation criterion, this allowed them to eliminate at least those suppliers who were e.g. in financial difficulties. This applied to 43% of German companies and 25% of Czech companies. However, the difference is not statistically significant either ( $p\text{-value} = 0.3379$ ). It can basically be assumed that German companies generally check the financial aspects of their suppliers slightly more than Czech companies, but the differences cannot be statistically proven on such a small sample.

Also, the question of how companies determine information about suppliers' financial aspects may indicate that German companies are more cautious, as they never rely solely on suppliers' websites (a source where information can be manipulated in various ways) but they mainly trust public registers, which are preferred by 50% of German respondents and 46% of Czech respondents, and another very good method is also the

combination of multiple methods, which is used by 45% of respondents in Germany and only 37% of respondents in the Czech Republic. However, the differences between Czech and German companies are not statistically significant (p-value = 0.6208 and 0.3739 respectively).

As before, in terms of determining information about suppliers' insurance and using it as an evaluation criterion, Czech industrial companies proved to be less cautious and prudent in comparison with German companies, because this information was not determined by 30% of Czech companies and only 15% of German companies, which can be regarded as a significant difference (p-value = 0.0062). The difference in the number of companies that explicitly took insurance into account as an evaluation criterion – 34% in the Czech Republic and 46% in Germany – is not significant (p-value = 0.1784). Similarly, the number of companies that only determined this information but did not take it into account as a criterion did not show any significant difference (p-value = 0.7356) between Czech companies (36%) and German companies (39%).

The question is, of course, what causes the above differences between the Czech Republic and Germany. Unfortunately, the questionnaire that was implemented did not address this question. Nonetheless, it can be presumed that there are certain differences in mentality, e.g. Germans tend to be considered more thorough, which may also affect supplier selection and evaluation. In addition, these differences may also be attributed to the fact that private enterprise only started in the Czech Republic after 1989, which is why there is less experience with issues such as insolvency etc. However, these are only two of many possible factors to which the above differences may be attributed. Even so, this topic might serve as a basis for further research into why these differences exist.

In essence, the following recommendations for Czech companies can be formulated:

- It can be recommended that suppliers' financial aspects should be taken into account in supplier-related decisions and in supplier evaluation, because a supplier's financial difficulties may also indirectly affect the customer, which is undesirable.
- It is advisable that stable companies with a long track record of successful economic performance should be selected as suppliers, because any instability in suppliers or any loss of supplies due to suppliers' winding up or financial difficulties would be undesirable.
- Also, it can be recommended that Czech companies should not underestimate the use of publicly available databases, such as the commercial register, insolvency register, trade register or central register of distraints, where many problems on the part of the supplier can often be uncovered.
- Similarly, it can be recommended that suppliers' insurance should not be underestimated and that e.g. the insurance policy number should be requested and subsequently verified with the insurance company, or possibly that other document should be required as proof of insurance.

## **6 CONCLUSION**

This paper addressed the role of the financial situation and liability insurance in the evaluation and selection of suppliers by companies. The aim of the present paper was to determine the extent to which the financial situation of companies and their liability insurance were used by Czech and German customers as supplier evaluation criteria. It turned out that information relating to financial aspects is considered an evaluation criterion by 38% of companies in the Czech Republic and 48% of companies in Germany, and insurance is considered an evaluation criterion by 34% of companies in the Czech Republic and 46% of companies in Germany.

Also, a sub-aim was to determine the most common ways in which customers verified this information. Generally, either public registers or a combination of multiple methods (e.g. a public register + website) were the most common forms of verification. However, other methods – e.g. verification only on the web, submission of various documents and other methods – were also used to a limited extent, especially in the Czech Republic.

Another sub-aim was also to determine the differences in the approach to this evaluation criterion between industrial companies in the Czech Republic and Germany. Basically, it was found that, by comparison with German industrial companies, Czech companies less frequently vet their suppliers in terms of financial situation and insurance and, even if they do, they are less thorough (e.g. they only use websites rather than other trustworthy sources). It was also found that, compared with Germany, fewer Czech companies use these findings as supplier evaluation criteria. However, the differences are neither substantial nor statistically significant.

Whereas the results are different, however, the differences are not essential, it would be interesting to carry out a large-scale research involving more than one enterprise (eg 1,000 from both countries) in order to obtain representative results and findings of this research either Confirm or, on the contrary, refute significant results using statistic.

## **References**

- Berning, R. (1996). Beschaffungsmarketing. Wiesbaden: Gabler.
- Dambowy, N. (2012). Lieferantenbewertung. Erbslöh Aktiengesellschaft: GSN Maschinen-Anlagen-Service GmbH.
- Neřád, J. (2006). Management partnerství s dodavateli: nové perspektivy firemního nakupování. Praha: Management Press.
- Pfefferli, H. (2002). Lieferantenqualifikation: Die Basis für Wettbewerbsfähigkeit und nachhaltigen Erfolg. Renningen: Expert Verlag.
- Reichel, J. (2009). Kapitoly metodologie sociálních výzkumů. Praha: Grada.
- Srpová, J. a Řehoř, V. (2010). Základy podnikání: Teoretické poznatky, příklady a zkušenosti českých podnikatelů. Praha: Grada.
- Šlapota, B., Grabarczyk, K., & Leták, J. (2005). Nákup? Havířov: Question Marks.
- Vašítková, M. (2014). Marketing služeb: efektivně a moderně. Praha: Grada.

## **Contact information:**

Ing. Dagmar Benediktová  
Technical University of Liberec, Faculty of Economics  
Department of Business Administration and Management  
[dagmar.benediktova@skoda-auto.cz](mailto:dagmar.benediktova@skoda-auto.cz)

# INTEGRATED SYSTEMS AND METODOLOGIES IN SPANISH FIRMS

*Marta Blasco Torregrosa, Elena Pérez Bernabeu, Víctor Gisbert Soler, María Palacios Guillem*

## Abstract

The aim of this article is to determine the integrated management systems (IMS) or methodologies (especially, Six Sigma) that Spanish companies have implemented and how integrated it. A questionnaire was sent to 68 Spanish companies that comply with a specific requirement: that they had implanted at least two management systems (MS) or methodologies to carry out the integration. The integration sequence will be determined and if there is an integration plan, the model followed to carry out the integration as well as the main benefits and difficulties found during the process of integration. In addition, there will be mention of a specific question about the knowledge of the companies on the Six Sigma methodology. The paper not only focuses on the integration of IMS, but also in the Six Sigma methodology and this paper is one of the first studies focussing on integration in the Comunidad Valenciana.

**Keywords:** *Integrated Management System (IMS), Management System (MS), integration, Six Sigma, Spain*

## 1 INTRODUCTION

In recent years many organizations have implemented Management Systems Standards (MSS) in order to improve their management (Bernardo, Casadesus, Karapetrovic, & Heras, 2008). A Management System (MS) may be defined as a set of inter-related organizational processes, sharing resources to achieve several organizational goals. In this context an organizational management system includes planning, product/service realization, monitoring and improvement activities (Sampaio, Saraiva, & Domingues, 2012). All these MS, certifiable or not, can be integrated into a single MS: an integrated management system (IMS) (Bernardo et al., 2008)(Bernardo et al., 2008).

Moreover, there are other many methodologies to improve the quality in the companies. Six Sigma is a good example. Six Sigma is a methodology that was based on earlier successful managerial programs. This methodology was developed mainly based on statistical process control and total quality control/total quality management (TQM) (Folaron, 2003; McAdam & Lafferty, 2004; Ranjan Senapati, 2004; Tjahjono et al., 2010).

The paper is divided in the following parts: firstly, a literature review; followed by a research methodology, the results of this research and finally, some conclusions.

## 2 LITERATURE REVIEW

On the one hand, when organizations have multiple management systems (MSs) implemented, the next step is to manage them as a single system in order to benefit from the related synergies (Bernardo, Simon, Tarí, & Molina-Azorín, 2015). The most common standards implemented are those proposed by the International Organization for Standardization (ISO, 2015), ISO 9001:2000 for quality management systems (QMS) and ISO 14001:2004 for environmental management systems (EMS) (Bernardo et al., 2008). According to the last ISO Survey of Management System Standard Certifications 2015, a total of 1.033.936 certificates were issued to ISO 9001 (including 4.190 issued to the 2015 version published in September 2015) a slight decrease of 0.2% to 2014. A total of 319.324 certificates were issued to ISO 14001 (including 947 issued to the 2015 version published in September 2015) up 8% to 2014 (ISO, 2015). Specifically, Spain is the



fifth in the world in terms of ISO 9001 certificates (13.310 certificates) and the seventh place in terms of ISO 14001 certificates (32.730 certificates) (ISO, 2015).

On the other hand, Six Sigma can be defined in statistical and business terms. In statistical terms, Six Sigma means 3.4 defects per million opportunities (DPMO). Sigma ( $\sigma$ ) is the term used to represent the variation about the mean of a process (Jesus, Antony, Lepikson, & Cavalcante, 2015). In terms of business, Six Sigma is a strategy used to improve business profitability by eliminating waste, reducing the costs associated with poor manufacturing quality and improving the effectiveness and efficiency of all operations to meet or exceed the needs and expectations of customers (Coronado & Antony, 2002).

### 3 METHODOLOGY

This research is a part of a doctoral thesis. The objective of this paper is to study the IMS or methodologies as Six Sigma that Spanish companies have implemented and how integrated it. At first it was extended to study the situation of SMEs in the Comunidad Valenciana however, it was impossible due to the low participation of companies. This was owing to the fact that it was very difficult to find SMEs that have implemented various MS or methodologies. Consequently, it was decided to extend it to all Spain (as they were SMEs or large companies). For the collection of data, a questionnaire was sent by email to the companies. The questionnaire is based on a literature review and some questionnaires used in other thesis have been taken as an example (Abad Puente, 2011; Bernardo Vilamitjana, 2009; Simon i Villar, 2012), although certain points of the questionnaire have been adapted. The questionnaire was addressed to those responsible of the quality and environment department. These emails were sent between September 2016 and January 2017, making a total of 5 shipments. Questionnaires were sent to approximately 300 companies, of which 68 valid questionnaires were obtained (Tab.1). A descriptive analysis using frequency charts was carried out to analyze the results. The software used for the analysis of the data was SPSS.

Table 1 Technical details of the survey. Source: Own elaboration.

Location	Spain
Population size	3.182.321 companies
Sample size	68 companies
Level of confidence	90% (z=1.65; p=0.5; q=0.5)
Sample error	10%
Time period	5 months (September 2016-January 2017)

### 4 RESULTS

The results of this research are showed in the following section.

#### 4.1 Number of workers and location of the company

Regarding the number of employees (Fig. 1), it should be noted that almost 90% of the companies are SMEs, meaning 88.24% of companies have fewer than 250 employees. The classification of the rest of the companies is divided between 7.35% which corresponds to those that have between 251 - 750 employees while the remaining 4.41% representing large companies with more than 750 employees. So that, it can underline that SMEs are the life-blood of modern economies (Ghobadian & Gallear, 1996). The SMEs

constitute the bulk of enterprise with the major contribution to private sector output and employment in all economies of the world (Antony, Kumar, & Madu, 2005).

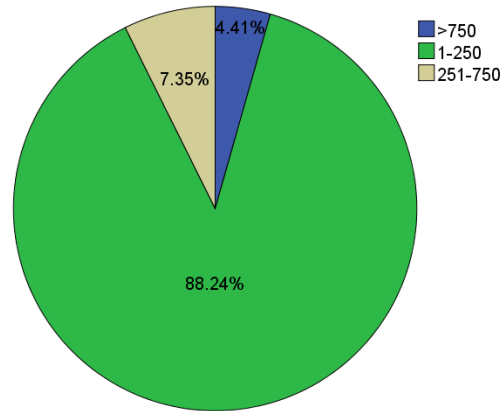


Figure 2 – Number of workers. Source: Own elaboration.

In reference to the location of the company, all companies were located in Spain. At the same time, it has differentiated itself if the company was located in the Comunidad Valenciana or in another Spanish Community (rest of Spain). Therefore, you can extract that 34 companies are located in the Comunidad Valenciana (50%) while the remaining companies are located in other communities (rest of Spain) (Fig. 2).

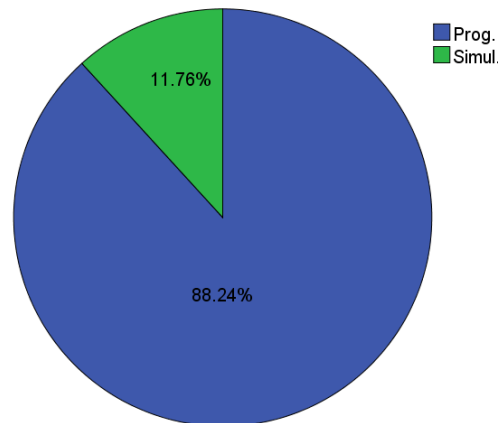


Figure 2 – Location of the company. Source: Own elaboration.

## 4.2 Integration process

To start with the type of integration that has been followed in the implementation process, it can distinguish between the progressive integration (implementation of a first system and later integration of the rest) and the simultaneous (integrated implementation from the beginning). As you can see (Fig. 3), 88.24% of companies have followed a progressive sequence as opposed to the remaining 11.76% which was simultaneous.

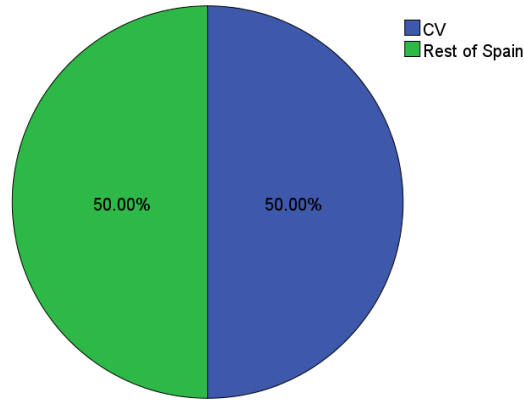


Figure 3 – Integration sequence. Source: Own elaboration.

In the second place, there are numerous MS or methodologies that companies can implement. This study can be deduce that the most common MS implemented by companies in Spain are ISO 9001 (33.33%) and ISO 14001 (31.31%) (Fig. 4). As a result, it could say that the IMS most commonly used would be those formed by a combination of both (ISO 9001+ISO 14001).

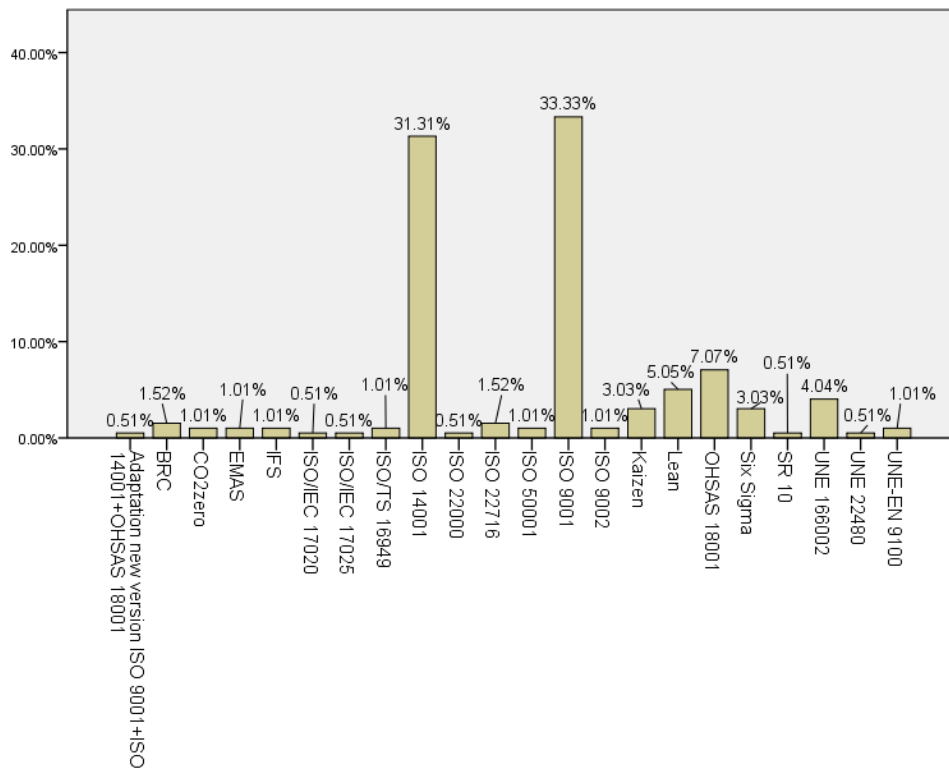


Figure 4 – Management systems and methodologies implemented. Source: Own elaboration.

After that, in this part, 18 companies have been eliminated due to these companies did not follow an integration plan. As a result (Fig. 5), the content that appears in the integration plan is the "degree of compliance with the requirements of the different management systems implemented and the degree of compliance expected with the integration" with 21.05%, followed by the "processes that will apply the integration" and "current organization of the processes and their documentation and the new proposed structure", with 18.42% and 13.68% respectively. On the contrary, the contents that have less included

companies in its integration plan have been "extraordinary actions to minimize risks" with a 2.63%, followed by a "SWOT analysis" (4.74%) and "composition and hierarchy of new documents, the integrated or specific elements of each system" (8.42%).

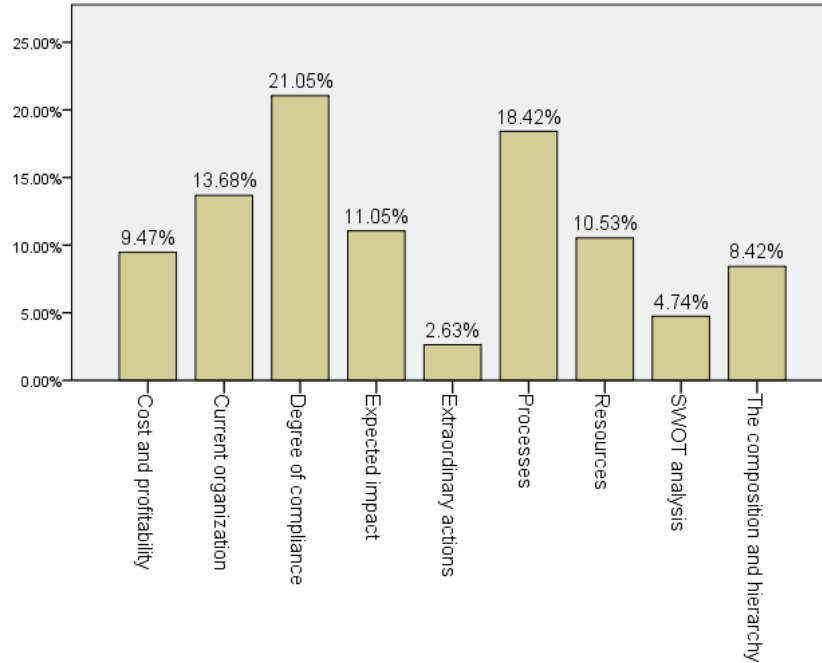


Figure 5 – Integration plan. Source: Own elaboration.

Below are the options in relation to the question about the model used for the design of the integrated system/methodology:

- A process map: "Map"
- The "PDCA cycle" for all the processes of the integrated system: "PDCA"
- An analysis of the common elements of the standards: "CE"
- An organization's own model: "OM"
- UNE 66177 standard: "UNE"

It should be underlined that one company did not make any of the models proposed for the design of the integrated system/methodology. There are 14 possible combinations given that companies could choose more than one option (Fig. 6). The model most used by companies is a process map (31.34%). Secondly, with a much lower amount, it would be an analysis of the common elements of the standards (16.42%). Thirdly, the model most used by companies is a combination of the previous two (Map + CE) (11.94%). Also mention that it should be emphasised, with a percentage very close to the previous one, an organization's own model (10.45%). The rest of possible combinations reflect much lower data since they do not exceed 8%.

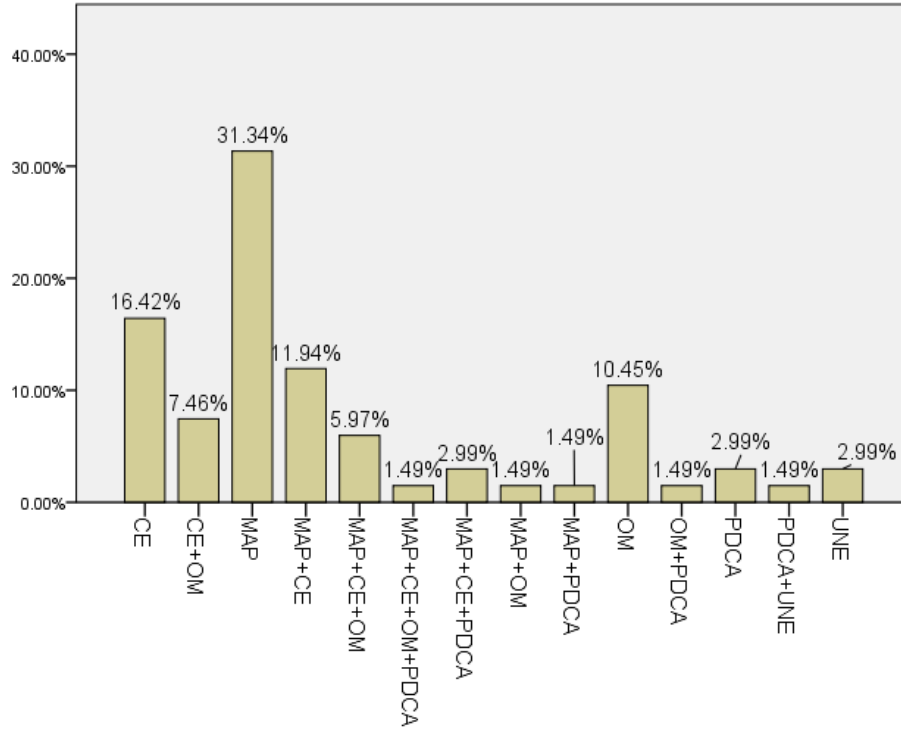


Figure 6 – Model for the design of the integrated system/methodology. Source: Own elaboration.

### 4.3 Benefits and difficulties of integration

The literature review highlights the potential benefits for organizations from integrating their different management systems into a single system (Zutshi & Sohal, 2005). Therefore, the three main advantages (Fig. 7) detected in the companies of this study would be those related to firm image improvements (64.71%), improving in the quality of the products and/or services (45.59%) and task simplification (44.12%). On the opposite side, the three least significant benefits would be better conditions to include new systems (11.76%), employee motivation improvements (11.76%) and organizational culture improvement (13.24%).

In contrast to that, the three main difficulties identified to companies (Fig. 8) are those related to the lack of human resources (25%), the lack of department collaboration (20.59%) and lack of employees' motivation (16.18%). On the contrary, the less valued are those related to differences in the elements of the standards (internal audits, external communication, etc) (2.94%), lack of certifying organizations support (2.94%) and lack of specialised consultants and auditors (4.41% each one).

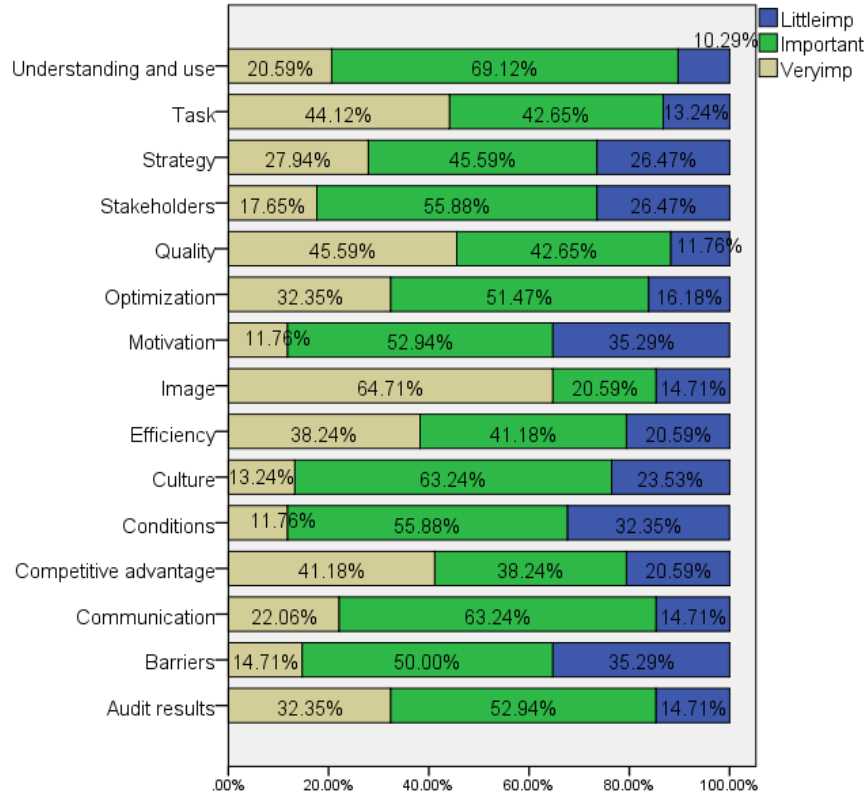


Figure 7 – Benefits of integration. Source: Own elaboration.

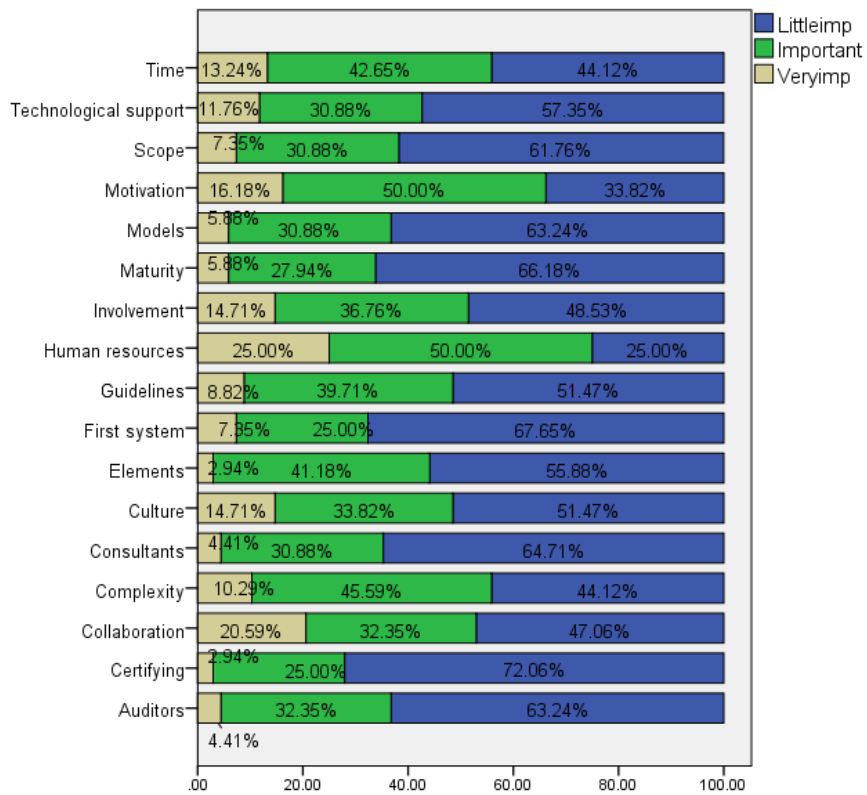


Figure 8 – Difficulties of integration. Source: Own elaboration.

#### 4.4 Six Sigma

In what refers to the methodology of Six Sigma (Fig. 9) more than half of companies (55.88%) are unknown of this methodology to improve the quality. On the contrary, the 42.65% of Spanish companies know it, ignoring the 1.47% of those companies which did not answer this question.

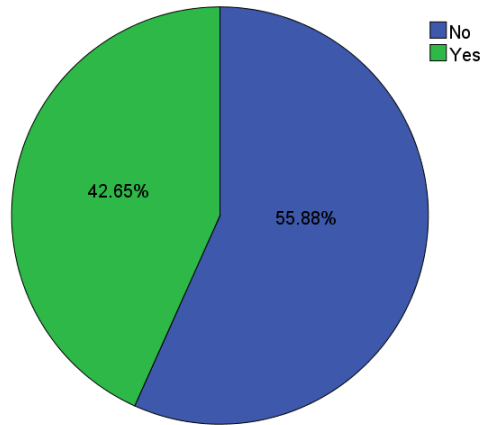


Figure 9 – Six Sigma. Source: Own elaboration.

### 5 CONCLUSIONS

In this paper is analysed how Spanish companies integrate their MS or methodologies. They have been made previous studies (Bernardo et al., 2008; Bernardo, Casadesus, Karapetrovic, & Heras, 2009, 2012a, 2012b; Simon, Karapetrovic, & Casadesus, 2012) however, this highlights the companies of the Comunidad Valenciana, since they were not taken as a basis only firms in Cataluña, Pais Vasco and Madrid. As a main conclusion can be noted that companies are SMEs and IMS which most implanted are ISO 9001 and ISO 14001 (that is what is reflected in the literature) by a progressive integration. Furthermore, most companies carry out an integration plan which includes mainly the degree of compliance with the requirements of the different management systems implemented and the degree of compliance expected with the integration followed by the processes that will apply the integration. Apart from that, the model used for the design of the integrated system/methodology is a process map (Map) and an analysis of the common elements of the standards (CE) or a combination of the previous two (Map + CE). Because of this integration process, benefits and difficulties appear. The main benefits are image improvements, improving in the quality of the products and/or services and task simplification; and, the main difficulties are lack of human resources, department collaboration and employees' motivation. Finally, regarding to the Six Sigma methodology, it isn't known in Spanish companies.

Further, this paper presents some limitations. It is a basic analysis to determine the general results in the Spanish companies, which will be subsequently analyzed in more depth in terms of SMEs in the Comunidad Valenciana.

## References

- Abad Puente, J. (2011). Implicaciones de la integración de los sistemas de Gestión de Calidad, Medio Ambiente y Seguridad y Salud Laboral basados en estándares internacionales. Universitat Politècnica de Catalunya.
- Antony, J., Kumar, M., & Madu, C. N. (2005). Six sigma in small-and medium-sized UK manufacturing enterprises: Some empirical observations. *International Journal of Quality & Reliability Management*, 22(8), 860–874.
- Bernardo, M., Casadesus, M., Karapetrovic, S., & Heras, I. (2008). Management systems: integration degrees. Empirical study. In 11th QMOD Conference. Quality Management and Organizational Development Attaining Sustainability From Organizational Excellence to SustainAble Excellence; 20-22 August; 2008 in Helsingborg; Sweden (pp. 843–859). Linköping University Electronic Press.
- Bernardo, M., Casadesus, M., Karapetrovic, S., & Heras, I. (2009). How integrated are environmental, quality and other standardized management systems? An empirical study. *Journal of Cleaner Production*, 17(8), 742–750.
- Bernardo, M., Casadesus, M., Karapetrovic, S., & Heras, I. (2012a). Do integration difficulties influence management system integration levels? *Journal of Cleaner Production*, 21(1), 23–33.
- Bernardo, M., Casadesus, M., Karapetrovic, S., & Heras, I. (2012b). Integration of standardized management systems: does the implementation order matter? *International Journal of Operations & Production Management*, 32(3), 291–307.
- Bernardo, M., Simon, A., Tarí, J. J., & Molina-Azorín, J. F. (2015). Benefits of management systems integration: a literature review. *Journal of Cleaner Production*, 94, 260–267.
- Bernardo Vilamitjana, M. (2009). Integració de sistemes estandarditzats de gestió: anàlisi empírica. Universitat de Girona.
- Coronado, R. B., & Antony, J. (2002). Critical success factors for the successful implementation of six sigma projects in organisations. *The TQM Magazine*, 14(2), 92–99.
- Folaron, J. (2003). The evolution of six sigma.
- Ghobadian, A., & Gallea, D. N. (1996). Total quality management in SMEs. *Omega*, 24(1), 83–106.
- ISO. (2015). The ISO Survey of Management System Standard Certifications 2015, 2008, 2010–2011.
- Jesus, A. R. de, Antony, J., Lepikson, H. A., & Cavalcante, C. A. M. T. (2015). Key observations from a survey about Six Sigma implementation in Brazil. *International Journal of Productivity and Performance Management*, 64(1), 94–111.
- McAdam, R., & Lafferty, B. (2004). A multilevel case study critique of six sigma: statistical control or strategic change? *International Journal of Operations & Production Management*, 24(5), 530–549.
- Ranjan Senapati, N. (2004). Six Sigma: myths and realities. *International Journal of Quality & Reliability Management*, 21(6), 683–690.
- Sampaio, P., Saraiva, P., & Domingues, P. (2012). Management systems: integration or addition? *International Journal of Quality & Reliability Management*, 29(4), 402–424.
- Simon, A., Karapetrovic, S., & Casadesus, M. (2012). Evolution of integrated management systems in Spanish firms. *Journal of Cleaner Production*, 23(1), 8–19.
- Simon i Villar, A. (2012). An empirical analysis of integrated management systems.
- Tjahjono, B., Ball, P., Vitanov, V. I., Scorzaface, C., Nogueira, J., Calleja, J., ... Srivastava, A. (2010). Six Sigma: a literature review. *International Journal of Lean Six Sigma*, 1(3), 216–233.



Zutshi, A., & Sohal, A. S. (2005). Integrated management system: the experiences of three Australian organisations. *Journal of Manufacturing Technology Management*, 16(2), 211–232.

### **Contact information**

Marta Blasco Torregrosa, Ph.D student

Universidad Politécnica de Valencia, Ph.D School

Camino de Vera, s/n, 46022 Valencia (Spain)

+34 695880343

E-mail: marblato@epsa.upv.es

Elena Pérez Bernabeu, Ph.D

Universidad Politécnica de Valencia, Dpto. de Estadística e Investigación Operativa Aplicadas y Calidad (Campus of Alcoy)

Plaza Ferrándiz y Carbonell, s/n, 03801 Alcoy (Spain)

E-mail: elenapb@eio.upv.es

Víctor Gisbert Soler, Ph.D

Universidad Politécnica de Valencia, Dpto. de Estadística e Investigación Operativa Aplicadas y Calidad (Campus of Alcoy)

Plaza Ferrándiz y Carbonell, s/n, 03801 Alcoy (Spain)

E-mail: vgisber@eio.upv.es

María Palacios Guillem, Ph.D student

Universidad Politécnica de Valencia, Ph.D School

Camino de Vera, s/n, 46022 Valencia (Spain)

E-mail: mapagui1@epsa.upv.es

# APPLICATION OF QUALITY MANAGEMENT SYSTEMS AS A STRATEGIC TOOL IN PERFORMANCE EVALUATION

*Ivana Čandrlić-Dankoš, Anton Devčić, Hrvoje Budić*

## **Abstract**

Quality management system according to international standard ISO 9001:2015 highlights the evaluation of performance. National and regional strategic documents define goals, priorities, measures and activities directed to encouraging sustainable economic growth, including rural development, for which funding are provided by national, regional and local budgets. Budgets of local and regional (territorial) administrations consists of general and specific part and plan of development programs as a third mandatory component prescribed by the Law. Plan contains descriptions of the program with performance indicators, goals and development priorities related to programming and budget organizational classification. Analysis of the program based on performance indicators are essential for argumentative business decision making. In other words, indicators confirm whether the program has achieved its purpose or not, i.e. whether the indicators were realistically and accurately defined.

The lack of established business practices in application of performance indicators in business decision making on administration level, was the motive for the conducted research of scientific and technical literature, which deals with these issues. The goal is to notice problems of defining indicators and its application in analysis for business decision making. Whereby a logical conclusion imposed was the possibility of using ISO 9001:2015 as a tool for successful management.

**Keywords:** *rural development, performance indicators, quality management*

## **1 INTRODUCTION**

Dissatisfaction with the economic decline raises the question of success, but also need of the public administration reform because of its importance primarily in economic life and social development. Limited financial resources and the need to reduce public expenditure as the basis for economic recovery, assumes a paradigm shift on the spending of public money. Critical thinking no longer applies only to earmarked spending, but the realized long-term and short-term results. Consequently, the regional and rural development and analysis of performance measures and activities represent an interesting area for the scientific and professional community. The question is how to evaluate programs and projects? Analysis needs to show actions and measures for projects and programs that have achieved its objectives, information's which programs did not achieve expectations, and how in future periods to reallocate money for the projects or programs to those investments that will significantly contribute to objectives achievements.

A significant part of the scientific and technical literature focus of interest focuses on the organization of national, regional and local governments. Pointing to the characteristics of the local government system in Croatia, as well as the underlying assumptions of development Koprić states that "the territorial structure of Croatian local governments is characterized by excessive complexity, lack of stability, imbalance, and lack of efficiency, weak growth potential and ensuring centralized mode of governance." (Koprić, 2010). Therefore the author proposes to cancel the belated historical models and acceptance of rational organization of the country.

County development strategy is the most important strategic documents of regional development. To support previously expressed opinions, as a basic limitation of development in the County, Development Strategy of Osijek-Baranja County defines that capabilities of counties to manage their areas development depends mainly on: jurisdiction of authorities, financial resources, institutional capacities for managing development, qualified human resources and developed methodology of action. ("Županijski glasnik",

2011-2013) The key problem and the changes in the Croatian public administration Koprić systematize into four basic groups: "orientation, organization, motivation and implementation" (Koprić, 2016). Those groups could be understood only as an initial analytical element, and author points to the links. However, the key issue is "the existence of a strong resistance to change and modernization of administration in higher professional levels of the public administration, which reflects in unnecessary formalism and protraction perpetuation, outdated modes of operation, rejection of innovations in procedures and techniques, and the rejection of good European practices and standards, and resistance to the administrative simplification. This bureaucratic resistance is sometimes glorified as fostering administrative traditions, sometimes supported by parts of the academic community " (Koprić, 2016) Earlier described characteristics of the system raises the question of success managing local, regional and rural development. The solution to this problem is visible in the work of Jurlina Alibegović and Blažević, who highlights the need to monitor performance indicators. Management of local development needs to create a monitoring and evaluation system based on input resources, on the results and effects in relation to specific and strategic objectives development. The authors do not stop on the findings, but their research carried out on a concrete example, with very concrete reflections. (Alibegović, Blažević; 2010)

Assessing the concept of evaluating the quality of governance Friday analyzes the capacity of executive authorities in the formulation and implementation of effective policies for the community. He concludes that "Overall the system of governance in Croatia is extremely low, especially when compared with the quality of democracy and public policy. Strengthening the capacity of the executive authorities in the shaping and implementation of public policies that are formed in the community, as well as the capacity for institutional learning and administrative reform, are a key prerequisite for increasing the efficiency and effectiveness of key economic and social policy. " (Petak, 2014).

Something different consideration success criteria provide research Ott and Bajo. Analyzing the effectiveness of fiscal decentralization Ott and Bajo indicate that it is not important where the budgeting functions have been performed, but how it is done. " (Ott, Bajo, 2001). After recognizing the problems of efficiency of Croatian local and regional budgets, these authors observed problems and propose recommendations to reform that includes performance indicators. „The system of performance in local units comes down to a comparison of planned and realized. There are individual examples of steps forward towards programs. However, it still does not follow the successful achievement of objectives, nor are the results of the program in terms of "produced" general good or citizen satisfaction. Information about performance does not have to be (and in the main are not) part of the documentation of the annual budget. The most important thing is to monitor the level of revenue and expenditure, and it is always in the forefront of balancing the budget and control of the borrowing of local government units. Local units do not keep up with expenditure in terms of individual activity or measure the effectiveness and costs of activities of investment and gain in the relationship, do not insist on quality, efficiency and management. Performance is not an imperative for the central government, and not local units. " (Ott, Bajo, 2001)

In other words, first of all it is necessary to change the paradigm of success. And although the way they are carried out activities identified as a key parameter, the available literature indicates that the analysis is not carried out, or if the conduct is not used sufficiently uplifted for business, but the question is how much the experience of countries that budget planning based on the measurement the results achieved can be used at the Croatian in the future.

## **2 BUDGET PLANNING BASED ON MEASUREMENT OBTAINED RESULTS**

Stressing the importance of budget planning based on the results achieved by King believes that "the government must be guided by the needs and wishes of the citizens, and not their own rules and laws, taxpayers pay results, not effort, the government must present a better realization than in the general and specific objectives" . (King, 1995)

After the analysis Broom stresses that governments are trying to do business leading the criteria for success and although many governments recognized the success of the program implementation, the question is "visibility" of the expected results with the aim of monitoring and reporting on the results and their use in business decisions that will make them more reliable. The author analyzes the success of the implementation of projects in five countries, seeks to define what success is and how to use the experience for future business planning. (Broom , 1995) Respecting the King's recommendations, with the aim of measuring and improving the performance of the administration Melkers and Willoughby conducted an analysis of the budget in the federal US states. Analysis related to the request for application of budget planning based on the results of the rules and instructions for the preparation of the budget in the federal US states. As the performance criteria were used to input, process, output, outcome, efficiency and effectiveness. The analysis showed that the principle of budget planning based on the results applied in 47 of 50 countries. This business practice in most countries is giving effect to the application in a few years, and work stressed the need for application of such planning as "the foundation stone for the establishment of effective methods and the creation of sustainable financing system in the states." (Melkers, Willoughby, 1998)

With Van de Walle, F Cornelissen analyzed using performance measurement to business decision-making in the public sector. Directing their research to health and education services, these authors analyzed scientific and technical literature with the aim of finding answers about the extent to which service users (citizens) used measures of performance, operating results and reports to select institutions as providers of services. That is, identify the users of services institutions that are behind the results as reliable and affect whether these results on their choice. The second part of the study, refers to business decision-making politicians based on the reports of the successful implementation of projects. (Van de Walle, Cornelissen, 2016). Although the authors emphasize that it is not always sure how many reports on performance and performance measurement directly affect the quality service amounts belief that perform analyzes of success in cases where the set objectives were not achieved imposes the need to redefine priorities and the need for measuring the efficiency of the staff. (Joyce, Tompkins, 2002)

After confirming the indisputable point of view about necessity of using indicators in the implementation of business decisions, is the question of criteria. Although the analysis of such performance indicators generally applied input, output, efficiency, effectiveness, etc., It is questionable whether they are applicable to all situations of business decisions?

The strongest indicators of the statistical analysis, which can be used for a reasoned decision. One of the most complete analysis of this kind was conducted by Rasic Bakarić, Simovic & Cowan in the analysis of economic indicators of the success of cities in Croatia. Statistical analysis was performed in 91 Croatian town and emphasizes the evaluation of performance at equal number of city governments and businesses that operate within them. "This paper specifically examines the economic performance due to the size of cities and its belonging to the counties and large geographical regions. In addition, the subject of analysis is the nature of the relationship of political parties that rule and the impact of these relations on the outcome of economic processes in the cities. The analysis used Levene test of homogeneity of variance, ANOVA and Sheffe post-hoc test. the results show that there are significant differences in the economic performance of cities, in which the most significant are the differences in the average share of tax revenues in total revenues and receipts that are persistent in the different attribute characteristics of cities. " (Rašić Bakarić, Šimović, Vizek, 2014)

General acceptability of performance indicators in an attempt to find a consensus between all stakeholders in defining the criteria, the application creates a general belief on performance and reliability of the public sector, administration or government. The basis of consensus consciousness administration to the image of reliability is crucial in the selection of services. In order to achieve reliability management must establish an integrated management, based on results in focus and defining measures and actions needed to achieve them as well as checking 39 indicators that according to the author holders of business decision-making, according to the experience and "common sense" can not be bypass. (Gadsen, 2015) Recognizing the role

and importance of the quality management system according to ISO 9001 co-authors of the introduction of the International Agreement IWA 4 to ISO 9001: 2000 state that the application of standards allows management the confidence of citizens that their needs and expectations to be recognized and that they will be realized in real terms. (ISO)

The most important document is the result of consensus of 82 participants from 18 different countries that are considered the suggestion success criteria administration (national, regional and local) is the result of 20 years of experience and research administration Gadsen. The criteria are divided into four basic categories: institutional development, sustainable economic development, sustainable environmental development and inclusive social development. For each of the categories defined threshold for eligibility or level of recognizable success. That is the limit below which should not be the quality of the service provided. (Gadsen, 2015)

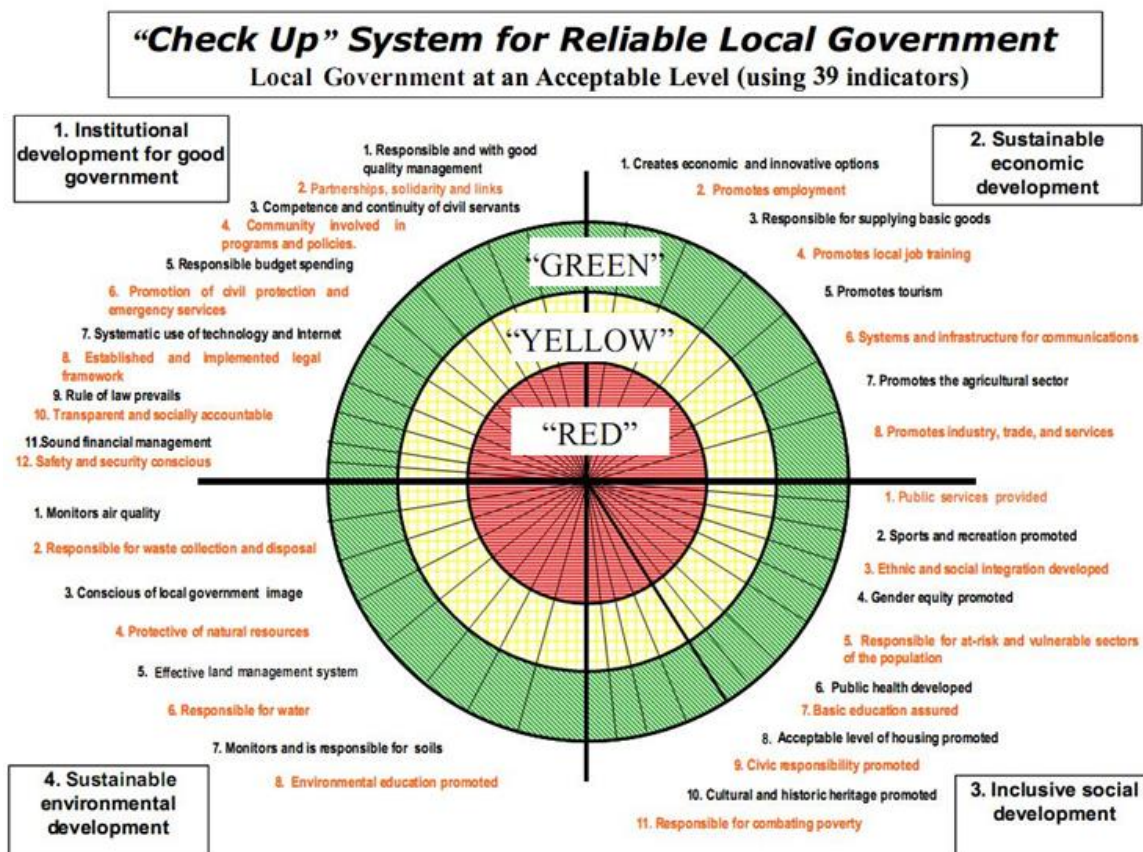


Figure 1. The check up system for reliable local government Source: Quality management systems — Guidelines for the application of ISO 9001:2008 in local government

And although the core focus of gathering the motive of those in power about the criteria considered by users as necessary, but also the lowest level that must be obtained guidance resulted with several beneficial effects: those in power give a strong strategic tool checks your own performance, define the criteria and areas which end users perceived as the most important in all aspects of business decision-making and evaluation of included end users.

### 3 IMPLEMENTATION OF A QUALITY MANAGEMENT SYSTEM FOR IMPROVEMENT OF MONITORING SYSTEM PERFORMANCE

The implementation of quality management systems at all levels of management, indicates the commitment of the Management Board to its own management measures and checks in accordance with international principles. This ratio shows the level of maturity in recognizing social responsibility based primarily on the responsible use of public money. Furthermore, the application of this system facilitates the implementation of budget planning based on the results, and the chart of business decision-making is shown below.



Figure 2. Plan-do-check –act circle in ISO 9001:2015; Source: Čandrić-Dankoš, I; Malenica, D; Gručić, O.; Linić, M.; Izmjene sustava upravljanja kvalitetom koje donosi ISO 9001:2015 u jedinicama lokalne i regionalne samouprave; Zadar, 2015.]

### 4 CONCLUSION

Management of public funds raises the question of responsibility, with the multi-functional administration imposes the need for continuous review of performance against the institutional development, sustainable economic development, sustainable environmental development and inclusive social development. The selection and implementation of programs and projects must be based on the evaluation of the achievement of goals, and if they are not realized or program did not achieve the planned results is necessary to conduct analysis and make a business decision whether the goals are set realistically, whether the performance indicators set realistically, if there are any programs / projects that can be made better, or whether the existing program / project to improve and / or justified by them to give up. The experience of the application of the quality management system according to ISO 9001 shows a gradual build trust in government, business decision makers enables transparency in the handling and reasoned confirmation vote.

## References

Alibegović, D. J., & Blažević, L. (2010). Pokazatelji uspješnosti i upravljanje lokalnim razvojem: primjer Fonda za obnovu i razvoj grada Vukovara. *Ekon. Pregl*, 61(11), 631-665.

Broom, C. A. (1995). Performance-Based Government Models: Building A Track Record. *Public Budgeting & Finance*, 15(4), 3-17.

Čandrlić-Dankoš, I; Malenica, D; Gručić, O; & Linić, M; (2015).Izmjene sustava upravljanja kvalitetom koje donosi ISO 9001:2015 u jedinicama lokalne i regionalne samouprave; Zadar; 17. međunarodni simpozij o kvaliteti "Kvaliteta čini razliku" 17th International Symposium on Quality

Gadsen, C.(2007) A government you can trust, *Main Focus, ISO Focus*, 50-53

ISO guidelines for improving quality management in local government, dostupno na [http://www.iso.org/iso/home/news\\_index/news\\_archive/news.htm?refid=Ref973](http://www.iso.org/iso/home/news_index/news_archive/news.htm?refid=Ref973)

Joyce, P. G., & Tompkins, S. S. (2002). Using performance information for budgeting: Clarifying the framework and investigating recent state experience. In *Meeting the challenges of performance-oriented government* (pp. 61-96). Washington, DC: American Society of Public Administration.

King, L. M. (1995). Operating and capital budget reform in Minnesota: Managing public finances like the future matters. *Government Finance Review*, 11, 7-7.

Koprić, I. (2010). Karakteristike sustava lokalne samouprave u Hrvatskoj. *Hrvatska javna uprava*, 10(2), 371-386.

Koprić, I. (2016). Reforma javne uprave u Hrvatskoj: ni bolni rezovi ni postupne promjene–nužna je nova upravna paradigma. *Političke analize*, 7(26), 3-12.

Melkers, J., & Willoughby, K. (1998). The state of the states: Performance-based budgeting requirements in 47 out of 50. *Public Administration Review*, 66-73.

Ott, K., & Bajo, A. (2001). Lokalne financije i lokalni proračun u Republici Hrvatskoj. *Financijska teorija i praksa*, 25(3), 311-449.

Petak, Z. (2014). Javne politike i djelotvornost javnog upravljanja u Hrvatskoj, *Gospodarstvo i država u krizi*, 41.

Rašić Bakarić, I., Šimović, H., & Vizek, M. (2014). Ekonomska uspješnost gradova u Hrvatskoj- statistička analiza, *Ekonomski pregled*, 65(2), 115-138.

Sustavi upravljanja kvalitetom - Smjernice za primjenu ISO 9001:2009 u upravi (IWA ISO 9001:2009)

Van de Walle, S., & Cornelissen, F. (2016). Performance reporting.

[Županijska razvojna strategija Osječko-baranjske županije 2011. - 2013](#) ("Županijski glasnik" broj 1/11.)

**Contact information**

Ivana Čandrlić-Dankoš, Ph.D.

Osijek-baranja County

Address Stjepana Radića 4, Osijek, Hrvatska

Telephone number : 00385-31-221-897

E-mail ivana.candrlic-dankos@os.t-com.hr

Anton Devčić, Ph.D.

Regionalna razvojna agencija Požeško-slavonske županije d.o.o.

Address Županijska 7, Požega, Hrvatska,

Telephone number : 00385-34-290-242

E-mail adresa: anton.devcic@gmail.com

Hrvoje Budić

Veleučilište u Požegi

Address Vukovarska 17, 34000 Požega,

Telephone number : 00385-34-311-459

E-mail hbudic@vup.hr



# FAMILY-OWNED WINERIES ONLINE COMMUNICATION WITH THE CUSTOMERS IN HUNGARY

*Gergely Farkas*

## **Abstract**

Most wineries are owned by families in Europe. In Eastern Europe, many of them protected the legacy during the socialist era and started their own business again as soon as it was possible. Family ownership can be a competitive advantage for businesses (Habbershon & Williams, 1999) if they know how to communicate it. According to researchers, the customers trust them more than public companies. People think they are honest with customers, and they prefer long-term goals because the reputation and the livelihood of the family are at stake. In the XXI. century the customers like to make connections, but impersonality is a psychological danger of the modern world. There is a growing popularity of bio and handmade products, a renaissance of farmer markets. In face to face transactions, the family members can develop a personal relationship with the customers. This can make a stronger connection with the family brand. For wineries, there are many festivals and tastings where they can show their product to the non-local customers and develop relationships. But not many family members can be a good brand ambassador, and it takes a lot of travel and small talk to do this. In online space, they can reach many customers. They can show or sell the products anytime for anybody. But what happens with the personal connection? How can they represent the family identity online? What kind of values do they express? How can they differentiate themselves from the competitors? Will they use the social media more to make more connections or less to protect the family privacy? I explore this problem with near full sampling of some Hungarian wine regions. I analyse the online content of the wineries of these regions on websites and their use of the social media.

*Keywords: branding, internet, family business, wineries*

## **1 INTRODUCTION**

Quality wine is a special product because its value comes from what we believe about it. "In 1976, a fascinating event referred to as the "Judgment of Paris" took place. An English owned wine shop in Paris organised a blind tasting in which nine French wine experts rated French and California wines - ten whites and ten reds. The results shocked the wine world: California wines received the highest scores from the panel. Even more surprising, during the tasting the experts often mistook the American wines for French wines and vice versa." (Ericsson, Prietula, & Cokely, 2007, pp. 115.). One part of the taste comes from the quality of the grapes and the process of wine making. The other part comes from the attitudes of the taster towards the area of production, the type of grape, the name of the winery and other related things. But from where these attitudes come from? Wine is not measurable well by specifications. Someone can trust the experts, or the winemakers if tasting is not possible. Therefore, I focus on the marketing communication of the winemakers. My question is: what and how they communicate online about the wineries. Especially, how they can preserve the quality of the relationship with the customer what is described in the family business literature in the case of face to face connections.

First, I show that in the literature of family businesses writes about a strong, personal bond with the customers in many cases. Next, I examine the problem of online branding the bottled wines when the direct contact is not possible. After that I describe the Hungarian wine market to point to the fact that at least a thousand competitors want to sell their products. All the above is needed to understand why is it crucial for family-owned wineries to make a competitive advantage from their familiness. In my research, I describe the actual situation in two wine areas and compare the online branding activity of family owned and other type wineries. In conclusion, I will summarise the best practice and I will make suggestions about further research possibilities.

## **2 COMMUNICATION OF THE FAMILY BUSINESS WITH THE CUSTOMERS**

Family business owners want to deliver the firm assets in the best possible state for the successor (James, 1999). Because of long-term goals, they want long lasting relationships with the outside stakeholders, mainly with customers (Miller, Breton-Miller, & Scholnick, 2008). Family businesses tend to extend the relationship with the customers, to enhance customer loyalty (Lyman, 1991). They prefer more enduring relationships. The communication does not happen only during the transactions, and they exchange broader information than what is required for the transactions. (Miller et al., 2008) The managers of the firm meet the customers more often (James, 2006). Of course, this works only if the manager has some marketing skills. As reported by Miller et al. (2008) family owned businesses conduct more networking by managers, especially via trade shows and direct marketing.

Craig, Dibrell and Davis (2008) found that family-based brand identity influence performance through customer orientation. Micelotta and Raynard (2011) identified three strategies of family-based branding: Family preservation strategy places the family in focus. Companies tend to use the family name in the name of the company, the family history is important and communicate detailed information about current managers. Family enrichment strategy emphasises the heritage of the family. Products and services developed through multiple generations, therefore they promise unique quality for the customers. Family subordination strategy differentiates clearly the family and the company. The family is depicted as a part of a larger organisation.

Astrachan and Astrachan (2015) surveyed 125 family owned businesses in the UK. More than half of them communicate about the family towards the customer, but less than 10 percent of them evaluate the effects of it. Most owners think it adds to the trustworthiness, social responsibility, quality-orientation and customer-orientation of the company. But there is also a risk of merging negative opinions about company and family in cases of a family of a scandal. They also differ three strategies for communicating messages about the family. “1. Building on one’s history and heritage. 2. Finding a balance between tradition and innovation. 3. Demonstrating responsibility and promoting one’s values.” (Astrachan & Astrachan, 2015, p. 11) It should be the decision of the family how far they go with opening up because it is a great responsibility to be always aware of their public roles. The authors also suggest that stating family ownership is not enough, but communicating values and customer orientation are also important.

## **3 ONLINE BRANDING OF WINERIES**

According to Dominic (2009) the 4P concept of McCharty (1964) is still valid and despite criticism, there is no new paradigm yet for the E-business era. The promotion of the bottled wine is difficult for the family-owned wineries. They cannot compete with the big producers in the field of advertising. In the shops, the label of the bottle contains only a very limited amount of information. It is exhausting to contact everyone at festivals and organised tastings. Wineries realised they can share a lot of information about themselves and their products on the internet. This way they can show themselves to customers and grow brand familiarity what accumulates all the direct and indirect experience related to the brand (Alba & Hutchinson, 1987). This way the customers will know more about the brand and the choices of them will be influenced more than a fading memory of a taste. Familiar brands may achieve better recall from memory and are better able to be protected from the interference of competitive advertising than less well-known brands (Kent & Allen, 1994).

Online presence of wineries as most of the time SMEs “based on the owner’s recognition of the business value of the Internet and their approach to planning business growth” (Beckinsale, Levy, & Powell, 2006, p. 362). Saban and Rau stated in 2005, that majority of SMEs only provide information on websites and number of web shops is small. Financial and knowledge constraints limit the usage of modern technology.

This is true for Hungarian wineries of nowadays according to my experience. They describe the wines, sometimes shows suggested prices, but web shops are very rare.

Duquesnois and Gurău (2008) found in the French Languedoc-Roussillon region that only 20% of wineries have a transaction function on their web pages. In Hungary, it can be even lower because of the market size. Most of the wines are available through sites of online traders, but the wineries miss the opportunity to communicate this on their own website. Therefore, the customers are left alone and conversion depends on their knowledge of traders and online search capabilities. The situation is similar in Italy (Begalli, Codurri, & Gaeta, 2008). The reader can note that more than five years is a great deal of time on the internet. I have no recent information about other countries, but in Hungarian wine industry, the growth is not so fast as in other areas. There are more websites with outdated technology and static design than with a dynamic user experience.

Iaia and others (2016) have a recent study about family owned wineries of Italy. The sample size is small (N=10), but the categorization of websites is interesting because it has a coding system instead of an ad-hoc list of possible contents. In their results, the family history always presented on websites. In my research, I had to search in many cases for interviews, company register and other sources to know more about the number of generations, or at least something about ownership structure.

## **4 THE WINE MARKET IN HUNGARY**

Hungary has 7 wine regions where are 22 areas of traditional wine producing. Growing area is 80600 hectares (KSH, 2015) what is only the half what was thirty years ago. There were no serious grape diseases in the background but changing lifestyle and European competition on market. In the XIX. century Hungary was famous for wine, especially the Tokaji dessert wine, what was on the tables of the royal families of the era. After the second world war, the agricultural cooperatives, and companies owned by the state degraded first the quality, then the quantity of the production.

After the political transaction of the 90s, many families got compensation from the state and they got back their lands. Until nowadays only citizens of the country can buy agricultural lands in Hungary, foreigners cannot buy farms with more than 0.6-hectare land. This way many families started wineries on a few hectares, and the big (more than 100 ha) companies are rare. The wine producing needs a lot of manual labour and contains a lot of risks, therefore outsiders invest in wineries only for prestige but let the local experts do the work and they do not expect a quick ROI. The market has two sides. The top 20 wine producers are interested in cheap wines, buy grapes instead of owning own vineyards, and centred in less traditional areas of wine production. The rest are hundreds of small family businesses and a few rich long-term investors. This study focuses on the online activity of the later.

Because the fractured, small vineyards the wineries cannot produce big volume and they cannot invest enough in modern technologies to produce stable quality. Some of them import grapes from Italy to produce more wine, some export to China because the traders take the whole stock. But wineries cannot compete in restaurants and shops of Europe with other countries where vineyards are larger. Hungarian customers drink Hungarian wines in 9 times from ten. Therefore, the competition is big on shop shelves. Prices are between 2 and 80 euros per litre and the majority of profit comes from the cheap table wines. Customers who want quality wines spend from 5 to 15 euros per bottle usually. Most of them are price sensitive, but there are measurable preferences in colour, grape variety and territory. Measurable but not measured. There is no representative study was taken about wine consuming in Hungary. In 2016 a so-called Big Wine Test had forty thousand participants in an online survey, but the results were highly criticised by the wine experts and traders because of the distorted sample.

Between 1995 and 2015 were an increase in interest from the customer side. Wine festivals and tastings become frequent in cities, hypermarkets sell hundreds of different kind wines and there are specialised shops also. The new trend in 2016 was the hand-crafted beer but it is not strong enough yet to shrink the

popularity of wine. There were 1355 different wine bottlers in 2016 according to the list of the National Food Chain Safety Office (2016). Number of wine producers are over six thousand, but it is hard to tell how many are different completely because many times different people from the same family, or different parts of a holding are on the list. So, the number of wine bottlers is a better estimation of the size of the market I want to study. There is a small segment where local producers sell wine in plastic cans for local people, but they are not presented in shops or online.

An estimated thousand families compete on the wine market. Wine production is 2.5 or 3 million hectolitres, depending on the year, what means a mid-range among European countries. Export is 0.6 million hectolitres, import is 0.2 million hectolitres (Hungarian Telegraphic Office, 2016). Most famous are the dessert wines of Tokaj and the Eger bull's blood what is a red cuvee. Customers buy bottles in supermarkets, hypermarkets and specialised wine shops. Online shopping is less frequent because the heavy and fragile bottles make the home delivery expensive. The number of festivals per year where the wine and wine tasting is in focus is between 50 and 100.

## **5 METHOD**

In my study, I analysed web pages of wineries from two wine regions of Hungary and searched their social network sites. There is no single database to gather all the wine makers of an area. Therefore I used databases discussed later. Finding social network activity was even harder because it is not always linked to company web pages and sometimes shared with the owners' personal profiles.

For text analysis of self-introductions, I used Microsoft Word because the amount of introduction texts was not more than a page per company and the coding system was simple. I coded information about owners, especially names. After that, I looked for values related to the wine production and to the family. There were some communication formulas that was used with high frequency, therefore I started coding them in vivo.

The database of hyperlinks and demographical data were gathered in Microsoft Excel and I analysed them with simple formulas. The data was gathered during early 2017. Webpages availability can change anytime and it also happened during the study in a few cases, but its effect was negligible because the content was available through search engine caches. The database is not anonymised, but it contains only public data and I am willing to make it available for researchers and experts interested in the field. Making it public for everyone will not happen because of the ongoing development.

## **6 SAMPLE**

The sample contains two traditional areas of vineyards. I gathered information about the wineries from open databases and websites. The sample is not representative for Hungary, but it is close to the statistical population of the given areas. Every winery is in the sample what was found through databases of Tab. 1 and has at least a working web page. Data quality of web pages was not checked, and I did not contact the wineries to collect any information. When the size of the vineyard was not present on the web page I used google.com to collect the information from other sources, like wine enthusiast pages, wine web shops and news sites.

Table 4 Databases of wineries. Source: own construction

Area	Used databases to find wineries	Number of wineries in the sample	Total size of vineyards in the area (hectare)	Total size of vineyards in the sample (hectare)
Tokaj	selection.hu tokaj.hu terravin.hu	45	5446	1316.5
Sopron	ilovesopron.hu sopronguide.com vinoport.hu	20	1705	375.5

The difference of total and sample vineyard size means there are many cases when the grape is sold as it is, or the wine is sold without a bottle. Based on my experience in these areas and at wine festivals: very few brands are missing from the sample. I identified only four wineries at all without a web page. Those wineries were removed from the sample. Therefore, the full sample contains 65 wineries.

Tokaj is a wine area and a wine region too. It is part of the UNESCO World Heritage as a historic cultural landscape. A small part of it belongs to Slovakia. The world's second oldest system of wine appellation is here from 1757. Wine production started in the 12th century. The median vineyard size is 15 hectares in the sample. The production of the famous aszú needs a lot of manual labour because workers must separate the grape berries with noble rot with bare hands. Disznókő, Royal and Oremus are the biggest wineries with one hundred hectares of own vineyards each but they buy a lot of grapes from farmers of the area.

Sopron wine area is also one of the seven wine regions. Wine production goes back to times before the Romans of the 1st century when the Celts lived in the region. Three-quarter of the wines are red and the most famous is the Blaufränkisch type, but it cannot compete with the Austrian wines on the other side of the border. The biggest vineyard is 85 hectares and is a joint venture of local winemakers. The median size of the vineyards in the sample is 9.5 hectare.

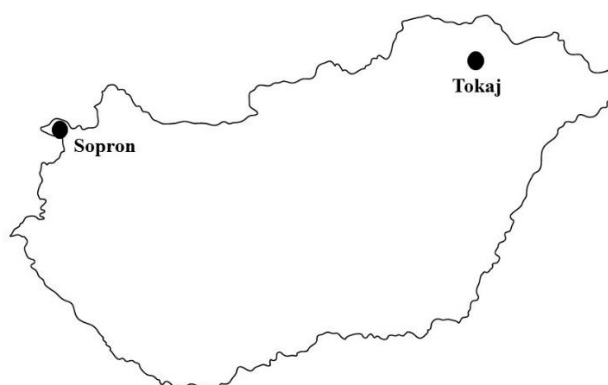


Figure -3 – Wine areas of Hungary in the sample Source: own construction

## 7 RESULTS

I found important differences between the two regions. There are typical communication formulas in both cases, but also similarities. I focus on family-owned wineries, but I also analysed other wineries to identify the communication formulas that are independent of the family values. I identified the number of generations in case of family owned businesses, but the difference is not visible. Of course, the sample size is small to make a conclusion about this. Later I checked the presence of wineries on Facebook and Instagram online social networks what have some popularity in the Country. Analysing posts on these networks is beyond the scope of this study.

In the Sopron region, 17 of the 20 wineries in the sample are family owned and 16 of them uses the family name in the brand name. In 10 cases wineries start their introduction with stating that they are family owned. Two from the three non-family wineries list the owners' full names. Only one winery hides the family ownership. Six families emphasise that they work in the vineyards many times with their own hands. Five family businesses state that they work with modern technology during preserving tradition. The number of generations is many in 9 cases from 17. Two families have three and one has two generations. Five of them are a first generation entrepreneurship.

Only the most famous winemaker family of the region denies the importance of fashions and trends of the wine industry because they committed to natural and exceptional quality. The traditional winemaker families of the area roots back to the XVII. century. Despite this long tradition, only five wineries communicate about specific family members. Values are missing from the messages most of the time. High quality and handling vineyards with care are important, but there is no information about the attributes of local tradition and personal values. In introduction texts, most of the sentences are about the size of the vineyard, wine types, cellar and other buildings, awards and quotes of famous guests. In 10 cases the text about the family is shorter than three sentences.

Using Facebook is popular in the Sopron region. 13 of the 17 family owned wineries uses it, but only one has Instagram profiles without any posts. One of the companies run by many winemakers has a profile with more than a hundred posts. It is important to compare these data to other regions to answer that it is a common trend or there is a specific culture in the area about using these modern ways of marketing communication.

In the Tokaj region, 35 of the 45 wineries are family owned and 23 of them uses the family name in the brand name and 25 starts the introduction with some reference to the current family or the ancestors. Only two family hides the family ownership in the introduction, but it clearly visible from the name of the wineries. Non-family companies refer to the history of the area and the cellars owned. Describing detailed history is more frequent than in Sopron, but the connection to winemaking is shorter in average. The reason that the area was always valuable for the country and the turmoil of history changed the owners' person more times than in the less famous Sopron region.

In 17 cases the family owned wineries note tradition and 7 notes the modern technology. 10 of the winemaker families committed to present the whole region and develop the brand of unique sweet wines from here. In 8 cases, they describe some connection with the nature and the unique terroir of the area. Handle with care is also important for 7 of them, 6 emphasise the personal work in vineyards. Perseverance is a personal value noted 4 times. There is one family who lists the family values and the work values separated. It seems that the second generation grips those values to manage the passing of a parent. As in the case of tradition, it is hard to describe the dimensions and factors of a thing the winemakers live in every day. But an unexpected succession enforces the descendants to decide what worth to reserve and make values explicit.

Facebook is used by 27 family owned wineries and all others use it too. The personal profiles are separated from the wineries'. 11 wineries have an Instagram profiles. This is a more popular tool than in the Sopron region. 7 profile belongs to family businesses or owners and 3 of them contains many posts of professional

photography. The rest is also active except one. This means the usually bigger non-family owned companies use this marketing tool with similar frequency, in one-third of the cases. This is more than is Sopron region but the international reputation is also better, so they can reach more customer this way. Instagram has the advantage of using pictures as main content, therefore the role of language barriers are less important.

## 8 DISCUSSION

I address the questions above from the abstract and introduction of study to get a conclusion. What happens with the personal connection? The immediate interactivity is not present, but the customers can reach the wineries through phone, e-mail, or Facebook message in most cases. If the family follow the strategy of communicating history and heritage than they can build trust with the customers. The customers can think, if the winemakers do their profession through generations there must be some know-how behind it. The first generation has some difficulty in describing a long history, but they can emphasise the schools and masters they learned from.

How can they represent the family identity online? Naming the family members and roles in wine making and selling process can be a good start. There are some good examples with separated introductions of different family members. Photos of the family or individual members can be also important, but it needs to extend this study in the future to measure the usage frequencies. Photos about the natural and built environment around the vineyard can also represent the family, but it is less personal.

What kind of values do they express? I expected far more explicit values. In introductions, it is exceptional if family values appear in an explicit form and it seems they use the communication clichés of the competitors about the quality of the product and the process. Based on the previous research of my colleagues and me (Málovics, Farkas, & Vajda, 2015), I do not think this is an intangible asset, but probably it needs a more direct approach, like an interview or survey to identify the important values behind common phrases.

How can they differentiate themselves from the competitors? It can be important for family owned wineries to differentiate themselves from the other similar family businesses. There is much to do about it. In both regions works some clichés in communication. They state the ownership but communicate the same way after it. A detailed and eventful family history can be unique. Even making family values explicit beyond tradition and quality orientation can add a lot in the current situation.

Will they use the social media more to make more connections or less to protect the family privacy? It also needs further research but I think social media usage depends more on the technical skills and the available resources than on a family decision. Facebook is used in both areas widely, but Instagram is only present in Tokaj. Personal photos can mix with work related if the profile is managed by a family member without clear communication goals. On the other hand, professional photography and targeting posts can cost a lot compared to the number of reaches and likes. Social media usage of the competitors can also be motivating to use the same channel.

## 9 CONCLUSION

As a reflection on strategy systems (Micelotta & Raynard 2011) from the literature , I state that family preservation and enrichment strategies are frequent, and family subordination is present but very rare. It is not easy to distinguish the first two because many families seem to follow both strategies at the same time. From the viewpoint of Astrachan and Astrachan (2015) all communication strategies are used. History and heritage are detailed in many cases. Tradition and innovation in the same time are also present. Winemakers can make the innovation part more explicit with describing the buildings and tools. Tradition can be detailed if they use some special technique for producing grapes or wine. Promoting values is the part where much can be done. Making explicit the family and the professional values is a missing step for many winemakers.

In Sopron region, the winemakers do not make these messages unique. In Tokaj region, there are slogans too as a good start in some cases.

This study is restricted by the barriers of the method and sample. Involving more Hungarian regions is already in progress. It could be important to compare the results to some wine regions with multigenerational family firms where the private ownership was not restricted during the half of the XX. century. Some parts can be extended by gathering information directly from winemakers and their customers. We know little about the exact effect of the communication of familiness through the internet. This study underlines that in the online branding of family owned wineries there are many similarities, but there are also important differences between different wine regions.

## References

- Alba, J.W., & Hutchinson, J.W. (1987). Dimensions of consumer expertise, *Journal of Consumer Research*, 13(1), 411-54.
- Astrachan, C.B., & Astrachan J.H. (2015). *Family Business Branding: Leveraging stakeholder trust*. Research report, London: Institute for Family Business Research Foundation
- Beckinsale, M., Levy, M., & Powell, P. (2006). Exploring internet adoption drivers in SMEs. *Electronic Markets*, 16(4), 361-370.
- Begalli, D., Codurri, S., & Gaeta, D. (2009). Wine and Web Marketing strategies: the case study of Italian speciality wineries. *British Food Journal*, 111(6), 598-619.
- Craig, J. B., Dibrell, C., & Davis, P. S. (2008). Leveraging family-based brand identity to enhance firm competitiveness and performance in family businesses. *Journal of Small Business Management*, 46(3), 351-371.
- Dominic, G. (2009). From marketing mix to E-marketing mix: a literature review. *International Journal of Business and Management*, 9(4), 17-24.
- Duquesnois, F., & Gurău, C. (2008). The Internet marketing strategy of French wine producers from Languedoc-Roussillon region. 4th International Conference of the Academy of Wine Business Research, Siena, 17-19 July.
- Ericsson, K. A., Prietula, M. J., & Cokely, E. T. (2007). The making of an expert. *Harvard Business Review*, 85(7-8), 114-122.
- Habbershon, T. G., & Williams, M. L. (1999). A resource-based framework for assessing the strategic advantages of family firms. *Family Business Review*, 12(1), 1-25.
- Iaia, L., Monica, F., Scorrano, P., Amedeo, M., & Cavallo, F. (2016). Wine Web Value: Web Marketing Strategies for Family Businesses. In D. Vrontis, Y. Weber, E. Tsoukatos (Eds.) *Innovation, Entrepreneurship and Digital Ecosystems* (pp. 992-1005). Warsaw: EuroMed Press
- Kent, R.J. & Allen, C.T. (1994). Competitive interference effects in consumer memory for advertising: the role of brand familiarity, *Journal of Marketing*, 58(3), 97-105.
- KSH (2015). *Statisztikai Tükör 2015/57*, Budapest: Központi Statisztikai Hivatal.
- James, H. S. (1999). Owner as manager, extended horizons and the family firm. *International Journal of the Economics of Business*, 6(1), 41-55.
- Lyman, A. R. (1991). Customer service: does family ownership make a difference?. *Family Business Review*, 4(3), 303-24.
- Málóvics, É., Farkas, G., & Vajda, B. (2015). Appearance of entrepreneurial values and strategic orientations in the basic values. *International Journal of Business and Management*, 3(1), 18-35.



McCharty, E. J. (1964). *Basic Marketing: A Managerial Approach*, 2nd ed., Irwin.

Micelotta, E. R., & Raynard, M. (2011). Concealing or revealing the family? Corporate brand identity strategies in family firms. *Family Business Review*, 24(3), 197-216.

Miller, D., Breton-Miller, L., & Scholnick, B. (2008). Stewardship vs. stagnation: An empirical comparison of small family and Non-Family businesses. *Journal of Management Studies*, 45(1), 51-78.

Hungarian Telegraphic Office (2016) Erősödött a borexport, csökkent az import 2015-ben. Retrieved from <http://www.kormany.hu/hu/foldmuvelesugyi-miniszterium/agrargazdasagert-felelos-allamtitkarsag/hirek/erosodott-a-borexport-csokkent-az-import-2015-ben>

National Food Chain Safety Office (2016) 2004-óta kiadott borászati üzemengedélyekhez tartozó regisztrációs számok betűrendben. Retrieved from [https://www.nebih.gov.hu/szakteruletek/szakteruletek/obi/kozerdeku\\_adatok/regisztralt\\_boraszati\\_uzemek](https://www.nebih.gov.hu/szakteruletek/szakteruletek/obi/kozerdeku_adatok/regisztralt_boraszati_uzemek)

Saban, K. A., & Rau, S. E. (2005). The functionality of websites as export marketing channels for small and medium enterprises. *Electronic Markets*, 15(2), 128-135.

### **Contact information**

Gergely Farkas

University of Szeged, Faculty of Economics and Business Administration

Hungary, Szeged, Kálvária sgt. 1.

+36702464647

farkas.gergely@eco.u-szeged.hu

# CASE STUDY OF COMMUNICATION OF THE PROJECT WATER FOR

*Eva Gartnerová*

## **Abstract**

This article is dedicated to the project Water for all and its ways of internal communication as well as marketing communication and PR. All the information is put to the case study of the project.

The first chapter is an introduction to the topic and explain what the whole project is about, the second part describes the realization team and different functions of people involved in the project. The main and last part focuses on communication tools in the project.

**Keywords:** *project management, marketing communication, PR, water, internal communication*

## **1 INTRODUCTION**

Water recently has become the most discussed topic not just among the whole world but specifically at our faculty. In the beginning of September 2016 Faculty of multimedia communication of Tomas Bata University (FMK TBU Zlín) in Zlín decided to spread the word about the problems connected with water mainly to the people living in Zlin region.

Almost 500 students worked in different fields to try to reflect their views on water topic. Based on that FMK UTB Zlín can now proudly presents almost 300 outcomes from 12 ateliers of the faculty.

There were a lot of things, which happened during the project and this following case study should reflect some of them.

This case study is dedicated to the communication of the project. Internal and external. Pros and cons, everything observed by the manager of the project, author of this article.

## **2 THEORETICAL BACKGROUND**

### **Marketing communication tools**

„The top marketing communication tools are advertising, sales promotions, and social media. There are some definite “Do’s” and some painful “Don’ts” when using these tools.” (Pestle analysis, 2017)

„Businesses use various marketing tools to communicate information, stimulate customer interest and motivate action. An integrated marketing approach applies several tactics to engage customers and build business.“ (Chron, 2017)

### **Types of marketing communication tools**

#### **1. Traditional Media**

Traditional media such as billboards, banners, newspapers, magazines, television, radio and telephone directories involve marketing tools such as paid print advertisements, commercials and news releases. This approach focuses on a one-way sales push and relies on reaching high numbers of people to ensure success. Advertising is a costly marketing tool; however, traditional media outlets remain the most trusted sources of information, according to the 2012 Edelman Trust Barometer survey. (Chron, 2017)

## 2. Digital Media

Computer software technology can reach potential customers with targeted, measurable communications. Specific digital media marketing tools include search engine optimization, mobile marketing, interactive online advertisements, opt-in email and online partnerships such as affiliate marketing and sponsorships. A key component of digital marketing tools is Web analytics, which provide information on an Internet user's online activities, IP address and search keywords. To engage in digital media marketing, companies can hire digital media marketing agencies or utilize software as a service applications. (Chron, 2017)

## 3. Social Media

Social media marketing is a subset of digital media marketing. However, the goal of social media marketing tools is to develop an interactive, online relationship with the customer rather than to mine covertly for customer data. Specific examples of social media marketing tools include blogging, tweeting, posting, sharing, networking, pinning, bookmarking, media sharing and commenting on social media websites such as Twitter, Facebook, Orkut, LinkedIn, Pinterest, Reddit and YouTube. Dan Zarrella, author of "The Social Media Marketing Book," explains that social media marketing levels the playing field for small companies and individual entrepreneurs by offering low-cost tools with potentially high returns. (Chron, 2017)

### *Social media is the key*

As a marketing communication tool, [social media is a vehicle to provide information](#) about your brand and products.

Consumers use social media to investigate product and company quality. [Customers are also looking for social proof](#); that is, other consumers who have interacted with your brand and/or bought a product already.

Because remember: don't forget the "social" part in social media.

A brand's social media profile filled with information is great. But when it's filled with information and interaction? That's the key.

Engagement is important. It doesn't matter if you have 10k followers if only 2 people are responding to your content. Active, engaged followers are a sign they care about your company in some way. It's easier to close sales with warm leads than cold leads, right?

Don't start social media profiles and expect to get sales that way. If you do get sales, that's great. (Pestle analysis, 2017)

## 4. Promotional Items

Promotional items, such as brochures, business cards, press kits, websites, informational videos and merchandise, are tangible marketing tools. Some of these items include large amounts of detailed information and highlight attributes of the product or service; business cards and trade show giveaways may display only a company logo and provide contact information. In addition to increasing sales, promotional items contribute to building brand awareness, but cost is a factor when selecting these items. (Chron, 2017)

## **3 METHODOLOGY:**

„Case studies is a popular research method in business area. Case studies aim to analyze specific issues within the boundaries of a specific environment, situation or organization. According to its design, case study research method can be divided into three categories: explanatory, descriptive and exploratory.

Descriptive case studies aim to analyze the sequence of interpersonal events after a certain amount of time has passed. Case studies belonging to this category usually describe culture or sub-culture, and they attempt to discover the key phenomena.

Advantages of case study method include data collection and analysis within the context of phenomenon, integration of qualitative and quantitative data in data analysis, and the ability to capture complexities of real-life situations so that the phenomenon can be studied in greater levels of depth.

Case studies do have certain disadvantages that may include lack of rigor, challenges associated with data analysis and very little basis for generalizations of findings and conclusions.” (*Research methodology*, 2017)

## **4 RESULTS: CASE STUDY**

About the project

Water for all (“Voda pro všechny”) is a new project, which has started at Faculty of multimedia communication, Tomas Bata University in Zlín in September 2016. The project has included all of 12 ateliers of the faculty, which have been working on the water Topic during the whole year.

Water for all runs under the auspices of Ministry of the Environment and has two main goals. The first one is to raise the awareness about better and effective water management and elicit public discussion on this topic. The second one is to enhance the communication. The internal communication among all ateliers plus the communication with the institutions out of faculty such as companies, municipality, NGO sector, etc.

Water for all is actually the first project of such a type at our faculty since it was established. The first project, which tries to connect not just students among each other, but other important subjects, which can Faculty of multimedia communication cooperate also in the future.

The whole project has begun 21st September 2016 with the conference called The block of experts: Water for all. Experts dealing with water management, water in architecture, water in city of Zlín or water in art presented their work, so they gave students the opportunity to look at the subject from different angles.

Presenting lectures such as Josef Nistler, director of the Water Protection Department of the Ministry of Environment, Mark Rieder director of the Water Research Institute of T.G. Masaryk or the journalist Vladimír Kořen. The conference ended with the panel discussion, where different kinds of water topic were discussed.

### **The realisation team**

As far as the project has such a big impact not just on the whole faculty, the team is very numerous. The main core consists of few people.

Manager of the project, Mgr. Eva Gartnerová, who is first grade student at PhD. Grade at Faculty of multimedia communication in Zlín. Her responsibility is to coordinate all the activities, which appears during the year, controlling and monitoring deadlines and managing the PR team of the project.

doc. MgA. Jana Janíková, ArtD., the dean of the faculty is the main coordinator. Her main task is to make the final decisions, approval of suggested activities and network of stakeholders who are part of the project.

Ing. Eva Šviráková, Ph.D is the administrator of the project. She is the head of the financial part of the project.

doc. Ferdinand Chrenka, Art Director of the project, is responsible for the content of the project and its visual side. The core of the team consists also of the heads of all ateliers, who supervise all student works and

projects and who are also responsible for the exhibition itself. The project also includes so called PR team, which composed of students of marketing, who has charge of internal communication in the project and promotion of what the faculty during the year, students of graphic and digital design, who are responsible for the united visual style and one student of fashion design.

## **4.1 Communication tools**

### Internal communication

#### **1. Meetings**

The core team has a meeting every week since January according the exhibition, which takes place during Zlin Design Week 2017. There is a newsletter made with tasks after every session. The PR team has weekly sessions as well to be updated about the activities and to plan communication of the project.

#### **2. E-mail**

The most of the communication through the internal team and also with external subjects goes via email. The newsletter is sent weekly to the core team. Also all tasks are sent via email to make them easily found through key words.

#### **3. Facebook group**

The PR team has its own private group on Facebook. All the tasks and information are discussed here. It's much more effective than email- it's faster and more interactive since you can see all comments and posts at one place. The big advantage of it is, that you can also tag people in the posts and comments, which reminds to the competitive person, that the answer is needed. It is more non-formal compering to the email, which makes the atmosphere in team more friendly.

#### **4. Google drive**

Because of many pictures, press releases, schedules and stuffs, we decided to create a google drive folder, where all materials of PR team are gathered and everyone from the team can find them easily. The google shared documents are also good, because everyone can interact in the document at the real time, which makes it more effective then sending word/excel documents via email.

### External communication

#### **1. Websites**

Water for all has its own website, where all information are published. One can find info about the project, contacts and news, which are posted in form of blog. One section is also dedicated to all ateliers, where all projects are available to the visitors of our web. The website is in Czech since is still just local project, but the English version is planned because of the upcoming exhibition and activities connected to the project abroad. You can see more at [www.vodaprovsechny.cz](http://www.vodaprovsechny.cz)

Information can be also found at the website of Faculty of multimedia communication and other websites, which share our press releases.

## 2. Social networks

The project itself runs 4 social media platforms.

Facebook – as it is the most visited and used social network we decided to make it our main communication channel. News from the projects, pictures from the ateliers and also other posts connected to water are published once or twice in week. Funny mems, gifs, but also educational videos are dedicated for a non-formal way of communication to bring this difficult topic to public in an alternative and easier way.

Instagram – pictures, pictures, pictures. Pics from workshops, atelier works, or non formal sessions for students are published here to spread the project even more.

Youtube – videos from the conference, videos from the presentations of all ateliers and also outputs from ateliers of audiovisual and animation are on YouTube to be easily watched any times.

Tinder – since we tried to communicate the topic of the project in alternative way, we found interesting to use tinder as one of our communication channel as well. Through tinder we invite people for a programme during the International Day of Water, for our Exhibition at Zlin Design Week and so on. It has high interactivity since the public see it funny and non-traditional.

## 3. Printed media

Press releases

All of our activities are spread among local and national media through press releases. One, about the preparation, is sent before as an invitation. Second press release is sent after every event. We have few media partnerships, where we frequently post articles about the project.

Our partners are local newspapers, but also design magazines and websites.

Posters

All posters are done by students of graphic design from our faculty. Each event has its own poster. Water for all has one general visual and other graphics is made for different campaigns of cooperation.

Catalogue and publication

Very important source of our PR is catalogue of Zlin Design Week, where the project has the majority of pages. All projects, activities and events connecting Water for all and Zlin Design Week are mentioned there as well as pictures. Catalogue is distributed during one week long festival of design in Zlin, so it has very high reach of different designers, companies and other subjects who could cooperate with faculty or university in the future.

Water for all will also have one final publication, where the all information and student works will be presented and which will be used as a PR material for the presentation of our faculty.

Cinema advertising

Golden Apple Cinema in Zlin is supporting us with free video advertising before the movie starts. Our video spot is made by students of audiovisual communication and except of invitation content for Zlin Design Week also has educational plot, which is focused on the problem of lack of water.

Events

The most interesting tool of communication are the events we organize or we are part of.

Conference

The first event which was done was a conference Block of experts: Water for all, which started the whole university year with lots of inspiration. The concept of conference was made with many professional speakers who are somehow in the field related to the topic of water. So, we host architects, speakers from Ministry of environment, municipality, sculptors and so on. All of them had a presentation which could be used as a source of inspiration for students who were about to start their assignments with water topic. There was also a discussion in the end, so all visitors could discuss their questions and ideas for projects.

#### Non-formal sessions

As far as one of the main aim of the project is effective internal communication, we prepare through whole year a non-formal session for students. Those meetings are good for networking and sharing experiences of students. They can connect their projects with students from other ateliers to make it complete.

#### Water day

We used The International Day of water as one of our PR tool as well. We prepared a whole day programme for families with children and for students as well in Zlin. Visitors could try a graffiti, slack line and also quiz focused on water, obviously. The whole day finished with the movie night, where the document about lack of water in developing countries was shown. WOM (word of mouth) is the best when spreading information to the people and events like this are the best to do it.

#### Zlin Design Week

The biggest exhibition of our faculty since ever. The biggest exhibition of Zlin Design Week 2017. Water for all will be placed during the design festival in Zlin in more than 5 places. Projects and design products of chosen students will be presented during the whole week.

#### Other exhibitions

We also cooperate with the Ministry of environment for which we have prepared a presentation stand for, we also participate during the International day of Earth which is organized by municipality of Zlin. Products of water for all suppose to be a part of DECOREX festival in London as well.

## **5 CONCLUSION**

Project water for all was the first project of such a type at Faculty of multimedia communications. It has brought a lot of pros but cons as well. To highlight the best practices, I would mention the networking and cooperation among students from different ateliers. The experience of working with people from different field is valuable skill for their future carrier as they would need to communicate in their professions in this way. The good practice is also the united topic which is great opportunity to present a faculty in one way and mostly at one place.

The disadvantage which appeared during the project was sometimes the lack of communication or communication without letting other responsible position known.

The project water for all open new opportunities for the faculty in field of cooperation with companies and institutions as far as increasing the PR of faculty and university itself.

## References

Berry, G. R. (2011) Enhancing Effectiveness on Virtual Teams: Understanding Why Traditional Team Skills Are Insufficient. *Journal of Business Communicatin.*, roč. 48, č. 2, s. 186-206. DOI: 10.1177/0021943610397270.

Kerzner, H. (2003) *.Project Management: A System Approach to Planning, Scheduling and Controlling.* 8th ed. Hoboken, New Jersey: John Wiley & Sons, 891 s. ISBN 0-471-22577-0

Rosenau, M. D. *Řízení projektů.* 1. vyd. Praha: Computer Press, 2000. 344 s. ISBN 80-7226-218-1.

Šuleř, O. (2002) *.Zvládáte své manažerské role?: Jak rozhodovat, předávat informace, organizovat a motivovat své podřízené.* 1. vyd. Praha: Computer Press, 187 s. ISBN 80-7226-702-7

Peste analysis [online]. MYTHEMESHOP: MYTHEMESHOP, 2017 [cit. 2017-05-19]. Dostupné z: <http://pestleanalysis.com/marketing-communication-tools/>

Chron [online]. Hearst Newspapers Hearst Newspapers, LLC: Hearst Newspapers Hearst Newspapers, 2017 [cit. 2017-05-19]. Dostupné z: <http://smallbusiness.chron.com/types-marketing-tools-61742.html>

*Research methodology* [online]. -: Necessary knowledge to conduct a business research, 2016 [cit. 2017-05-22]. Dostupné z: <http://research-methodology.net/research-methods/qualitative-research/case-studies/>

## Contact information

Mgr. Eva Gartnerová

Faculty of multimedia communication, Tomas Bata University in Zlin

Dolní 34, Prostějov, 79601

+420722507877

fkgartnerova@gmail.com



# HOW THE MANAGEMENT SYSTEMS HAVE BEEN IMPLEMENTED IN SPAIN

*María Palacios Guillem; Elena Perez Bernabeu; Víctor Gisbert Soler and Marta Blasco Torregrosa.*

## **Abstract.**

The main objective of this article is to analyze the situation of Spanish organizations with respect to the management systems, that is, to study which systems have been implemented by Spanish companies, the way in which they have been implanted, in addition to the difficulties that have arisen during implementation and the benefits obtained with the implementation. For this purpose a questionnaire was made covering these fields and we sent to 100 companies from Spain with two or more management systems, of which it is possible to conclude that Spanish companies started to implement management systems from the year 2000 and that the management systems more implemented were ISO 9001 and ISO 14001. Although, it should be noted that only 68 companies replied to the questionnaire.

The idea of writing this article emerged as a response to the gap in the literature, since, although there are many articles related to this subject, none makes an in-depth study on the way in which Spanish companies with two or more management systems have integrated such systems.

**Keywords:** *Quality Management Systems, Integration of Management Systems, Spain, ISO 9001, ISO 14001.*

## **1 INTRODUCTION**

Currently, the Spanish industry is composed of a considerable number of SMEs, concretely, 99.88% of Spanish companies in 2015 were SMEs (DIRCE, 2015). This become in a competitive market, where the main objective of the companies is to be among the best in their sector, satisfying the needs of its customers with products or services of a higher quality than their competition, differing, in this way, from it.

This situation has caused that a phenomenon has been originated in the later years, which has made it possible to improve the efficiency and effectiveness of companies: the creation of management systems (Bernardo Vilamitjana, 2010).

According to the International Organization for Standardization, the most implemented management systems are the quality management system based on ISO 9001 and the environment based on ISO 14001, with 1,033,936 certifications and 319,324 certifications in the year 2015, respectively (Charlet, 2011).

But the success of the implementation of management systems based on international standards is not exhausted with the dissemination of ISO 9000 and ISO 14000 standards. Indeed, in the last years an important process of emission of new standards is taking place, national as much as international. These are standards related to such diverse fields of business management as the prevention of occupational risks and occupational safety and health, corporate social responsibility or activities related to human resources management, to give just a few examples (Heras Saizarbitoria et al., 2007).

Although many companies have Quality Management Systems (QMS), Environmental Management Systems (EMS) and Occupational Health and Safety management Systems (OH&SMS), only some of them have succeeded in developing an effective integrated management system (IMS) (Bornay Barrachina et al., 2002).

In this sense, the literature on the integration of management systems is based essentially on theoretical studies that define an integrated management system (IMS); The methodology used in the integration; The levels of integration of the company and the advantages and difficulties, as main aspects to be taken into

account in the process (Heras Saizarbitoria et al., 2007). Although two articles and a thesis that empirically study the integration of management systems stand out, specifically the article of Samuel Vinícius and Carla Schwengber (Samuel Vinícius & Carla Schwengber Ten, 2015); the article of Roselyn Martínez; Beatriz Agüero; Alejandro Penabad and Ricardo Montero (Martínez et al., 2011) and the thesis of Mercè Bernardo Vilamitjana (Bernardo Vilamitjana, 2010). However, they study management systems in particular, organizations in particular or places in particular, so we decided to do a study updating the existing data with the only restrictions that the companies studied were Spanish and with two or more management systems implemented.

## **2 LITERATURE ANALYSIS**

There are many definitions of "integrated management system" that can be found in the literature, although it can be concluded that an "integrated management system" can cover different aspects of business management; therefore, it is important to identify which aspects are involved. Usually, integrated management systems can be described as a combination of quality management and environmental management, with the management system of health and safety (Labodová, 2004), since all these standards have a methodology creation, structure, process implementation and verification by a third party, very similar (Heras Saizarbitoria et al., 2007).

The topic of Management Systems (MSs) integration started to appear in the literature more than fifteen years ago (e.g. (Beechner & James, 1997); (Wilkinson, 1998)). Other investigations exist on how organizations have chosen to integrate their MSs focusing on different topics such as their integration methodologies and degrees as well as the advantages and challenges of the integration (e.g. (Karapetrovic & Willborn, 1998a) (Karapetrovic & Jonker, 2003); (Zeng et al., 2007); (Bernardo et al., 2009). Due to these researches, empirical investigations on the integration of standardized MSs are becoming numerous, for example,; (Douglas & Glen, 2000); (Bernardo et al., 2009), among others (Villar, 2012).

Table 1 Main Contribution. Source: (Heras Saizarbitoria et al., 2007)

Authors	Main contributions
(Karapetrovic & Willborn, 1998b)	Unique system consisting of subsystems specific function completely loses their unique identities, "system of systems".
(Winder, 2000 )	Raises 14 rules for integration, highlighting importance of the commitment of management, IMS rate decision and common goals. IMS databases: policy, programs, procedures and planning, common to the entire organization.
(G. Wilkinson & Dale, 2000)	Five key elements: understanding different concept "integration", simplifying terminology, differences in objectives difficult process, integration based on the total quality improves outcomes, importance of culture.
(Karapetrovic, 2002)	Two categories: management systems and audits, with the aim of increasing the performance of the company. Three levels of integration: documentation, alignment of key processes, objectives and resources, and system "all in one".
(Beckmerhagen, Berg, Karapetrovic, & Willborn, 2003)	Process of unifying the various specific functions of management systems into a single integrated management system more effective.
(Karapetrovic, 2003))	Interconnected processes that share the same resources to achieve the objectives related to the satisfaction of a wide range of stakeholders.
(McDonald, Mors, & Phillips, 2003)	Three processes: management review, operational control and internal audits. Unique system for each organization, different systems for all.

It should be noted that the benefits of integrating management systems have been widely discussed by the authors (Bamber, Sharp, & Hides, 2000) ; (Karapetrovic & Willborn, 1998a); (Heras Saizarbitoria et al., 2007); (Fraguela et al., 2011) and (Peña-Escobio et al., 2011). To summarize, the main advantages are:

-Its implementation is simplified.

-Cost reduction.

-The possibility of conducting audits of implementation, monitoring and review of the three systems at the same time.

-Certified company registration in the three management areas is achieved faster because there is a single certificate for all three management systems.

- It allows certification to each new area in an easier and faster way, not being necessary to consider nothing more than the specific aspects of the new area in question.
- Reduction of the necessary documentation, which brings transparency, ease of management and reduced maintenance costs.
- Improving their competitiveness and market position.
- The probability of error / cost is avoided.
- Organizational alignment of strategy is enhanced.
- The initial existence of philosophical and technical identities between individual systems (optimization of resources, multidisciplinary, image enhancement, etc.) makes for those companies in which the culture of one of them is implemented, easier advancement towards full integration.
- Improved development and technology transfer.
- Improved operational performance, improved internal management methods and multifunction devices.
- Increased customer confidence.
- Simplification of the system requirements.
- Optimization of resources.
- Aligning the objectives of the various standards and systems.
- Creating synergies.
- Reducing duplication of policies and procedures.
- Increased worker motivation.
- Reducing conflicts.
- Improved satisfaction of stakeholders or interest groups.
- Is greater effectiveness evaluation, control and monitoring.
- There is greater participation of workers in their implementation.
- Highest levels are achieved in improving Working Conditions, Quality and Environment.
- Improvements achieved reduce liability lawsuits for breach.
- Insurance premiums are reduced.
- Performance, skills and training of the members of the organization increases, since determined and supplement the training needs of individuals in various subjects.
- Improving the effectiveness and efficiency of processes, increasing consistency, traceability, avoiding redundancies and inconsistencies.

Regarding drawbacks, according to (Heras Saizarbitoria et al., 2007); (Fraguela Formoso et al., 2011); the most noteworthy disadvantages could be:

- Higher implementation cost in relation to one particular management system. Thus the current trend of organizations is to implement a quality management system and then go integrating environmental management and safety and health at work.
- Greater efforts in training, organizational matter and change of business culture.

- There are many duplications, documentaries relationships and requirements that must be resolved within the framework of a project that integrates not only systems but also functional areas involved that may not be well coordinated in advance.
- The disappearance of the identity of each management system and fear of job loss by misalignment of the operational objectives.
- Lack of education, awareness and training by the manager and workers.
- Difficulty of achieving a team responsible for its implementation with adequate training in all three areas.
- Temporality, subcontracting and job insecurity that abuses cause and high accident rate, lack of awareness of employer of their responsibilities in each of the subjects.
- Lack of inspectors who control the safety and health of companies.
- Lack of propaganda of the advantages of an Integrated Management System by the Confederation of Employers and governments.

### **3 METHODS**

To perform this study and to be able to collect data, a closed-ended questionnaire was carried out with 16 questions divided into 2 sections: general data and system integration, which, in turn, are subdivided into: general information about the company; integrated systems and duration and year of implementation; way of implementation; order of implementation; methodologies used for the design of the implementation; integration plan and its elements and difficulties and benefits of implementation.

This questionnaire was sent via e-mails to companies based in the Spanish territory, as it is one of the countries where more certifications are making (Bernardo Vilamitjana, 2010), and that they had implemented two or more management systems, because only with a system it is impossible to make an integration process. Of those companies that were sent the questionnaire, only 68 resubmitted the questionnaire answered via email. So we proceeded to send the questionnaire a second time and try to meet personally with nearby companies that were interested in the project.

After observing that no questionnaire was returned and seeing that it had a 90% confidence level, we proceeded to analyze the data obtained by using the Statgraphics X64 program using methods such as decision trees and the graph generator.

### **4 DATA ANALYSIS AND DISCUSSION**

Following in this section we will analyze the data that have been obtained with the sending of the questionnaire.

As in the questionnaire, this section has been divided into different parts, which are: integrated systems and year of implementation; duration of implementation; methodologies used for the design of the implementation; integration plan and its elements and difficulties and benefits of implementation.

#### **4.1 Integrated systems**

In this section we will see the management systems that the companies surveyed have implemented, as well as the year in which they have been implemented.

But before that, it should be mentioned that the options that were offered to companies as answers were: ISO 9001; ISO 14001; OHSAS 18001; UNE 166002; ISO 31000; SIX SIGMA; LEAN y KAIZEN, since it is a closed-ended questionnaire. These methods were chosen as options for two reasons: because, as

mentioned above, they are the systematic ones most used by the companies and because they are methodologies used in the doctoral thesis of this article.

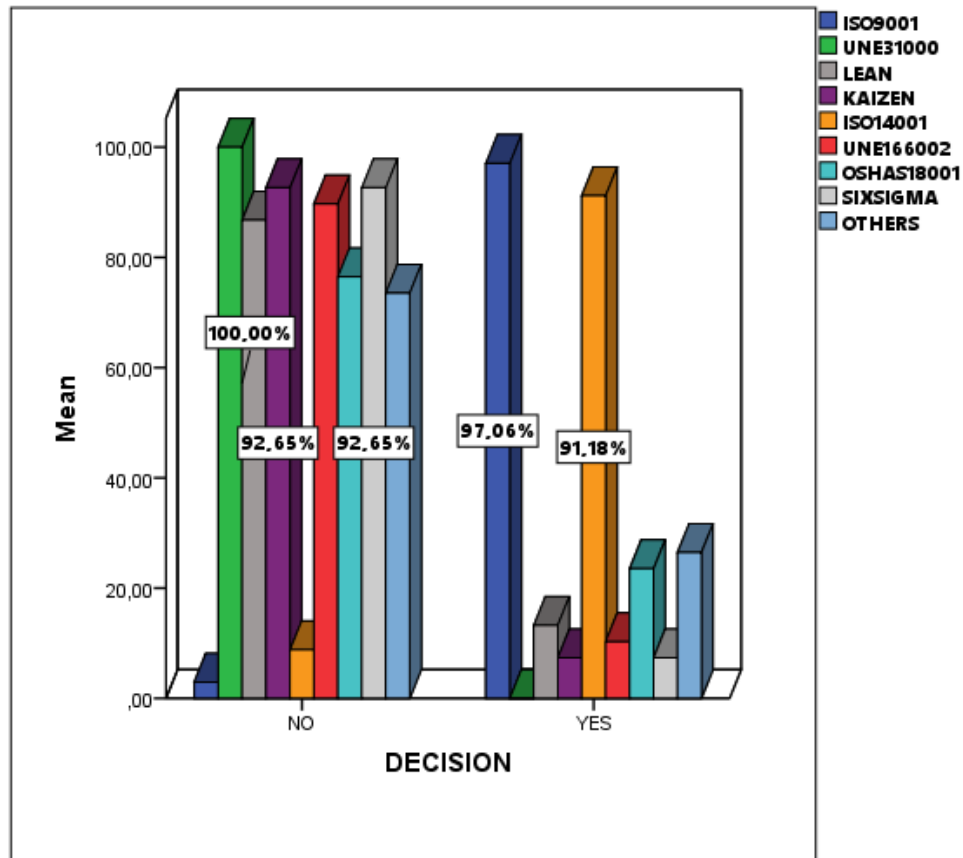


Figure 1 –Integrated systems. Source: Own preparation

As can be seen in the Figure 1, the most implemented methodologies were ISO 9001 and ISO 14001, 97.06% and 91.18%, respectively. There are also companies, a 26.47% in particular, that have decided to implement others systems different from those mentioned in the questionnaire, among which we can highlight ISO-TS 16949, which is the Quality Management System in the Automotive Sector, or ISO 22000, which is the Management System to ensure the safety of food.

This can be translated as a growing interest of the companies to reach the maximum quality, since all the systems that stand out have direct relation with the quality. And a great concern in to respect the environment and comply with current regulations.

On the other hand we can see in the Figure 1 that the least implemented methodologies have been ISO 31000; Kaizen and Six Sigma, specifically Kaizen and Six Sigma, have only been implemented by 7.35%, while the ISO 31000 "Principles and guidelines for risk management" has not been implemented by any of the companies, but this does not mean that they are less beneficial or effective than other systematic ones, they are simply less known than the others, simply they are less known than the others because they are relatively new systems.

Regarding the year of implementation, it should be explained that the options offered to respondents were groups of 5 years ranging from 2000 to 2016, since it is the last year from which we can extract information.

Table 2 Year of implementation. Source: Own preparation

	< 2000	2000-2005	2006-2011	2012-2016
ISO 9001	39.71%	38.24%	10.29%	8.82%
UNE-ISO 31000	0	0	0	0
LEAN	0	1.47%	2.94%	8.82%
KAIZEN	0	2.94%	1.47%	2.94%
ISO 14001	5.88%	33.82%	30.88%	20.59%
UNE 166002	0	2.94%	4.41%	2.94%
OSHAS 18001	0	5.88%	10.29%	7.35%
SIX SIGMA	0	1.47%	2.94%	2.94%

As can be seen in Table 2, the most implemented systems were integrated during the years 2000 and 2005, because it is at that time when they have more height because it is in that years when the market became more competitive and the companies decided to implement management systems to differentiate themselves from the rest.

However, with the passage of the years have been decreasing the implementations of ISO 9001 and ISO 14001 to create and implement other management systems, as is the case of OSHAS 18001 or Lean Manufacturing and like this they improve other aspects of the organization.

## 4.2 Implementation

In this section we will see the duration of the implementation of the systems that have been implemented by the companies, as well as the methodologies and the integration plan that they used.

As for the duration of implementation, the options available to respondents in the questionnaire were less than 1 year; between 1 and 2 years; between 2 and 3 years; between 3 and 4 years; between 4 and 5 years and more than 5 years.

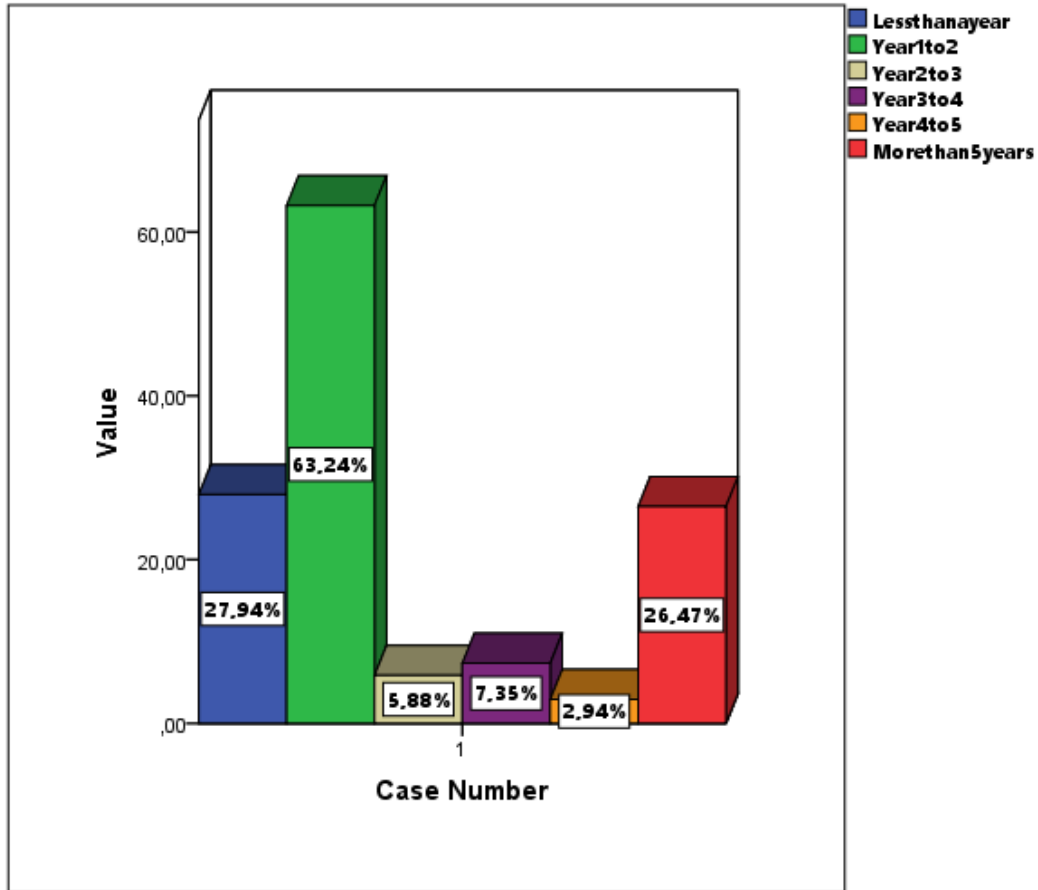


Figure 2 – Duration of implementation. Source: Own preparation

As can be seen in Figure 2, 63.24% of the companies responded that the duration of implementation of some of their methodologies lasted between 1 and 2 years, while 27.94% companies replied that the duration of implementation of some of their systems lasted less than 1 year.

The duration of implementation that less marked the companies as a response was the duration that oscillates between 4 and 5 years, 2.94%, since most of them established as maximum time of 2 years, because they think that after 2 years, the implementation will be very costly.

With regard to the question "What methodology was used for the design of the Integrated System?", The options that were presented in the questionnaire as answers were "Based on the definition of the organization's process map"; "An analysis of the common elements of the standards"; "An organization's own model"; "The PDCA Cycle for all the process of the integrated system" and " UNE 66177 standard" since they are the methodologies that were extracted from the state of the art.



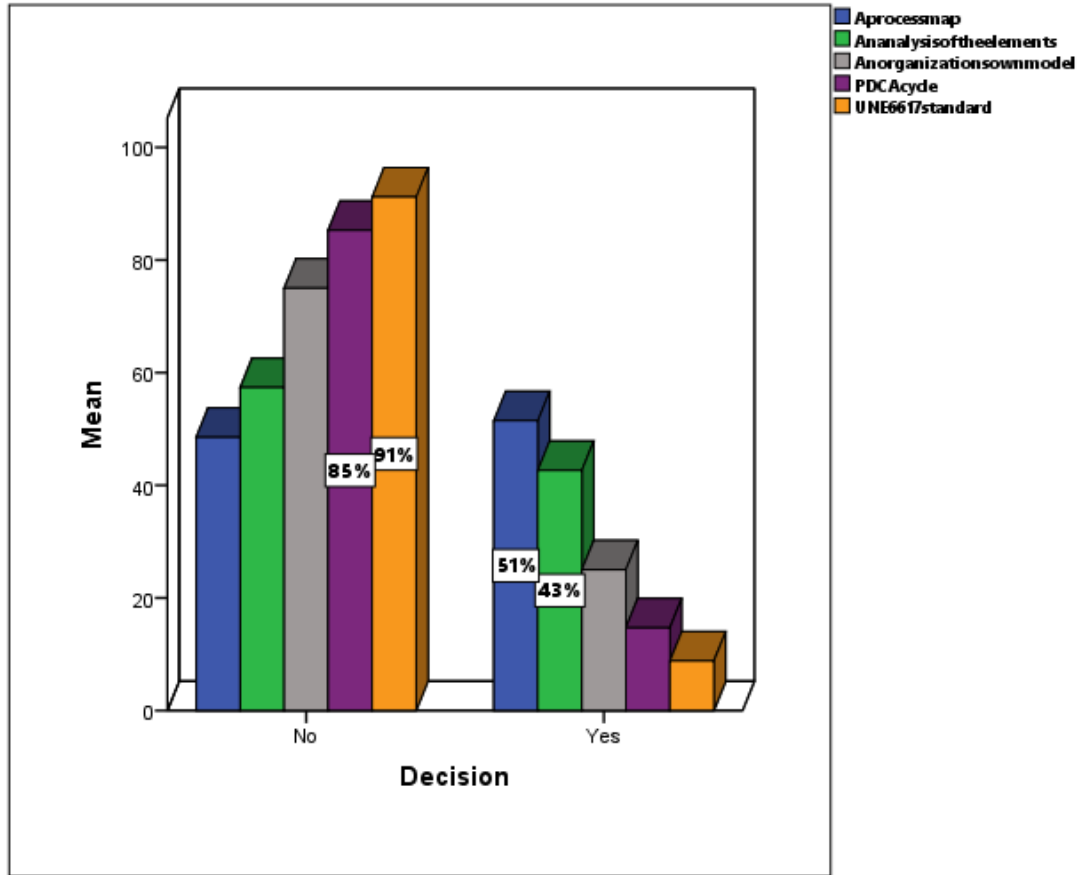


Figure 3 – Methodology is used for the design of the Integrated System. Source: Own preparation

Of these options, the most used by the companies is the option of “Based on the definition of the organization's process map”, with a total of 51% of the organizations that answered the questionnaire (Figure 3).

The second most used option is "An analysis of the common elements of the standards", which was chosen by 43% (Figure 3).

While the least used by companies for the design of their system is "Based on the standard UNE 66177", a total of 8.82% (Figure 3).

Among other things, this is due to the fact that it is easier for companies to implement an integrated system made to measure and with elements common to each other.

Moreover, to implement management systems or models, 75% of the companies that responded to the questionnaire used an integration plan to perform the implementation.

In this plan, some of the elements included are: “Cost and profitability or estimated benefits of integration”; “Resources needed to develop integration at each level” and “Degree of compliance with the requirements of the different management systems implemented and the degree of compliance expected with the integration”, among others elements that may affect the implementation of the system.

### 4.3 Difficulties during the integration process

As in any process, in the implementation of management methodologies there are difficulties that make it a little more complicated to implement the systematic ones that have been chosen. A summary of these

difficulties could be: “Lack of integration guidelines (books, articles, documents, etc.)”; “Lack of human resources”; “Lack of department collaboration”; “Lack of specialised auditors”; “Excessive time to conduct the integration”; “Lack of employees motivation”, among others.

In this section we will observe that difficulties have been found the companies surveyed.

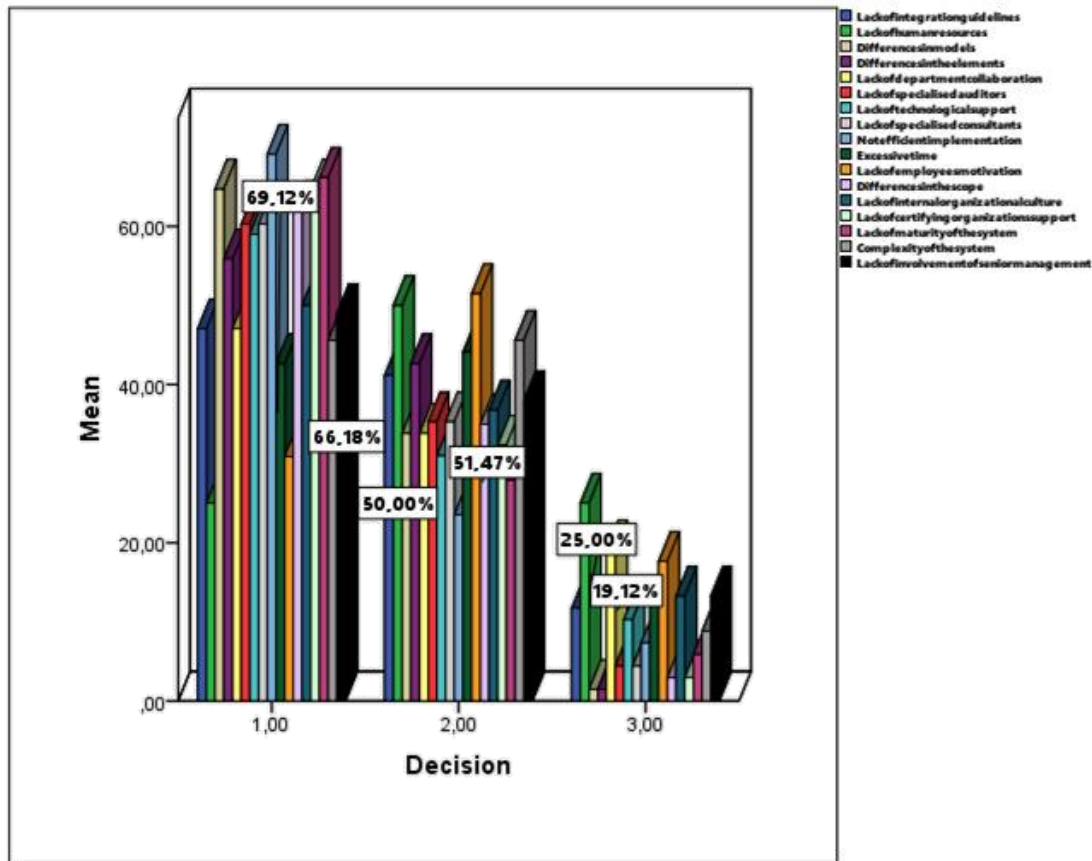


Figure 4 – Difficulties Source: Own preparation

In this question a Likert scale was used which are "Little Important"; "Important" and "Very important", to which the numbers 1; 2 and 3, were assigned, respectively.

The difficulty that most companies have responded as "Very important" is the "lack of human resources", 25%. Followed by "Lack of collaboration of departments", 19.12%. While the difficulty that most companies have marked as "Little important" is "inefficient implementation of the first system", 69.12% (Figure 5).

And is that, apart from not having the necessary resources to perform the integration, one of the problems with which companies find themselves is the lack of collaboration on the part of the different departments, among other things, for the lack of knowledge and culture with respect to management systems. One of the measures that can be applied to avoid this is to train the departments that are part of the integration of the systems before the implementation.

#### 4.4 Benefits

What makes companies interested in implementing management systems are the benefits they present. These can be summarized in: “Task simplification (documentation, control, requirements)”; “Increase of

organizational efficiency (cost reduction, etc.); “Better use of the internal and external audit results”; “Firm image improvements” and “Competitive advantage in the market”, among others.

In this section we will see the benefits that companies have obtained with the implementation of management systems.

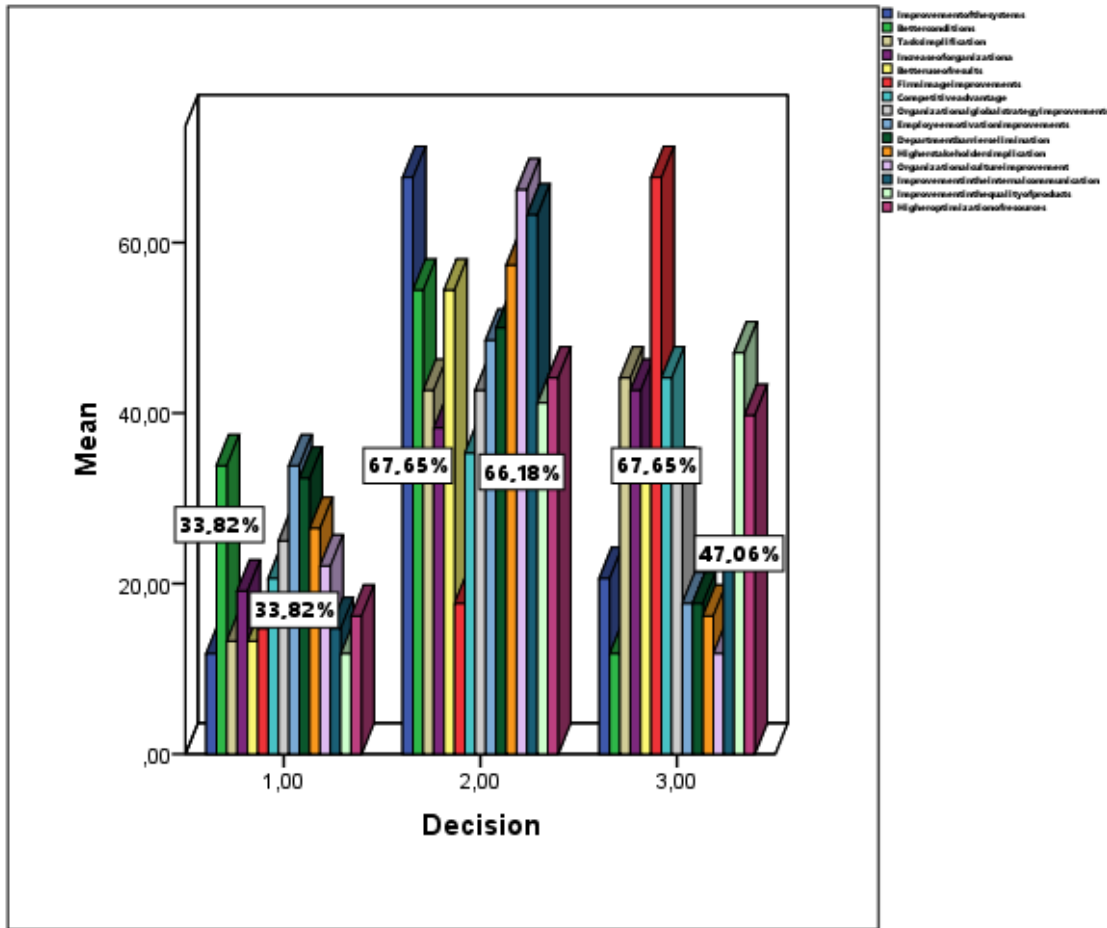


Figure 5 – Benefits. Source: Own preparation

Like the previous question, this question also used a Likert scale which is “Little Important”; "Important" and "Very important", to which the numbers 1; 2 and 3, were assigned, respectively.

The benefits that have been valued by the companies that have responded have been "Improvement of the external image of the company", 67.65%. The other best evaluated is "Improvement in the quality of the products and / or services", 47.06%, as one of the causes by which management systems are known and by which companies decide to implement them, is the ability of management systems to improve the competitiveness of companies by means of improving the quality of their products or services and, therefore, the image transmitted by the company.

The most voted as "Little important" and therefore, the least valued by the companies are "Better options to include new systems", 33.82%, and “Employee motivation improvements”, also with 33.82% (Figure 6).

## 5 CONCLUSIONS

For all of the above reasons, it could be concluded that although the management systems arose at the end of the 90s, it is not until the years 2000 and 2005 that there is a great number of companies that implement the above mentioned methodologies, such as ISO 9001 and ISO 14001, with a duration of implementation, in general, of no more than 2 years.

Regarding how companies have implemented their systems, most have made a map of processes, in which they have integrated elements such as "quality objectives and planning to achieve them"; "System Review" and "System Improvement".

In relation to the difficulties that companies have found in their systematic implementation one could conclude that "Lack of human resources" and "Lack of collaboration of the departments" are those that most affected them.

On the other hand the benefits that the companies have obtained with the integration are "Firm image improvements" and "Improvement in the quality of the products or services".

Observing the above conclusions, it is possible to be affirmed that with this study the conclusions are verified to which they arrived Samuel Vinícius and Carla Schwengber (Samuel Vinícius & Carla Schwengber Ten, 2015); Roselyn Martínez; Beatriz Agüero; Alejandro Penabad and Ricardo Montero (Martínez et al., 2011) and Mercè Bernardo Vilamitjana (Bernardo Vilamitjana, 2010).

### References

- Bamber, C. J., Sharp, J. M., & Hides, M. T. (2000). Developing management systems towards integrated manufacturing : a case study perspective, 454–461.
- Beckmerhagen, I. a., Berg, H. P., Karapetrovic, S. V., & Willborn, W. O. (2003). Integration of management systems: focus on safety in the nuclear industry. *International Journal of Quality & Reliability Management*, 20(2), 210–228. <https://doi.org/10.1108/02656710310456626>
- Beechner, A. B., & James, E. (1997). Integrating ISO 9001 and ISO 14001. *Quality Progress*, 33–36.
- Bernardo, M., Casadesus, M., Karapetrovic, S., & Heras, I. (2009). How integrated are environmental, quality and other standardized management systems? An empirical study. *Journal of Cleaner Production*, 17(8), 742–750. <https://doi.org/10.1016/j.jclepro.2008.11.003>
- Bernardo Vilamitjana, M. (2010). Integració de sistemes estandarditzats de gestió: Anàlisi empírica. Retrieved from <https://www.educacion.gob.es/teseo/mostrarSeleccion.do>
- Bornay Barrachina, M. del M., García Rodríguez, M., & Ferguson Amores, M. C. (2002). Modelos de implantación de los sistemas integrados de gestión de la calidad, el medio ambiente y la seguridad. *Investigaciones Europeas de Dirección Y Economía de La Empresa*, 8(1), 97–118. <https://doi.org/10.1016/j.ssci.2006.07.003>
- Charlet, L. (2011). The ISO Survey of Management System Standard Certifications – 2011 Executive summary, 2008, 3. Retrieved from [http://www.iso.org/iso/iso\\_survey2011\\_executive-summary.pdf](http://www.iso.org/iso/iso_survey2011_executive-summary.pdf)
- DIRCE. (2015). Retrato de la PYME, 1–8.
- Douglas, A., & Glen, D. (2000). Integrated management systems in small and medium enterprises. *Total Quality Management*, 11(4), 686–690. <https://doi.org/10.1080/09544120050008075>
- Fraguela Formoso, J. A., Carral Couce, L., Iglesias Rodríguez, G., Castro Ponte, A., & Rodríguez Guerreiro, M. J. (2011). Integration of management systems. Need for a new entrepreneurial culture . *DYNA (Colombia)*, 78(167), 44–49. Retrieved from <https://www.scopus.com/inward/record.uri?eid=2-s2.0-83155172914&partnerID=40&md5=b6f6f3055827e3933b0fb7be18df68f1>

- Heras Saizarbitoria, I., Bernardo, M., & Casadesús, M. (2007). La Integración De Sistemas De Gestión Basados En Estándares Internacionales. *Revista de Dirección Y Administración de Empresas - España*, 14, 155–174.
- Karapetrovic, S. (2002). Strategies for the integration of management systems and standards. *The TQM Magazine*, 14(1), 61–67. <https://doi.org/10.1108/09544780210414254>
- Karapetrovic, S. (2003). Musings on integrated management systems. *Measuring Business Excellence*, 7(1), 4–13. <https://doi.org/10.1108/13683040310466681>
- Karapetrovic, S., & Jonker, J. (2003). Integration of standardized management systems: Searching for a recipe and ingredients. *Total Quality Management & Business Excellence*, 14(4), 451–459. <https://doi.org/10.1080/1478336032000047264>
- Karapetrovic, S., & Willborn, W. (1998a). Integration of quality and environmental management systems. *The TQM Magazine* *The TQM Magazine Iss The TQM Magazine*, 10(2), 204–213. <https://doi.org/10.1108/09544789810214800>
- Karapetrovic, S., & Willborn, W. (1998b). International Journal of Quality & Reliability Management Integrated audit of management systems. *International Journal of Quality & Reliability Management Managerial Auditing Journal Iss The TQM Magazine Iss*, 15(3), 694–711. <https://doi.org/http://dx.doi.org/10.1108/02656719810218220>
- Labodová, A. (2004). Implementing integrated management systems using a risk analysis based approach. *Journal of Cleaner Production*, 12(6), 571–580. <https://doi.org/10.1016/j.jclepro.2003.08.008>
- Martínez, R., Agüero, B., Penabad, A., Montero, R., Finlay, I., Investigación, C. De, ... Lisa, L. (2011). Sistema Integrado de Gestión de Calidad , Seguridad y Ambiental en un centro biotecnológico Materiales y Métodos. *VacciMonitor*, 20(2), 24–31. Retrieved from <http://scielo.sld.cu/pdf/vac/v20n2/vac05211.pdf>
- McDonald, M., Mors, T. A., & Phillips, A. (2003). Management System Integration: Can It Be Done? *Quality Progress*, 36(10), 67–74. Retrieved from <http://www.scopus.com/inward/record.url?eid=2-s2.0-0142052968&partnerID=tZOtx3y1>
- Peña-Escobio, D., Moreno-Pino, M., & Rigol-Cardona, B. (2011). *Ciencias Holguín , Revista trimestral*, Año XVII, Julio-septiembre, 2011.
- Samuel Vinícius, B., & Carla Schwengber Ten, C. (2015). Diagnóstico da integração dos sistemas de gestão ISO 9001, ISO 14001 e OHSAS 18001. *Production*, 626–640. <https://doi.org/10.1590/0103-6513.004811>
- Villar, A. (2012). AN EMPIRICAL ANALYSIS OF INTEGRATED Doctoral Thesis An Empirical Analysis of Integrated Management Systems Alexandra Simon i Villar. *Universitat de Girona*. Retrieved from <http%3E//.handle.net/0803184065>
- Wilkinson, B. G. . D. (1998). System Integration: the Views and Activities of Certification Bodies. *The TQM Magazine*, 10(4), 288–292. <https://doi.org/10.1108/09544789810222658>
- Wilkinson, G., & Dale, B. G. (2000). Management system standards: The key integration issues. *Proceedings of the Institution of Mechanical Engineers, Part B: Journal of Engineering Manufacture*, 214(9), 771–780. <https://doi.org/10.1243/0954405001517838>
- Winder, C. (2000). Integrating OHS, Environmental, and Quality Management Standards. *Quality Assurance*, 8(2), 105–135. <https://doi.org/10.1080/105294100317173880>
- Zeng, S. X., Shi, J. J., & Lou, G. X. (2007). A synergetic model for implementing an integrated management system: an empirical study in China. *Journal of Cleaner Production*, 15(18), 1760–1767. <https://doi.org/10.1016/j.jclepro.2006.03.007>

**Contact information**

María Palacios Guillem, Ph.D Student  
Universidad Politécnica de Valencia , Ph.D School  
Camí de Vera, s7n, 46022  
Valencia- España  
+34 665849289  
[mapaguil@epsa.upv.es](mailto:mapaguil@epsa.upv.es)

Elena Perez Bernabeu , Ph.D  
Universidad Politécnica de Valencia, Dpto. de Estadística e Investigación Operativa Aplicadas y Calidad  
Camí de Vera, s7n, 46022  
Valencia- España  
[elenapb@eio.upv.es](mailto:elenapb@eio.upv.es)

Víctor Gisbert Soler, Ph.d  
Universidad Politécnica de Valencia, Dpto. de Estadística e Investigación Operativa Aplicadas y Calidad  
Camí de Vera, s7n, 46022  
Valencia- España  
[vgisber@eio.upv.es](mailto:vgisber@eio.upv.es)

Marta Blasco Torregrosa, Ph.D Student  
Universidad Politécnica de Valencia , Ph.D School  
Camí de Vera, s7n, 46022  
Valencia- España  
[marblato@epsa.upv.es](mailto:marblato@epsa.upv.es)

# COST STRUCTURE IN SLOVAK STARTUPS BASED ON DEVELOPMENT PHASE

*Ráchel Hagarová*

## **Abstract**

Startups are hot topic not only in business world, but also in general. Startups constantly bring innovations, they solve problems of all people and that is the reason of their popularity. But startups are still new topic in academic or scientific sphere. One of the topics we need to describe is Cost Structure, e.g. what cost items are important for startups and which are not. How are costs changing through life cycle of startups. Basis for the survey is Business model Canvas. Question is what kinds of costs have place in startups firms and are they changing based on development cycle of firm. Article represents new data about Slovak startups and their Cost structure.

*Keywords: startup, cost, development, phase*

## **1 INTRODUCTION**

Startups are not absolutely new topic in Slovak enterprise environment. But we still can consider them as hot topic, which deserves attention from government, business environment and academic field as well.

Although, startups are one of the most popular topics nowadays, there isn't one general definition of startups. Each part of startup related environment has its own definition for startup. But it is only natural, because they all have their own views on startups. Definition varies also based on level of development startup ecosystem in various counties. Level of startup ecosystem development is based on enterprise environment in particular country or region. For example in Silicon Valley, or USA in general, Israel is startup ecosystem on higher level, it is more developed. Startups are not new topic in these countries and their business environment is ready to work with startups and fulfill their special needs.

However, we can say that one general problem is exact definition of startup. Steve Blank (2012), one of the best known startup author and guru wrote that startup is not a smaller version of a large company. Startup is a temporary organization in search of scalable, repeatable, profitable business model. Research by Harvard Business School shows that 75 % startups fail (Blank S. , 2013). It can be explained by many reasons; one of them could be related to a cost structure. For startup is typical long period without any revenues. Teams work on product/service development and it takes some time. During this period, startup have only costs, no revenues. Disproportionately high cost to low revenues could be one of the failure reasons. Thanedar (2012) described the biggest difference between small business and startup. Small businesses have the same goal - profitability and stabile long term position among competitors. Startups are aimed at revenue streams in short term view and growth potential.

New methodology in startup environment describes how startups should work, if they want to minimize failure risk. It is called Lean Startup made by Eric Ries (2011). This methodology is basically about proofing everything, every thought, and assumption startup has. These should higher chances off bringing product or services to market which customers really want. Therefore, startup could save cost on developing wrong product. Eric Ries (2010) wrote, that startup is human organization designed to deliver new products or services under conditions of extreme insecurity. The most important part of the definition is newness of product or service and also extreme insecurity. Startup tries to bring new product or service to market and it doesn't have knowledge about customer reactions.

Cost structure in startups is described marginally if only from particular point of view. Startupers want to know how much it cost to launch a startup, or to develop a product, to get to the market (Pozin, 2016). But we still know too little about real costs in startups. There is only little, if any, information about cost items

and their importance for startups. Ash Maurya (Maurya, 2012) wrote, that it is too hard for startup to predict and describe their costs into the future. Startup should be focused on the present. Question he suggest are: What will it cost you to interview 30 to 50 customers? What will it cost you to build and launch your MVP? What will your ongoing burn rate look like in terms of both fixed and variable costs? Founders should calculate break-even point, based on revenue streams and cost structure. Than they should estimate how much money, time and effort they need to get there. Costs in terms of customers are one of the issue in Blanks (Blank, 2012) work. Customers are for startup important, but they must be also affordable to get. He suggested to measure 'get customers' cost. Meaning, 'all in' cost of activating or selling for number of customers. Costs structure as one of the components of profits is described by A.Affuah (Afuah, 2014). Firm must pay attention to growth of costs. Firm needs to know about two kinds of costs – production and transaction costs. Production costs are made of fixed, variable, marginal and sunk costs. These costs types are related to the product or service. Transaction costs are associated with searching and acquiring information about inputs the contracting associated with value creation and capture activities, and the monitoring and enforcement of contracts/agreement. The profile of these costs is the cost structure of the business model. Keeping costs low is more important for cost-driven business model that differentiation-driven model.

In our startup research we use business model as basis to search their inner workings. Business model as topic has some vagueness, same as startups. Authors have different opinions on this topic. Kesting and Günzel-Jensen generated main categories for business model sophistication based on the relationship between main and the secondary business activities in one company. In business as we know it, traditional business model, revenues and cost are addressed only in one particular business. Free business model is kind where all revenues are received from secondary businesses and all costs are covered by firm on its own (e.g. Google). Second type of business model is, when revenues are from secondary business, but costs are in hybrid structure, covered by firm and partner together (e.g. Ryanair, Tripadvisor). Authors are not aware of any example for type when all revenues are from secondary business and all costs are covered by partners (Kesting and Günzel-Jensen, 2015). Ghezzi at .al. (Ghezzi at. al., 2015)claimed, that „the origins of the business model concept date to the late 1990s, a period of strong technological innovation in the form of the widespread commercial diffusion of the Internet and related ICTs (information and communication technologies).“ Business model is important tool in strategic management, which connects strategy formulation and implementation in the form of business processes, resources and relationships. Ghezzi at. al. identified four most common dimensions in business models interpretations: value proposition, value creation, value delivery and value appropriation. Business model has a meta role in relationship between strategic planning and change. Joan Magretta (Magretta, 2010) approached business model as story that explains how company works and answers questions about customers and value for them by certain costs and revenues. Teece (Teece, 2010) described business model as manager's hypothesis about customers and their needs, for what they want to pay. Business model is description of how company creates, delivers and captures value.

## **2 RESEARCH AND RESULTS**

The main objective of article is to present cost structure in Slovak startups and costs allocation in various development stages of startup. As a foundation for our research we use Business Model Canvas from authors Osterwalder and Pigneur (2009). Hence, we use also term Cost Structure, as it is stated in model Canvas. Authors wrote that The Cost Structure describes all costs needed in all business model activities. We decided to use Business model Canvas because of its complexity and easiness in use. Canvas is very popular in startup enviroment, for the same reasons. Model Canvas gives us complex view on business and all important parts. Authors of business model Canvas Osterwalder and Pigneur wrote: “A business model describes a rationale of how an organization creates, deliver and captures value.” (Osterwalder at al. 2009) Model Canvas has 9 equally important blocks. Customer Segments identifies the most important customers, to be clear for whom is value made. Segments are groups of customers based on similarities. Firm should



focus on the most important segments. Value Proposition describes set of product or services for Customer segments. Value is the reason why customers choose product. It is what the product or service provide to them. Distribution Channels are different ways of delivering value to the customers, e.g. own stores, or partners. Customer Relationship describes relationship between firm and customer. This is applied through process of sale or collaboration. Revenue Streams is block connected do revenues, which flow from value and customers. Firm can have different ways to earn revenues. Key Resources describes the most important resources needed to accurate operation. Firm can own or rent these resources. Key Processes are the most important parts of delivering value to the customers. It starts with production, ends with customer services. Key Partners are blocks which group all important partners for process of creating and delivering value - suppliers, investors, distributors. Cost Structure are all cost connected with other block of model.

Article presents results of survey made on 76 Slovak startups. In sample are included all kinds of startups - software and hardware oriented, in different level of development. Survey is based on formalized questionnaire, which includes closed as well as open questions. Survey is divided into 3 phases. The first phase took place from December to January 2015 and second phase on June/July 2016. In order to compare results from each phase and to trace the development we use the same questioners in every phase. Every startup included in research sample was visited personally by one of research team member. Questionnaire was used as guideline for open conversation between researcher and startup team member (mostly founders). Thanks to this, we were able to manage data collecting as open conversation which led to more honest and accurate answers. Open questions are great way to get better understanding of closed one and results from statistics. Article reflects results from 1st phase of research.

### Basic information about Slovak startups

Based on research we can say that average age of founders is between 26 and 30 years. Founders in general have education on secondary and college level. Average practice before founding startup (particular startup included in survey) is from 5 to 10 years, approximately 7,5 years. Average Slovak startup team has 5,9 members. Duration of startups in sample is around 2 years.

Table 1 Basic information about Slovak startups. Source: own

	Mean	Stdev	Modus	Median	Min.	Max.
<b>Founder's age / scale*</b>	2,32	0,93	2	2	1	5
<b>Founder's education /scale **</b>	3,87	0,57	4	4	1	5
<b>Practice length before startup / scale***</b>	2,49	0,99	2	2	1	5
<b>Number of team members</b>	5,63	3,33	4	5	1	20
<b>Duration of startup /years</b>	1,84	1,82	1	1,5	0,25	15

\*scale: 1 – 18-25, 2 – 26-30, 3 – 31-35, 4 – 36-40, 5 – over 41

\*\*scale: 1 – elementary, 2 – secondary education, 3 – college education, 4 – Phd./3.rd college degree

\*\*\*scale: 1 – none, 2 – to 5 years, 3 – to 10 years, 4 – to 15 years, 5 – 15 and more years

## 2.1 Block of business model

In research we use Business model Canvas from authors Osterwalder and Pigneur. In this model Cost Structure is only one part from overall 9 building blocks. In Table 2 below is comprehensive comparison of all nine blocks and their development level. Presented results are means from set of questions, we used to fully describe each block. Scale is formed by 5 - 1 is the least developed and 5 the most.

Table 2 Development levels of all Business Model Blocks. Source: own

	Mean	Stdev	Mode	Median	Min.	Max.
Value Proposition	4,15	0,97	5,00	4,50	2,00	5,00
Customer Segments	3,90	0,73	4,00	4,00	2,00	5,00
Distribution Channels	3,62	1,29	5,00	4,00	1,00	5,00
Customer Relationship	3,84	1,12	4,00	4,00	1,00	5,00
Key resources	3,91	1,07	4,00	4,00	1,00	5,00
Key Activities	3,80	1,01	4,00	4,00	2,00	5,00
Key Partners	3,50	1,34	5,00	4,00	1,00	5,00
Revenue Streams	3,11	1,04	3,80	3,20	1,20	5,00
Cost Structure	3,95	1,16	5,00	4,00	1,00	5,00

Cost Structure is formed almost in level 4 out of 5 levels. We can say that startups know their cost items, but they don't know the amount of costs yet. In order to complete knowledge about level of development of Cost Structure, we need to compare it with other parts of business model. In Table 2 we can see that development levels of all blocks are very close to each other. Value Proposition, which reflects how product/service fills customer needs, is in general developed into higher level. It means that startups have clear vision about this block even they are not so sure about Revenue Streams. Level of Revenue Streams development is one point lower than Value Proposition. This can bring some risks into startup. Cost Structure is the second one block in development range. It relates to high level of Value Proposition level. On the other hand, respondents have difficulties to separate product cost and operation costs. As they think are sure about their cost structure, however they don't know operation cost. And operation costs can be problem in later stages of startup life.

## 2.2 Cost Structure

If we want to describe Cost Structure fully, we must know percentage structure of individual Cost items. In Table 3 is presented share of individual cost items in overall costs. An in Figure 1 we can see graphic display.

Table 3 The basic overlook of Cost Structure in startup. Source: own

Cost structure – share of individual items / % share									
Cost item	Material	Depreciation	Energy use	Rent	Travel expenses	Services (cooperation)	Financial cost	Payroll	Others
Share %	11,73	0,1	2,26	3,46	5,15	14,87	1,01	45,82	13,91

\*scale: development level of cost structure: 1 – none, 2 – first ideas, 3 – complete concept, 4 – experiments with implementation, 5 – nearly complete or complete

Startups specified the percentage share of given options. Table 3 shows share of individual Cost items. The largest percent share belongs to Payroll, almost half of the all costs. Much less, around 15%, belongs to all kinds of services. In many cases it means marketing, PR or special IT services. Slightly smaller share has Material in all kinds – almost 12%. In table we can see, that other items are not even slightly close these first three. Travel expenses are important and have bigger share in total costs mostly in hardware oriented

startups. It includes various conferences, exhibitions. Startups working with some application or some kind of service can promote their product online worldwide on smaller costs.

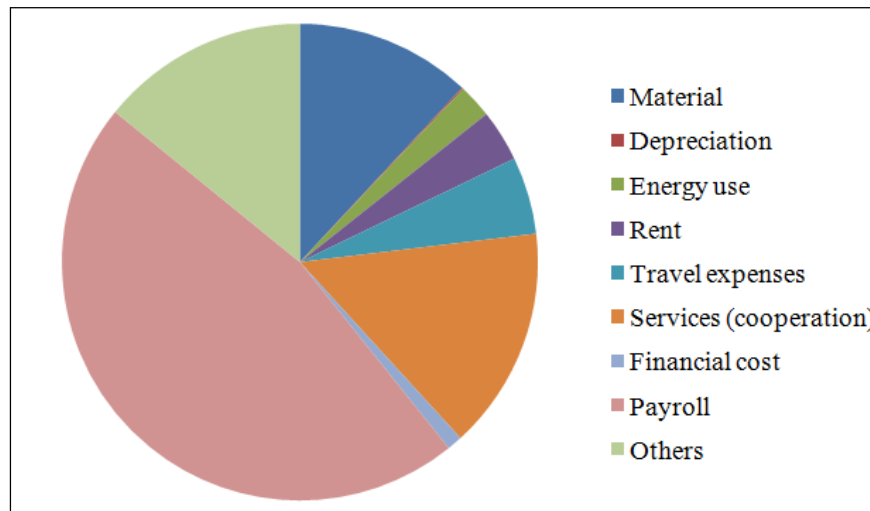


Figure 1 Share of Cost items

### 2.3 Cost Structure based on Development levels

In order to conclude main objective of the paper we link Cost Structure with several development indicators. As the main indicator we consider Development of business idea. We want to see, how is awareness of cost structure changing based on stages of Business idea development.

Table 4 The Cost Structure based on Business idea development level. Source: own

Business idea development	Cost Structure						Mean (Cost Structure)	Stdev
	1	2	3	4	5	Total		
1		2		1		3	2,67	0,94
2		5	2		1	8	2,63	0,99
3		5	6	4	5	20	3,45	1,12
4			1	9	16	26	4,58	0,57
5	1		2	4	12	19	4,37	1,04
<b>Total</b>	<b>1</b>	<b>12</b>	<b>11</b>	<b>18</b>	<b>34</b>	<b>76</b>	<b>3,95</b>	<b>1,16</b>

We can see that total 34 startups have Cost Structure developed to 5th level. On the other hand the most of the startups, total 26, have developed business idea into 4th level. It means that development of costs is ahead business idea. Startup count and calculate their costs before they finish idea. Average level of Cost structure development in this fourth level is 4,55, which is almost the higher level.

Similar situation is reflected in Table 5. Cost Structure awareness raises altogether with duration of startup.

Table 5 Cost Structure based on Duration of startup. Source: own

Duration of startup/years	Cost Structure							
	1	2	3	4	5	Total	Mean (Cost Structure)	Stdev
0 - 0,5		5	1	2	1	9	2,89	1,10
0,5 - 1		6	6	5	9	26	3,65	1,18
1 - 1,5			3	2	4	9	4,11	0,88
1,5 - 2		1		5	10	16	4,50	0,79
3	1		1	2	7	11	4,27	1,21
more than 3				2	3	5	4,60	0,49
<b>Total</b>	<b>1</b>	<b>12</b>	<b>11</b>	<b>18</b>	<b>34</b>	<b>76</b>	<b>3,95</b>	<b>1,16</b>

Table 6 Cost Structure based on Business Model development. Source: own

Business model development - level	Cost Structure							
	1	2	3	4	5	Total	Mean (Cost Structure)	Stdev
2		9				9	2,00	0,00
3		2	8	1	1	12	3,08	0,76
4	1	1	3	17	22	44	4,32	0,87
5					11	11	5,00	0,00
<b>Total</b>	<b>1</b>	<b>12</b>	<b>11</b>	<b>18</b>	<b>34</b>	<b>76</b>	<b>3,95</b>	<b>1,16</b>

Table 6 shows how Cost Structure is related to the Level of Business model development. We can say, that if startup has business model developed in 5th level, it means, all blocks are developed on relatively high level, startups knows its cost absolutely.

Table 7 represents distribution of cost items share through levels of Business idea development.

Table 7 Share of Cost items based on Business model development. Source: own

Business idea - development	Material	Depreciation	Energy use	Rent	Travel expenses	Services (cooperation)	Financial costs	Payroll	Others
1	20,00	1,67	1,67	3,33	5,00	6,67	0,00	28,33	33,33
2	10,63	0,00	8,13	0,63	5,63	10,63	0,00	33,75	30,63
3	7,00	0,00	0,25	1,55	2,30	19,65	0,00	48,50	15,75
4	13,51	0,11	1,60	3,43	7,90	16,09	0,27	49,52	6,42
5	13,42	0,00	2,90	6,74	4,21	11,26	3,68	45,79	12,11
<b>Total</b>	<b>11,73</b>	<b>0,10</b>	<b>2,26</b>	<b>3,46</b>	<b>5,15</b>	<b>14,87</b>	<b>1,01</b>	<b>45,82</b>	<b>13,91</b>

In Figures below we can see graphical visualization of costs items distribution through levels of Business idea development. As we can see, item Payroll has the biggest share on total costs in every Business idea level. Cost item Material is also significant in every phase. As third we can give costs under item Services, which are all cooperation or services that startup get from external environment, third parties. In most cases under this item belong marketing, PR or special IT services.

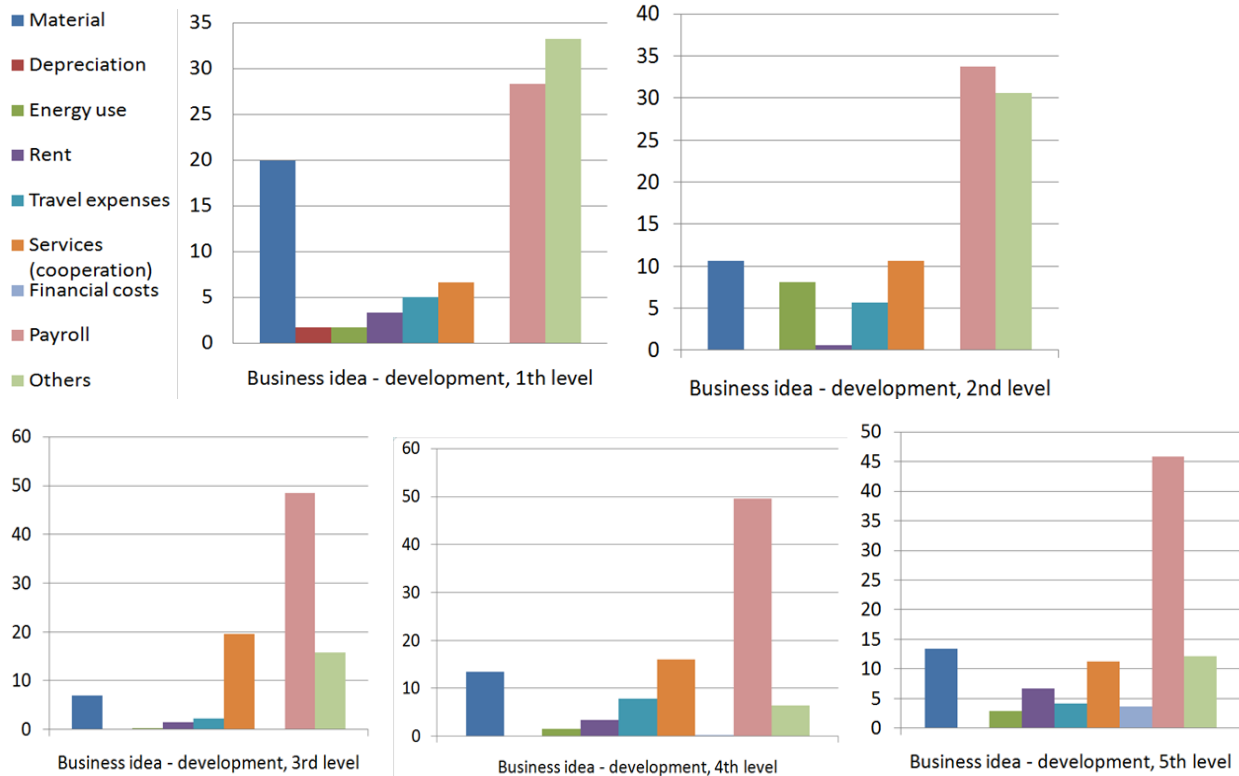


Figure 2 Share of Cost items on levels of Business model development. Source: own

At last places as the least important costs for startups are Depreciations, Energy use and Rent. Most of the startups are software based. And as they said, they do not need special place to work from. Startupers like to work from coworking spaces, where they can network with other teams, or find freelancers for their project if needed. This confirms assumption, that startups do not consider offices as important part of their activities.

## 2.4 Conclusion and Discussion

Typical Slovak startup, based on our research, has young founder with higher education and some practical experiences. Typical startup team has 5 to 6 members. Average duration of startup is almost 2 years.

A topic of cost items and structure is not easy to research. Startups have difficulties to separate products/services costs from operation costs. This problem often appeared in first stages of development startup, when team is focused only on product/services.

Cost Structure is only part of Business Model Canvas, on which research is build on. In order to understand importance and level of development of Cost Structure, we need to know these aspects about all nine blocks. We found out that block Value Proposition it the most developed block. Founders start their activities with product or service, on which they later eventually build a company. Value Proposition is most important for founders and they often focus all activities and recourses into development of value proposition. On the other hand it can be very dangerous, and there are some examples when it was deadly for startup. Startups should not forget about other parts of business models too.

Cost Structure is the second most developed among all nine building blocks. It means that startups can tell their costs with some certitude, maybe based on their Value Proposition. We can assume that these two blocks are linked. On the other hand respondents identify product costs with overall costs. It means, we

cannot take this level of development as absolutely right. Because, product costs are not the same as organizational costs. Awareness and knowledge about operation cost is crucial especially in later stages of startups, in time when product/service is developed and ready to launch. Awareness of costs rises together with development of Business idea. It is only logical, because the more realistic the idea is, the more realistic necessary costs are. Time factor plays the role also. Exactness of defining Cost Structure rises with duration of startup. In general we can say that concreteness or accuracy rises along with tangibility of startup.

In overall percentage share of cost items we can see that the biggest share have costs related to Payroll (45%). Services and Others have radically smaller share, 14% and 13%. All kind of materials are at the third place with 11%. This is also headed to problem with product/service costs. If startup is hardware oriented material is one of the greater parts of all costs. Payroll has such a big share because people are important in every kind of startup. Payroll is the most important and has the biggest share in all stages of Business model development. The importance of the Payroll we can link with strong feelings about importance of startup team. Founders said that team is very important for success and they always try to get best team members. Such a big share of Payroll is also linked with software focusing. In these cases, startup does not need specific material or devices. They need great people, as factor of their success.

Along with higher Business model Development, share of Others cost decreases. We can assume that some activities are not necessary anymore and some are included into internal team. Also Share of item Material decreases with rising of Business model Development. As respondents said, they still need Material, but the already have more effective processes. So they can work better with stocks and they build better position towards suppliers.

Awareness of costs rises together with development of Business idea. It is only logical, because the more realistic the idea is, the more realistic necessary costs are. Time factor plays the role too. Exactness of defining Cost Structure rises with duration of startup. In general we can say that concreteness or accuracy in costs rises along with tangibility of startup.

## References

- Afuah, A. (2014). *Business Model Innovation*. New York: Taylor and Francis.
- Blank, S. (May 2013). *Harvard Business Review*. Cit. 7. December 2015. Dostupné na Internetu: Why Lean startup changes everything?: <https://hbr.org/2013/05/why-the-lean-start-up-changes-everything>
- Blank, S. (2012). *Startup Owners Manual*. Pescadero: KS Ranch, Inc.
- Ghezzi, A., Cortimiglia, M., Frank, A., 2015. Strategy and business model design in dynamic telecommunications industries: A study on Italian mobile network operators. *Technological Forecasting & Social Change* 90, 346-354.
- Kesting, P., Günzel-Jensen, F., 2015. SMEs and new ventures need business model sophistication. *Business Horizon* 58, 285-293.
- Maurya, A. (2012). *Running Lean (Second Edition. vyd.)*. Sebastopol: O'Reilly Media, Inc.
- Magretta, J., 2002. Why Business Models Matter. *Harvard Business Review* 80, 86-92.
- Osterwalder, A. , (2009). *Business Model Generation*. Self Published.
- Pozin, I. (29. August 2016). This is the real cost of building a startup. Cit. 10. January 2017. Dostupné na Internetu: Inc.com: <http://www.inc.com/ilya-pozin/this-is-the-real-cost-of-building-a-startup.html>
- Ries, E. (2010). *startuplessonlearned.com*. Cit. 4. December 2016. Dostupné na Internetu: What is startup?: <http://www.startuplessonslearned.com/2010/06/what-is-startup.html>
- Ries, E. (2011). *The lean startup : how today entrepreneurs use continuous innovation to create radically successful business*. New York.

Thanedar, N. (2012). Are You Building A Small Business or Startup? Cit. 5. November 2016. Dostupné na Internete: Forbes: <http://www.forbes.com/sites/theyec/2012/08/15/are-you-building-a-small-business-or-a-startup>

Teece, D., 2010. Business Models, Business Strategy and Innovation. Long Range Planning 43, 172-194. Pereira, B., Caetano, M., 2015. A conceptual business model framework applied to air transport. Journal of Air Transport Management 44-45, 70-76.

### **Contact information**

Ing. Ráchel Hagarová

University of Economics in Bratislava, Faculty of Business Management

Dolnozemska cesta 1, 852 35 Bratislava

+421 2 6729 5111

rachel.matuskova@gmail.com

# PERSPECTIVES AND DEVELOPMENT OF THE TOURISM SERVICE IN AZERBAIJAN

*Sabuhi Hasanov*

## **Abstract**

The aim of the study is to examine the level of tourism sector in Azerbaijan, its' present situation and the problems in this area, to determine development tendencies and perspectives. Analyzes were made on statistical indicators. The economic development of Azerbaijan, its current status and role of the service sector in economic development were noted in the article. The researches of the researchers have been analyzed and the approaches that can contribute to the development of the service sector in Azerbaijan have been evaluated.

**Keywords:** *service sector, tourism business, tourism services, services market, aspects of the oil sector, services economy, basic indicators of tourism facilities.*

## **1 INTRODUCTION**

Service sector in the country, especially current state of tourism, its analysis and characteristics of formation are observed in the article. The article firstly focuses on the importance of the service sector in the country's economy, and then the requirement of the development for this area as it is one of the major constituent elements of the non-oil sector. The author examines the ways and means of identifying possible directions to address the problems existing in the sector of tourism services and ensure the development of this field.

At the current level of development of the economy, the service sector is one of the areas distinguished by its characterization. The service (in English "service" was the word) – is the outcome of the purposeful and efficient activity aimed to meet the needs of people. The increase in the people's demands and complexity of modern manufacturing processes affect the service sector. As a result of this, the demand for services is increasing. Services also have a special role in the world economy. Placement of more than 40% of foreign direct investments in this field reflects the prestige of the service sector in the world economy. In developed countries, the share of services in GDP is more than 70%. Currently the number of employees in the service sector is increasing day by day, and thus 85% of the growth of new jobs, on average, falls to the share of the service sector (Alirzayev A.Q., Aslanova S. Socio-economic problems of tourism development. Look. 2006) .When analysing economic processes demographic factors, natural environment, political, legal, cultural and environmental impact, technological progress and economic factors can be noted as factors that influence the development of the service sector. The service sector covers education services, transport services, financial services, health and social services, tourism services, and etc. With the development of society, there is an increase in its spiritual and recreational needs. Certain part of meeting these needs accounts for the tourism industry and economy spheres being its component. The tourism industry, which provides for 33% of today's services market, more than 10% of consumer expenditures, and encompasses up to 10% of the employed population has been introduced to compete with the oil industry and mechanical engineering industries, which are the leading sectors in the world economic system. According to the World Tourism Organization prediction, the number of tourists traveling each year is increasing by 4.1% annually and will reach 1.6 billion in 2020(Alirzayev A.Q. Tourism economics and management. Look. 2011.). The above-mentioned shows that the role of tourism in the world is increasing and will increase even more in the near future. This factor can be analyzed so that the organization of tourism in the country and increasing its role in the national economy should be an incentive for the activities to be undertaken in this direction. The aim of the study is to examine the level of the tourism sector and determining development tendencies and perspectives of tourism services in Azerbaijan.



## 2 DEVELOPMENT OF THE TOURISM SERVICE IN AZERBAIJAN

The development of the oil and gas sector has served as a driving force in the development of other sectors of the economy. In 1999, under the Decree signed by the national leader Heydar Aliyev the State Oil Fund was established to ensure efficient management of the funds received from the sale of oil obtained as a result of the joint development of oil fields with the foreign companies, and direct these funds to the development of priority sectors of the economy and the implementation of projects of particular importance (Alirzayev A.Q. Tourism economics and management. Look. 2011). Just as in all areas, as a result of the sound economic policy on the use of the Fund's assets the foundation of the sustainable economic development was laid. As a result, reforms started to be implemented in all sectors of the national economy and serious steps have been taken in order to improve the quality of life of the population. It can be noted as one of the areas in the service sector. Moreover, the Law on "Tourism" adopted in 1999 based on the Decree by the national leader, and the "Tourism Development Program for 2002-2005" certified in 2002 gave an impetus to the development of the tourism sector in the country in following years (The state program for the development of tourism in the Republic of Azerbaijan between 2002 and 2005. Azerbaijan. 2002). As a result, favourable conditions for the development of tourism were created and foundation of the country's integration into the international tourism market was laid. The rapid socio-economic progress achieved in recent years has opened up new opportunities for the comprehensive development of this field. It is no coincidence that, despite the fact that in 2002 tourists coming to our country afforded its economy income of 432 million manats, in 2014 this figure rose to 1 billion 122 million manats. The country's strong potential in the sphere of tourism creates favourable conditions for partnerships with international organizations aimed at the development of this sector. It is worth noting such organizations as the Commonwealth of Independent States (CIS), the World Tourism Organization (WTO), the Organization of Islamic Conference (OIC), GUAM and others (Alirzayev A.Q. Tourism economics and management. 2011).

It should be noted that President Ilham Aliyev, the worthy successor of the political course of the great leader Heydar Aliyev, always pays attention to the development of tourism as one of the priority directions.

Declaring 2011 the "Year of Tourism" in his closing speech at a meeting of the Cabinet of Ministers on the results of socioeconomic development of 2010 and upcoming challenges in 2011, President Ilham Aliyev said: "This year, 5 five-star hotels will be opened in Baku. I actually think that this is probably unique for the whole world. Over the course of one year, 5 five-star hotels will be opened in one city, in Baku. At the same time, three- and four- star hotels are under construction in Baku. A lot is being done in the region to develop the hotel business, tourism development in Azerbaijan is already a reality. To create this infrastructure, of course, the state requires significant resources. They are channelled into infrastructure issues. Hotels are being built by the private sector. This means that the level of confidence in Azerbaijan's development is so high that people can invest millions, hundreds of millions here. Investors are sure that these funds will pay off. Meanwhile, our city is improving and modernizing. Creation of good conditions for those coming to Baku is, of course, an important issue."

A special attention is paid to the development of the service sector, which is one of the main elements of the national economy of the country. While researching the development of the service sector, it should be noted that the major strategic task of the service sector enterprises in the conditions of formation and development of market relations is to ensure economic stability in the market. In 2014, the share of service sector in GDP structure was as follows (Figure 1):

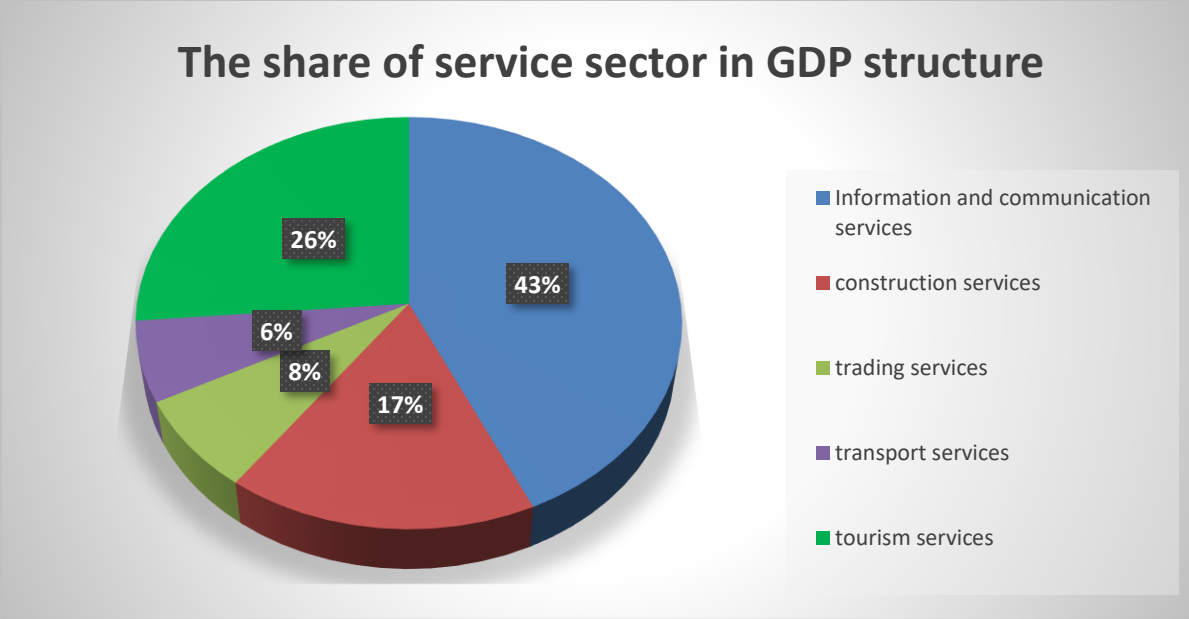


Figure 1 – The share of service sector in GDP structure. Source: Azerbaijan Republic State Statistics Committee 2015.

Being an important part of the economy tourism plays a crucial role in the economy of many countries. Tourism service is one of the main components of the world economy. It is a high-speed economic development in this field gives an impetus to invest large-scale revenues of the countries to the development of other sectors of the economy (Mammadov C.A, Soltanova H.B., Rahimov S.H. International tourism geography. 2012.). That is why the scale of the tourism industry in the world economy is expanding year by year. Tourism, for a long time, encompasses not only Europe, but also the North and South America, Africa, Asia, Australia and Oceania. Though exchange of tourists is mainly realised between the neighbouring countries, the number of tourists wishing to travel for long-distance regions, get acquainted with the lifestyles, cultures and traditions of the people living in these countries is gradually increasing.

Location of Azerbaijan in East-West and North-South transport hubs, as well as the country's favourable geographical situation between Europe and Asia, objectively, make it play the role of an economic and geopolitical bridge and create conditions for the country's active participation in international transit (Mammadov C.A, Soltanova H.B., Rahimov S.H. International tourism geography. 2012.). It in return creates an incentive to take more serious measures for the rapid development of the tourism sector, which is one of the major and leading non-oil sectors, and for the optimal use of the country's tourism potential as well.

The main economic objective of Azerbaijan is to ensure maximum living standards and security through the comprehensive and effective use of the country's economic potential. Study of the current state of tourism, which is one of the main components of the economic development strategy and strategic planning, as well as determination of aims in this area and mechanisms of regulation can be regarded as one of the primary objectives of the state. The availability of important and perspective opportunities for the development of tourism in Azerbaijan will stimulate the attention paid to this area.

While assessing the current state of tourism service it is advisable to pay attention to and consider the number of tourism enterprises operating in the country, as well as the number of employees working in these enterprises, shipping forms sold to the population and the number of tourists. In addition, it is necessary to evaluate the statistics of the income gained by the tourism enterprises, the cost of shipping forms sold to the population and expenditures incurred in connection with the tourism activity.

Table 1 Key indicators of tourism enterprises. Source: Azerbaijan Republic State Statistics Committee 2015.

	2009	2010	2011	2012	2013	2014
The number of enterprises	124	126	141	170	197	218
Number of employees (not including substitutes), one person	1393	1418	1541	1730	1729	1 794
Income gained by enterprises, a thousand manat	17839,6	19065,3	22634,8	27121,5	29600,9	31 107,1
Production costs of the product (service), a thousand manat	16907,9	17811,3	20662,1	23540,8	25292,5	27 018,1
The number of shipping forms of tourism sold to the population, one piece	28509	34121	42583	62866	65448	66 233
The cost of shipping forms sold to the population, a thousand manat	15071,7	25848,7	29316,6	40693,2	42892,3	44 820,3
The number tourists received and sent, one person	59700	69923	83620	101431	91 961	92 305

The statistical analysis shows that in recent years only growing dynamics has been observed both in the number of enterprises and employees operating in the field of tourism, as well as in the revenues from the tourism sector, and in the number of tourists received and sent.

During 2011-2014, the number of accommodation facilities in the country increased to 527 from 508. Since 2011 the number of accommodation facilities, places and numbers, the number of persons and workers, as well as income from the businesses have increased. For comparison, we may note that statistics for the current year demonstrates increase of 6% in the number of seats in accommodation facilities, 7% in the number of rooms, and 5.8% in the number of employees.

According to the estimates of the World Travel and Tourism Council (WTTC), the direct share of tourism in GDP for the current year was 1.3 billion AZN, and the gross weight was 4.9 billion AZN, that is 2.4% and 8.8%, respectively. As informed by the WTTC, the domestic tourism expenditures has increased by 21% to 1.7 billion AZN, and equity capital invested in tourism has increased by 20% to 360 million AZN.

As for the number of persons placed in hotels and hotel-type facilities and nights spent there, there has been an increase both in the number of individuals placed and both nights spent in such facilities. We would like to inform you that 80% of persons placed across the country accounts for those arrived with the purpose of tourism.

However, it should be noted that during the period of 2008-2014 in Azerbaijan, the overwhelming majority of foreign citizens who prefer to stay in hotels and similar establishments were from the United Kingdom, Turkey, Russia and Iran. It is not surprising that over these years among foreign citizens coming to Azerbaijan from these countries business travellers have been prevailing. If we take for example the calendar year 2014, we can see that the number of business travellers only from these 4 countries makes up 25% of the total number of business tourists. The vast majority of foreign tourists, who visited our country, as in previous years, were from Russia, Georgia and Turkey (Figure 2).

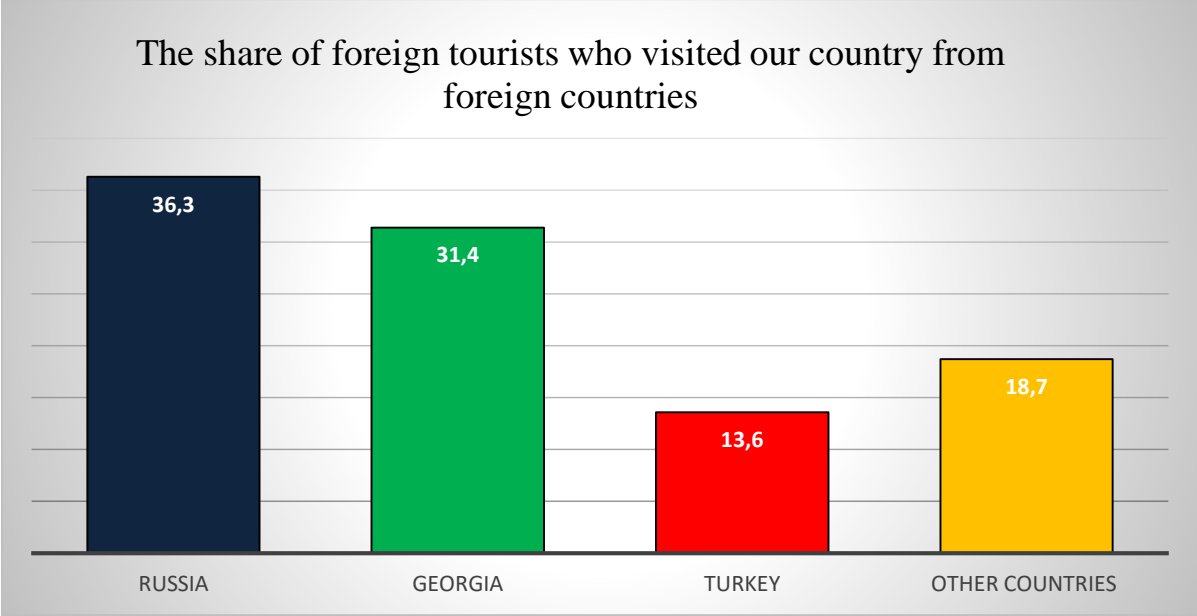


Figure 2 – The share of foreign tourists who visited our country from foreign countries. Source: UNECE Statistical Database 2015.

Compared to the last year, there has been an increase in the number of visitors from France, Spain, Italy, Norway, Greece, Croatia, Great Britain, Germany, Belgium and some other countries of Europe and the world.

Table 2. The classification of the tourism purposes of foreign citizens of the country. Source: Azerbaijan Republic State Statistics Committee 2015.

	2005		2012		2013		2014	
	thousands of people	%	thousands of people	%	thousands of people	%	thousands of people	%
The total number of tourist arrivals to the country for foreign nationals	692,7	100	1985,9	100	2129,5	100	2159,7	100
Leisure, entertainment, tourism	404,5	58	687,8	35	705,2	33	709,9	33
Business tourism	261,8	38	595,3	30	648,9	30	670,5	31
Medical tourism	7,6	1	43,0	1	46,2	1	46,3	1
Religious tourism	4,2	1	13,2	1	13,7	1	13,7	1

### 3 METHODS

The analyses in this review paper are prepared by the statistics of Azerbaijan State Statistics Committee and United Nations Economic Commission for Europe. Some researchers' important studies with regard to the tourism sector in Azerbaijan have been examined comparatively. The positive and negative effects of these investigations on Azerbaijan were evaluated.

The study based on the years between 2009 and 2014 to examine key indicators of tourism enterprises in the selected country. Considering the factors that are related with the classification of the share of foreign tourists who visited Azerbaijan from foreign countries, the paper investigates the years between 2005 and 2014. On the other hand, the study takes into the consideration of the year 2015 to analyze the share of foreign tourists who visited our country from foreign countries.

### 4 RESULT

Development of tourism services and increase of its role in the national economy characterize the development in the following fields:

1. Development of entrepreneurship in this area;
2. Financial resources being formed in the regions, creation of new jobs;

3. Formation of the first manufacturing and service sector, which is necessary for tourism and business activity; development of production and infrastructure in a competitive atmosphere.

The development of tourism services and the promotion of the Republic of Azerbaijan as the tourism country should be one of the key tasks of the state economic policy.

## 5 CONCLUSION

On the other hand, there is quite a number of the problems existing in the in the field of tourism services. The respective development of the current state in the field of tourism in the country compared to other years justifies the state policy implemented in this direction. However, non-achievement of tourism to the desired level resulted in outflowing of the majority of citizens to neighbouring countries. In this regard, it is obvious that satisfaction of domestic needs would be a multiplier in the development of tourism in the country. For this, the tourism would be better to be directed to the following areas:

1. Determination of objectives in order to achieve the intended level;
2. Study of problems and shortcomings existing in this field;
3. Determination of optimal and efficient management methods in order to remove problems;
4. Creation of a perfect infrastructure system for tourism development;
5. Exact determination of the country's tourism potential; conducting large-scale researches with the purpose of ensuring full and effective use of this potential; working-out science-based recommendations for the development of tourism services in the country;
6. Creation of favourable environment for tourism enterprises and realization of possible benefits in financial transactions;
7. Increasing the state's role in the regulation of prices, and etc.

## References

- Statistical indicators of Azerbaijan. (2015). Statistical Committee of the Republic of Azerbaijan. Bak.2015. 811 p.
- The state program for the development of tourism in the Republic of Azerbaijan between 2002 and 2005. Azerbaijan. 2002, August 27
- Mammadov, C. A, Soltanova H.B., & Rahimov S.H. (2012) International tourism geography.. Mutarcim.
- Alirzayev, A.Q. (2011) Tourism economics and management. Baku. Iqtisad Universiteti.
- Alirzayev, A.Q., & Aslanova S. (2006) Socio-economic problems of tourism development. Look.. Adiloghlu.
- UNECE Statistical Database (2014).
- Osman, N. A. & Elchin, S. (2010). Azerbaijan economy. Baku,. “Şərq-Qərb”
- Brown, D. & Stern, R.M. (2000) Measurement and Modeling of the Economic Effects of Trade and Investment Barriers in Services. Discussion paper 2000-01, Tufts University.
- Buera, F.J.; Kaboski J.P. (2009) The Rise of the Service Economy. National Bureau of Economic Research Working Paper # 14822. Available at [www.nber.org/papers/w14822](http://www.nber.org/papers/w14822).
- Cimoli, M.; Dosi, G.; Stiglitz, J.E. (2009) The Political Economy of Capabilities Accumulation: the Past and Future of Policies for Industrial Development. Oxford University Press.

McLachlan, R.; Clark C. & Monday I. (2002). Australia's Service Sector: A Study in Diversity. Productivity Commission Staff Research Paper, AusInfo, Canberra.

**Contact information**

Sabuhi Hasanov, Ph.D.

Baku Business University, Economy and management Faculty

Address: Azerbaijan, Baku. Sahil, V.Alakbarov 5A

Telephone number: +420776644862

E-mail: Sebuhi.hesenov.1991@mail.ru

# INTRODUCTION TO MARKETING METRICS AND CHARACTERISTICS OF SELECTED ONLINE MARKETING METRICS

*Vladimír Hojdík*

## **Abstract**

This article is focused on introduction of marketing metrics. It explains the concept of marketing metrics and describes some of the fundamental marketing metrics, which help to quantify the effectiveness of company's web advertising and marketing communication. The aim of this work is to introduce a reader into a problematics of marketing metrics, offer methods those can help marketers evaluate the performance of marketing activities and describe basic online metrics. It should also underline the need for quantification of advertising and marketing effectiveness in the company.

**Keywords:** *marketing metrics, marketing efficiency, web metrics, online metrics, advertising*

*JEL classification: M31, M37*

## **1 INTRODUCTION**

Innovative trends in the business environment are forcing marketing experts to quantify the marketing opportunities and competitive threats. There is a growing need for evaluation of plans and results, interpretation of different variables assessing the effectiveness of marketing activities, identification of crucial data for improvement – and all that based on calculations. For companies, it is therefore important to implement systems for the acquisition and subsequent evaluation of the relevant data for the marketing department – in other words, marketing metrics. The aim of this paper is to explain the issue of marketing and web metrics, and also highlight the importance of marketing metrics as an necessary aspect of the marketing effectiveness evaluation in the enterprise.

## **2 THE NEED FOR QUANTIFICATION OF ACTIVITIES EFFICIENCY**

Despite its undeniable importance, marketing remains one of the least measurable areas within the company. Nowadays, most businesses are aware of marketing metrics importance and their possible benefits, but still have a problem to implement them efficiently. A survey in 2010 on a sample of 400 companies proved that only 25% of companies had successfully implemented marketing metrics (Best, 2012). Considering the fact that marketing costs represent a significant part of total business expenditures, it is necessary for managers to assess how effectively they are spent for their intended purpose. However, many managers and directors are lacking deeper knowledge to evaluate the effectiveness of marketing activities.

In the context of these claims we may conclude that a number of decisions in marketing are made without a information and data analysis, or even without analysing target groups feedback. In today's highly competitive market, company should be much more concentrated about "hard" – quantitative approach, because "soft" skills such as intuition and creativity are no longer sufficient. Company should therefore focus on calculations and measurements. Managers then must find answer for two important questions – what to measure and how to measure. As a solution of these questions, the company may use marketing metrics that allow to measure the impact of marketing campaigns on corporate results.

It is therefore essential to quantify that impact, but it is not the only important thing. If company implements the system of marketing metrics and evaluates the results, it is crucial to identify links and connections between metrics and analyse them as a complex, not as isolated numbers. Only after such a complex analysis managers can reveal, what is the final impact on the financial results of company.



### 3 MARKETING MATRICS

Generally, a term metric represents a tool of measurement that determines the current condition, direction or trend. Metrics are broadly used in wide spectrum of disciplines and they allow us to identify the causes, explain the trends and also predict future results. Moreover, they allow to analyse problem from an objective point of view and also enable to understand the essence of the problem (Metrics, 2015).

Recently, marketers have found themselves under the pressure to use the marketing metrics. That pressure comes from managers who want marketers to demonstrate marketing benefits on the company's financial results (Bolton, 2004).

Marketing was once considered more an art rather than a science, but it is not the case anymore. Marketers need to review their activities in quantitative terms. They must be able to measure the potential new opportunities, and also need to know how to quantify the necessary investments to achieve them. They should also master how to determine the value of products, customers and distribution channels – and all of these in an environment of changing prices and market conditions. There is as well an increasing need to capture the impact of marketing decisions on the company's financial results.

Marketers have been for a long time in difficult situation because financial managers used to ignore their requirements. Not every time marketers were able to quantify the level of efficiency funds were spent. In addition, financial budget for marketing activities was often a matter of very rough estimates, intuition and creativity. But these times – times of inaccurate and loose marketing budgets are over and marketers have to face new challenges – measurability and traceability (Brady, 2004).

Forcing marketing managers to use a scientific approach is definitely a major challenge. This is due to the complexity of the business environment. Some metrics are too complex and difficult to quantify. On the contrary, some are highly specialized and can be used only in specific conditions. Next, many metrics use data that are not exact, are incomplete or unavailable. Under such conditions, none of the metrics can be considered as perfect. It is therefore necessary for marketers to work with a portfolio of multiple metrics and look at results from several points of view. It is important to find the links between marketing activities, marketing metrics and business performance (Abela, 2007).

#### **3.1 Marketing metrics categories (chapters 3.1, 3.2, 3.3, 3.4, 3.5 and 3.6 composed in accordance with Farris et al., 2010)**

Marketing metrics represent a complex system of indicators and there is a multitude of them. Farris, Bendle and Pfeifer (2010) created a complex system of marketing metrics, and divided them into groups according to the area they are related, as shown in the following table.

Tab. 1 – Marketing metrics distribution according to analyzed area. Source: Farris, 2010

Analyzed area	Activities of research
Market	customers perception, market share, measure of competitiveness
Profits and margins	total revenues, structure of corporate costs, rentability
Product & Product portfolio	product strategy, brand awareness,
Customers	customers lifetime value, aquisition costs,
Sales & Distribution	sales organization, distribution network, logistics
Pricing strategy	price sensitivity, price optimization
Promotion	discounts, rabats, customers benefits
Advertising	advertising efficiency, reach, advertising impressions, marketing campaigns evaluation
Marketing & finance	financial indicators, ROS, ROI, EVA, ROMI (rentability on marketing investments)

### 3.2 Characteristics of selected web metrics

Marketing communication has big impact on corporate financial results. Extremely important part of marketing strategy is also the quality of corporate website, especially for companies those businesses are closely related with their websites (for example e-shops). It is very important for marketers to know, how efficiently its website operates and how customers perceive this website. That is why company should focus on measuring so-called web traffic of company and analysing all available data.

The Internet provides much better availability of data about advertising and campaigns. Based on that, metrics measuring Internet advertising are likely to use data that are more easily obtainable than data from conventional channels.

It may prove difficult to assess the effectiveness of some marketing activities since it is difficult to capture the impact of marketing decisions and advertising campaigns on business revenue. But metrics, if interpreted correctly, may lead to increased efficiency of allocated financial resources. The Internet gives opportunities to get more information about customers – how they move through the system and how they behave in different stages of purchase process.

For companies using a combination of online and offline marketing campaigns, it will be more difficult to distinguish the cause and effect relationships between advertising and sales from both online and offline sources.

### 3.3 Impressions, Pageviews, Hits

Impressions represent the number of opportunities to see an advertisement. This metric is then called advertising impressions but also opportunities to see (OTS). It is the number of times the ad was viewed by potential customers. The impression arises every time an advert has been seen – we calculate total number of impressions by multiplying the reach (number of people in audience who saw an advert, may be expressed as a number or also percentually) and frequency (number of views of one person). This metric is relevant not only for online campaigns but also for classic advertisements.

Impressions = Reach \* Frequency

Other important term is pageviews. Marketers monitor pageviews in order to be able to quantify the traffic a website generates. Finally, pageviews is the number of times a specific web page is accessed by users.

A count of the number of files served to visitors on the website is called hits. Because web page usually contains multitude of files, number of hits depends on number of page visits and also on number of files on each page. The number of hits may be calculated according following formula:

Hits = Pageviews \* Files on the Page.

Pageviews can be easily calculated by dividing total hits by the numbers of files on the web page:

Pageviews = Hits / Files on the Page.

All of above mentioned metrics quantify advertisement impressions (opportunities to see), but they do not take into consideration the number of ads actually seen or quality of these impressions. Impressions, pageviews and also hits do not account for following aspects:

whether the message of advertisement appeared to a relevant and defined audience,

whether the people to whom the pages were shown actually looked at them,

whether those who actually looked at the pages had any recall of content, or advertising messages they contained at the end of the campaign.

Although using the term impression, we have to take in account that this metric does not tell anything about the quality of advertisement and its impact on potential customers. Marketers are never sure what effect impressions and also pageviews have on users. Pageviews results are very often made up of data that include duplicate showings to the same user. Based on this, opportunities to see may be delivered to the same viewer not only once, but on multiple occasions.

### **3.4 Gross rating points of campaign**

Gross rating points (GRP) represent a metric that can be efficiently used both in online and also offline marketing campaigns. Gross rating points of advertisement is another metric which calculation is based on reach. In this case reach will be used as a percentage. Rating points are calculated as number of individuals reached by campaign divided by total number of people in defined population. Result of this calculation represents rating points of advertisement. The rating points of all ads may be summed, thus yielding the aggregate reach of the campaign known as gross rating points, as shown in following example.

A company created and placed 10 advertising insertions while estimating 5 people as a population. Following table outlines the way of calculation of gross rating points of marketing campaign. In this table, “1” represents an opportunity to see, “0” means that impression was not delivered to the individual.

Tab. 2 – Gross Rating Points calculation of marketing campaign. Source: Farris, 2010

Ad	Individual					Impressions	Gross Rating Points (%)
	A	B	C	D	E		
1	1	1	0	0	1	3	60
2	1	1	0	0	1	3	60
3	1	1	0	1	0	3	60
4	1	1	0	1	0	3	60
5	1	1	0	1	0	3	60
6	1	0	0	1	0	2	40
7	1	0	0	1	0	2	40
8	1	0	0	0	0	1	20
9	1	0	0	0	0	1	20
10	1	0	0	0	0	1	20
Total	10	5	0	5	2	22	440

Advertisement 1 generated impressions among three people from five members of population. Rating points of this ad is thus  $3/5 * 100\% = 60\%$ . Similarly, rating points of advertisement 6 is  $2/5 * 100\% = 40\%$ . Finally, we may sum up rating points of each advertisement to get GRP for the campaign. Other way for defining GRP of the campaign is a using of following relation:

Gross rating points = Total number of impressions / Population \* 100%

Total number of impressions of this campaign equals 22 and population has 5 members. In this case, calculation of GRP of marketing campaign is  $22/5 * 100\% = 440$ .

### 3.5 Clickthrough rates

Nowadays, most of internet companies use metrics based on clickthroughs. Clickthrough rate is the percentage of impressions which lead users to click on the advertisement link. Even though this metric provides useful information for marketers, it is not the crucial one since it does not inform if a user actually buys a product.

Clickthrough rate (%) = Clickthroughs/Impressions

Clickthroughs help marketers to capture response of customers to websites. Clickthrough rate measures the number of users who initiated action related to an advertisement that redirected them to another page where they may buy an item or get additional information about products or services.

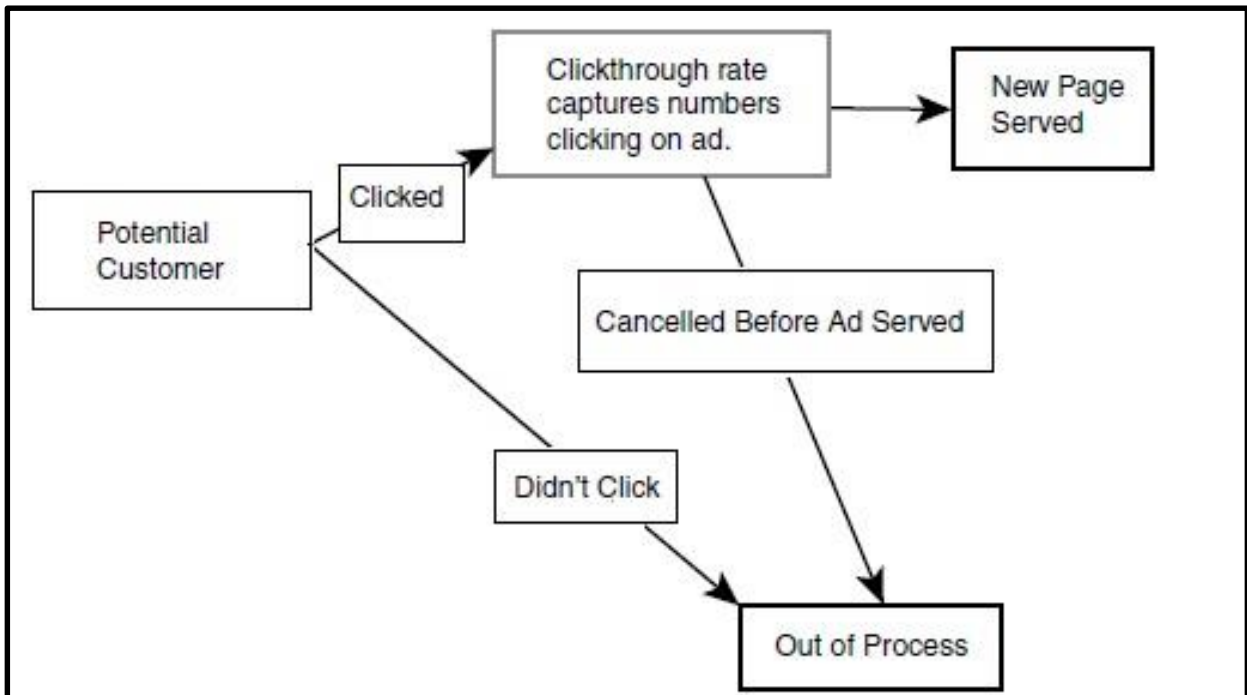


Figure 1 – Clickthrough process. Source: Farris, 2010

Example: A corporate website serves up completely 500 000 impressions. There were totally 5 000 clicks on this website. Calculation of clickthrough rate will be as follows:  $5\,000/500\,000 = 1\%$ . Clickthrough rate from this example equals 1%.

Clicks are the number of times there was an interaction with advertisement. It is not the number of customers who clicked on this advertisement. An individual visitor of website may click on an advertisement more than once. Not all websites are able to control the number of times an advertisement was shown to the same customer. This means that most websites can count only the number of times the advertisement was clicked, not the number of individual visitors who clicked an the ad.

### 3.6 Cost per Impression, Cost per Click, Cost per Order

Cost per impression, cost per click as well as cost per order are measuring the cost efficiency of Internet based campaigns. Each of these metrics has some benefits, but it depends on perspective with which they are used. Cost per impression is calculated according a following relation:

Cost per impression = Costs of advertising / Number of Impressions

Cost per impression is a cost to offer potential customers one impression, or opportunity to see an advertisement. Cost per click represent how much funds company spent to get a click on the advertisement. This means that cost per click is more important and also more accurate indicator about efficiency of marketing campaign, because clicks enable measuring attention and interest of users. If the priority of campaign is to get as many clicks as possible, then cost per click will be preferred metric. Cost per click can be defined with the help of following formula:

Cost per Click = Costs od advertising / Number of Clicks

Cost per order express show expensive for company it was to acquire an order. If the main goal of advertisement is to maximize sales, then this will be the metric preferred by company.

Calculation of cost per order is following:

Cost per Order = Cost of advertising / Total Orders Generated

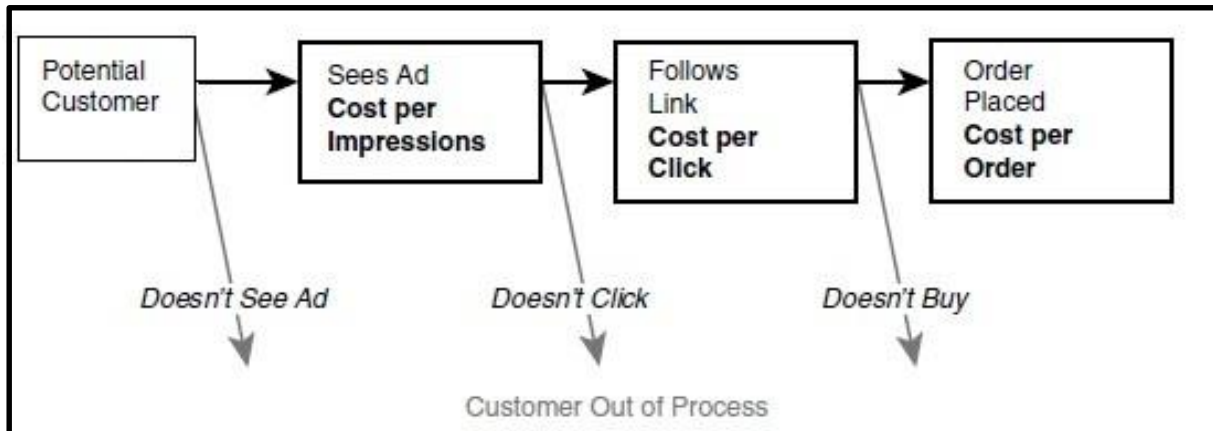


Figure 2 – Process of acquiring an order. Source: Farris, 2010

Example: Company sells its products on their Internet website. This company spent totally 48 000 € on online advertising. This online campaign generated 2,4 million impressions and that helped to generate 40 000 clickthroughs. From total number of clickthroughs, 10% resulted in a purchase of product.

Cost per impression = 48 000 € / 1 200 000 = 0,02 €

Company had to spend 2 cents to generate one opportunity to see – or in other words one impression.

Cost per click = 48 000 € / 40 000 = 1,20 €

For generating one click on advertisement, company spent 1,20 €.

Cost per Order = 48 000 € / (40 000\*10%) = 12,00 €

At first, total number of orders needs to be calculated. As 10% of clickthroughs resulted in purchase, it means the number of orders (or purchases) is 40 000\*10% = 4 000. Thus, cost per order (or cost per purchase) for company equals 12 €.

## 4 SUMMARY

The issue of marketing metrics still represents largely unexplored area. This paper informs the reader about options how to measure advertising efficiency or marketing communication performance for certain types of advertising. A detailed analysis of all known marketing metrics is beyond the scope of this work, but this brief introduction to this topic should encourage marketers to increase their interest in exploring the effectiveness of marketing activities. Proper evaluation of calculations related to efficiency of campaigns can save a lot of company's funds, and may also help to allocate corporate finances even better.

### Acknowledgement

This paper is part of research project VEGA no. 1/0546/15 Evaluation of modern marketing approaches performance (from the original Hodnotenie výkonnosti moderných marketingových prístupov a ich dosah na výkonnosť podniku).

## References

- Abela, A. & O'Sullivan, D. (2007). Marketing Performance Measurement Ability and Firm Performance. In : Journal of Marketing, vol. 71, no. 4, s. 79-93 <[https://www.researchgate.net/publication/228247724\\_Marketing\\_Performance\\_Measurement\\_Ability\\_and\\_Firm\\_Performance](https://www.researchgate.net/publication/228247724_Marketing_Performance_Measurement_Ability_and_Firm_Performance)> [accessed 31.10.2016].
- Best, R. (2012). Getting Started Using Marketing Metrics. <<http://www.marketingmetricssolutions.com/pdf/MMH%20-%20WP%20Final%20RB.pdf>> [accessed 30.10.2016].
- Bolton, R. (2004). Linking Marketing to Financial Performance and Firm Value, In Journal of Marketing, vol. 68, no. 10, s. 73-75. <<https://archive.ama.org/archive/ResourceLibrary/JournalofMarketing/Pages/2004/68/4/14342453.aspx>> [accessed 27.10.2016].
- Brady, D. (2004). Making Marketing Measure Up. <<http://www.bloomberg.com/news/articles/2004-12-12/making-marketing-measure-up>> [accessed 25.10.2016].
- Farris, P. & Bendle, N. – Pfeifer, P. (2010). Marketing Metrics. The Definitive Guide to Measuring Marketing performance: Pearson Education Inc., 2010. ISBN-10: 0-13-705829-2
- Marketing Performance Measurement. Target Areas Where Marketers Want To Improve How They Measure Up. (2008). <<http://www.vigilmetrics.com/Resources/Articles/buyline-marketing-automation-performance-measurement.pdf>> [accessed 24.10.2016].
- Metriky (Metrics). (2015) <<https://managementmania.com/cs/metriky>> [accessed 28.10.2016].
- Miller, J. (2011). Definitive Guide to Marketing Metrics and Analytics. <<http://www.surrey.ac.uk/Training/documents/definitive-guide-to-marketing-metrics-marketing-analytics.pdf>> [accessed 21.10.2016].

## Contact information

Ing. Vladimír Hojdík

University of Economics in Bratislava, Faculty of Business Management

Department of Business Economy

Dolnozemska cesta 1/b

852 35 Bratislava

Slovenská republika

Telephone number: +421 918 638 894

Email: [vladimir.hojdik@euba.sk](mailto:vladimir.hojdik@euba.sk)

# COMPARISON OF THE SMART CITIES IN THE CZECH REPUBLIC AND FOREIGN COUNTRIES

*Iva Honzková*

## **Abstract**

Cities play a major role in the social and economic aspects of our lives and have a huge impact on the environment. Over the last 35 years there has been a worldwide increase in population by about 60 % and more and research shows that this trend will continue. More and more people are therefore moving to urban settlements mainly due to offer the jobs. SMART city is trying to find a concept that ensures sustainable model of development, quality of life, public safety and energy efficiency. This article focuses mainly on comparison of the smart cities in the Czech Republic and foreign countries deploying clever parking, traffic optimization, and systems that are beneficial for maintaining the transport infrastructure to the satisfaction of all residents. Using comparative analysis is processed compared the concept of SMART cities in the Czech Republic and abroad in order to obtain an objective comparison creation, approval and implementation of the strategy on a sample of selected countries to create a design concept of SMART city in the Czech Republic. Compare analysis shows that the feature of SMART cities in the Czech Republic is strongly connected with the government. It was proved that the mobility ranking is really important for the concept of SMART cities in future. In comparison with the other European countries, is the Czech Republic in the implementation of SMART cities rookie.

**Keywords:** *SMART city, transport, mobility, public transport, urban mobility, Czech Republic*

## **1 INTRODUCTION**

Since 2008, over the half of the world's population live in cities. UN predicts that the trend of population will grow to 70 % by 2050. The SMART cities are necessity if the human civilization want to effectively respond to the critical challenges. Cities are increasingly forced to work better, but at a lower cost, compete in a globally networked economy and ensuring the environment of their citizens by truly sustainable way. In short, these cities must be intelligent. (Townsend, 2014) SMART City is a tool for change of thinking that builds on the concepts of economic sharing. Economy sharing is a concept of social change 21st century man who does not need to own things daily consumption is due to the existing range of different communication tools able to use common products. This concept includes schemes in the field of transport. For example, sharing vehicles, bicycles, public transport in the area of energy, such as the concepts of shared production of electricity from public space, such as sharing investments and activities in joint projects in the field of social. For example, sharing living space, catering etc. (Townsend, 2014)

Modern and SMART cities are becoming an important topic not only on European soil. Centralization of population in large cities and growing agglomeration of European capitals actually causes the problems, which are hundreds of years ago, when this city was created, not count. There are no traffic jams in SMART cities and the people are happier because they know what is happening around them and will happen because they breathe fresher air and also because the life in a city is safe. Such a condition leads a relatively long road that is paved with billions in investments and especially generational change in the mindset of local politicians and citizens themselves.

SMART cities can be identified along six main axes of dimensions: a SMART economy, a SMART environment, SMART mobility, SMART people, SMART living, and SMART governance. (SMART City, 2016) There are views on the concept of a SMART city as diverse as the authors' fields of expertise. Tranos and Gertner (2012) portrayed a SMART city as a combination of sensor networks. Shapiro (2006) referred to a SMART city as an improvement of social operation quality. The core infrastructure elements in a SMART city would include: 1. adequate water supply; 2. assured electricity supply; 3. sanitation, including



solid waste management; 4. efficient urban mobility and public transport; 5. affordable housing, especially for the poor; 6. robust IT connectivity and digitalization; 7. good governance, especially e-Governance and citizen participation; 8. sustainable environment; 9. safety and security of citizens, particularly women, children and the elderly; 10. health and education (Scmagazine.cz, 2016)

The important part of the concept of SMART cities is the efficient urban mobility and public transport. Intelligent traffic management is necessary to be available 24 hours a day, 7 days a week, current information on utilization of individual roads, which can be obtained, for example, from sensors embedded in the roadway. Based on these data can then at the involvement of relevant IT tools to predict the future burden on key roads in the city and thus dynamically route traffic. Mobility, as a concept, is more usually applied not to industries but to specific people or groups whose ability to move is restricted. The restriction may be owing to people’s personal characteristics – they may be physically or financially disabled or perhaps, just uninformed. There may be barriers due to the nature of the transport system – steps or poor service levels. This suggest an interaction between mobility and accessibility: poor accessibility together with restricted mobility may trap some people but liberate others. (Hutton, 2013)

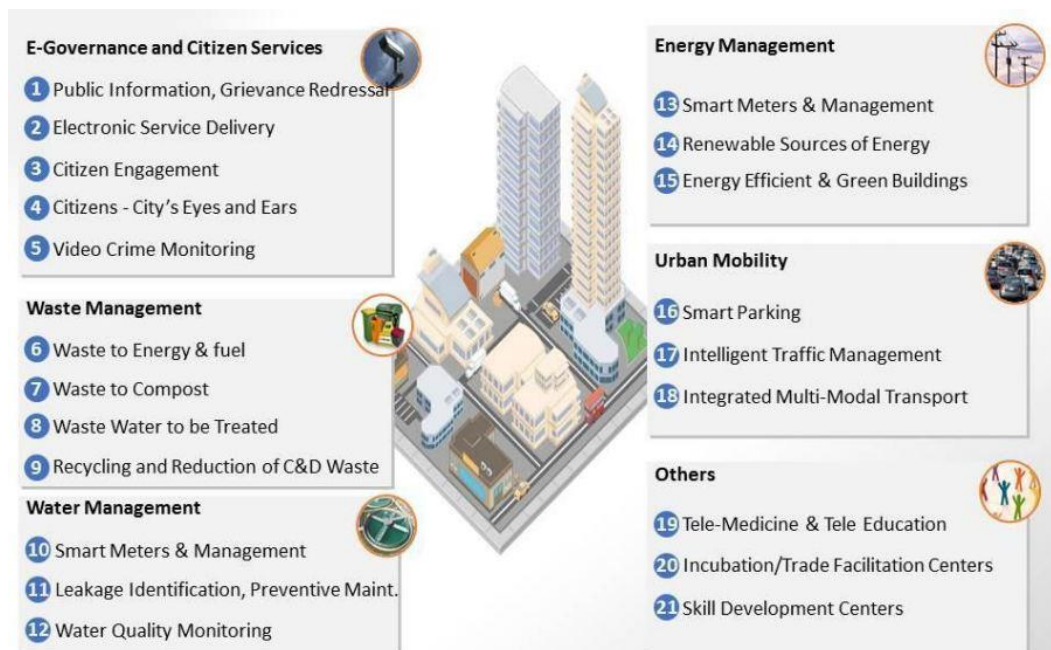


Figure 1 - SMART CITY concept (SMARTcities.gov.in, 2016)

foreign countries deploying clever parking, traffic optimization, and systems that are beneficial for maintaining the transport infrastructure to the satisfaction of all residents. The structure is following: firstly, it is described the theoretical basis, then the method whose primary objective is to compare smart cities in European cities to Prague. According to the comparative method are selected indices that indicate readiness of the concept of smart cities. The analysis is evaluated according to the index standardization and all values are compared. The table compares all indexes related to smart cities and evaluation is also described in conclusion. At the end of the paper is Prague compared in the following table with other European cities and also suggested the possibility of greater involvement in the concept of smart cities following the example of other European cities.

## **2 FACTORS AFFECTING THE MOBILITY OF THE FUTURE – THEORETICAL FINDINGS**

Transport is the fastest growing fields of human activity and its growing importance in the daily life of the population is also an issue intensively perceived by the general public. (Marada, 2010) Predict traffic development in the new millennium is an activity requiring a great deal of balance and imagination due to the amount, scope and diverse nature of the intervening factors. Even many so-called short-range forecasts regarding traffic even individual parts often proved inaccurate. Development of individual motorization has been underestimated many times, while the shift of traffic from trucks to rail or the number of rail passengers has been overestimated. Incorrect forecasts in transportation planning and policy JMI supported the strike action were often untrue because of limited imagination of their creator's speech just wish as the actual state or escape from certain, currently hard resolvable problem. (Schmeidler, 2010) Frequent subject of research are also urgent problems of urban transport, especially the automobile competition of individual transport and public transport and traffic congestion. (Arentze, Timmermans, 2007)

There is an endemic link between accessibility, transport costs and commercial success, a link which is subtler and explicit in modern times but which has always been in the background. Relative accessibility works at a local scale: production needs working people. Until just over a century ago, working people had to live within a maximum of five kilometers or so walking distance of where they worked. As production became more specialized, larger groups were organized. (Hutton, 2013)

The accessibility concept is also connected with optimization in transport. Transportation can be divided according to several point of view, the basic breakdown by object of transport – passenger transport, freight transport and transmission of information. The basis means, which can be used include: rail, road, air transport, ship, pipelines. (Straka, Malindžák in Weiszer, 2015) Optimization methods are successfully used in each of these areas, some examples of optimization problems include:

in rail transport, optimization is applied in the design of lines, timetables, circulation of railway vehicles, assignment of trains to platforms at stations, scheduling of trains crews, planning of freight trains (Weiszer, 2015)

in road transport, these are the dynamic models of freight management, finding the optimal path of vehicles, vehicle scheduling, planning of transport on demand, determining the optimal frequency of deliveries, or a variety of tasks in public transport

air transport applies optimization in ATC, for restoring schedules after the incident and creating robust schedules

in water transport, optimization tasks involve the design of shipping lines, temporal and spatial planning, loading ships

in multimodal transport, these are fleet management, terminal management, or scheduling of trucks in the container terminal (Weiszer, 2015)

It is clear that our future is at relatively rapidly evolving technological advances and the amount of knowledge is still worse predictable. Diversity of technological systems in the next thirty years cannot be estimated. Future itself cannot always be predicted in scientific sense. They can also be presented different scenarios for the future. We anticipate the various aspects of the future development under otherwise identical conditions, but they are unlikely when radical change. (Schmeidler, 2010) Mobility is inevitable spare parts of contemporary life. As the economy and leisure. Note its negative impacts of our lives. More and more transport vehicles clogging city streets. Scientists already some time ago revealed the relationship between economic growth and the country's need for mobility. Simply put, raising living standards and rising transport. (Schmeidler, 2010) With the live standards is connected the transport planning. The aim of transport planning is a concrete expression of the public interest in public transport.

Transportation planning also helps to ensure the interdependence of the various transport services. (Mojžiš, 2008) Some authors predict future developments in the field of transport and many are betting on the creation of the integrated transport systems. Linking multiple carriers, whether bus or rail transport into one integrated system is the main task of the integrated transport system. The main objective is to ensure efficient and economical operation of a particular area in terms of economic and non-economic needs of people and organizations. (Hájek, 2005) All over the world, from Zurich to Barcelona, to Bogotá, to Pyongyang, to Columbus, to Ohio, mayors and city planner are building in a new way – or, more accurately, in an old, time-wasted way. They are creating environments that are dense and connected, affordable and desirable, appealing both to SMART employers and the employees they want to recruit. They are building roads and rails for a SMART future. (Schwartz, 2015)

SMART city projects are big investments that are supposed to drive social transformation. Decisions made early in the process determine what exactly will change. But most research and planning regarding SMART cities is driven by the technology, rather than the needs of the citizens. Little attention is given to the social, policy and organizational changes that will be required to ensure SMART cities are not just technologically savvy but intelligently adaptive to their residents' needs. Design will make the difference between SMART city projects offering great promise or actually reinforcing or even widening the existing gaps in unequal ways their cities serve residents.

This paper refers to the predictions of using the SMART cities in the Czech Republic, deploying clever parking, traffic optimization, and systems that are beneficial for maintaining the transport infrastructure to the satisfaction of all residents. To summarize, this article argues theoretically and show empirically that the implementation of SMART cities is a useful and essential for cities in the Czech Republic. The next section presents a theory and hypotheses and is followed by sections describing examples in other cities where is the concept of SMART cities more widespread. These sections conclude with detailed description of methods and results. This paper concludes with a discussion of findings and the implications of examples for future research of SMART cities in the Czech Republic.

### **3 METHODS USED IN THIS PAPER**

This paper elaborates the strategy of the concept of SMART cities abroad in comparison with the Czech Republic. Using comparative analysis is processed compared the concept of SMART cities in the Czech Republic and abroad in order to obtain an objective comparison creation, approval and implementation of the strategy on a sample of selected countries to create a design concept of SMART city in the Czech Republic. A detailed review of existing key indexes provided either by different electronically sources identify solutions of using SMART cities. Comparative analysis provides competitive edge by identifying opportunities, gaps in other indexes, and potential design patterns to adopt or avoid.

Comparative analysis based on facts and theoretical findings includes mainly:

The current state of preparation of the concept of SMART cities in the Czech Republic.

The examples of using SMART CITIES focuses to transport in the world.

Comparative analysis based on index of standardization:

Comparative analysis of foreign approaches to drafting the SMART city, identification of good practices arising from foreign approaches and compared the current state of SMART city strategy focuses mainly on transport in the Czech Republic and abroad, and good practice.

Forecasting of possible development of the concept of SMART city with focuses mainly on transport by foreign examples.

To evaluate the correct development of SMART cities in the world and compare this concept with the use of the Czech Republic SMART cities have been chosen five European cities, among which were analyzed

also Prague as a capital of the Czech Republic. Cities were tested according to a predetermined key. The data were divided into several groups. The economic factor of cities was characterized by GDP of each city. Ecological factor by Green City Index, a factor of urbanism by Innovation Index, data management and protection of websites in cities by Overall E-governance Index and mobility in cities were judged by several interrelated factors. It analyzed data like the number of cars per 1 000 inhabitants, fare prices, the number of cycle lines and the number of stations for bike sharing. Cities were compared and ranked according to the results of individual factors and then put into a single table reflecting their position in the concept of SMART cities.

For a correct assessment of the individual cities and their maturity in respect of SMART cities concept is necessary to establish the index of standardization. To compare the different indicators, it is necessary to standardize the values. One method to standardize is by z-transformation. This method transforms all indicator values into standardized values with an average 0 and a standard deviation 1. This method has the advantages to consider the heterogeneity within groups and maintain its metric information. To receive results on the level of factors, characteristics and the final result for each city it is necessary to aggregate the values on the indicator level.

$$z_i = \frac{x_i - \bar{x}}{s}$$

## **4 SMART CITIES IN THE CZECH REPUBLIC WITH FOCUS ON TRANSPORT**

Concerning to research in the Czech Republic, 66 % of people believe that while the trend is in the Czech Republic or in the world of sustainable and 53 % of young people aged 18-34 believe that it could do more for a sustainable future.

The examples of a good public transport strategy and its application can be seen in large European cities such as Munich, Vienna, Copenhagen, and also cities of a medium size such as Graz, Bern, but also Czech regional cities like Pardubice or Jihlava. The index of a good mobility is also using of electric buses. The city Krnov has three new buses, including one electric bus. All cars of Krnov urban public transport have low floor and also offer paying by bank cards. New system for paying by bank cards in public transport has also in Ostrava. Thanks to the new system tourists do not have to hunt down in Ostrava tickets, but only attached to the terminal in the vehicle contactless payment card. A sale of electronic tickets purchased thus sharply increasing. We talked about the electric public transport but the city hall in Trebic tested electric bikes. If the test proves successful, it creates a network of stations around the city, where every citizen or visitor can rent an electric bike for free. In the Czech Republic is also carried out many surveys of urban mobility. In Prerov held the first-ever survey of intensity cycling. It pointed in particular the need to refurbish and complete the main routes in the city. Zlin again preparing a new Master Plan of Transport, which is to relieve the city from cars and traffic jams.

One of the biggest weaknesses of modern cities is isolation of the population. The symbol for it may be a car standing in the morning traffic jam, inside which there is a one-man crew of lone drivers. People in cities trying to cut out a piece of their own peace, but the result of their effort is paradoxically stressful. For real relaxation because eventually they flee out of the city. SMART city vision is to change this. Thanks to mobile applications to gain residents the possibility of recommending a specific food in restaurants, to negotiate the sharing of cars, bicycles or need the tools. SMART technology in the streets, saving time and money at home again.

Current traffic management is confined to a restricted scope due to several limitations. Drivers choose their own driving routes, for instance, based on their personal knowledge and experience, which often results in traffic congestion and inefficient usage of certain urban road resources. With instant traffic flow information, street conditions, temperature, and traffic accidents recorded by sensors, a SMART city can

achieve real-time communication among people, vehicles, street conditions, and the environment for the purpose of route choice. It can also provide dynamic and optimized transportation plans and driving routes through cloud computing.

## **5 SMART CITY PRAGUE**

From 1990 to 2000, car ownership in Prague almost doubled from 276 to 525 per 1,000 inhabitants while vehicle km of car use rose from 7.7 million to 16.6 million on an average weekday. Simultaneously, public transport use fell from 1,319 to 1,033 million passenger trips per year, leading to serious road congestion, illegal parking of cars, rising traffic injuries, and worsening noise and air pollution. Consequently, the City of Prague undertook a range of policy measures such as parking management with preference for neighborhood residents, while increasing parking prices and limiting parking time.

In addition, Prague expanded its pedestrian zone in the city center and restricted many streets to local traffic. Improvements in public transport focused on expanding and modernizing the metro, tram and bus systems, and integrating fares, ticketing, routes and coordination among 17 different public transport operators throughout Greater Prague. From 1990 to 2014, Prague's metro grew from 39 to 59 kilometers and the tram network from 130 to 143 km. The bus service network was expanded with suburban routes growing from 607 to 2,258 route km. For all types of public transport combined, both in Prague and its suburbs, the network services rose from 153 million in 2010 to 208 million km in 2014. The outcome has been a public transport ridership growth from 1,033 million trips in 2000 to 1,297 million in 2014. Prague has also succeeded in improving traffic safety, reducing traffic fatalities from 94 in 1990 to 20 in 2014 while serious traffic injuries fell from 369 to 206. In cooperation with the EU, Prague has undertaken two major projects to reduce congestion and improve safety. As part of the EU's Cohesion Policy, Prague received EUR 20 million in funding to improve its road traffic management system, mainly through the establishment of a centralized traffic control center which provides information on congestion and accidents both to traffic controllers and drivers. The same programme provided Prague with EUR 18 million to improve road safety through advanced information technology.

## **6 STANDARDIZED INDEX AND ITS DETERMINATION**

Indexes were selected from various electronic sources that determine the value of the concept of SMART cities in the different cities. This data was taken from several different studies. Whether the research on the economic advancement of pages taken from Eurostat or the Mobility index, which was calculated according to several aspects such as the average of these values. All these indexes being assigned an index value according to the standardization index and the resulting values were compared and evaluated by importance. In the end, all indexes were summed and the city with the lowest value was considered as the city with the best mastered the concept of SMART CITY.

Cities in Europe ranking by the Innovation Index. The Innovation Index aims to capture the multi-dimensional facets of innovation and provide the tools that can assist in tailoring policies to promote long-term output growth, improved productivity, and job growth. Innovation Index determines the level of urbanization in different cities.

Rank	City	Innovation index
5	Prague	48
1	London	57
3	Copenhagen	54
2	Amsterdam	55
4	Brussels	50

Table 1 – **Innovation Index of European cities**, author's construction according to (Innovation-cities.com, 2015)

Cities in Europe ranking by the Green city index. The Green City Index methodology was developed by the Economist Intelligence Unit (EIU) in cooperation with Siemens. Cities were selected for their size and importance (mainly capital cities and large population or business centres). They were picked independently, rather than relying on requests from city governments to be included or excluded, in order to enhance each Index's credibility and comparability. The Green City Index series measures cities on approximately 30 indicators across eight to nine categories depending on the region. It covers CO2 emissions, energy, buildings, land use, transport, water and sanitation, waste management, air quality and environmental governance. About half of the indicators in each Index are quantitative – usually data from official public sources, for example, CO2 emissions per capita, water consumption per capita, recycling rates and air pollutant concentrations. (Siemens, 2012)

Cities in Europe ranking by the Overall E-Governance Ranking. To examine how local populations, perceive their governments online, the study evaluated the official websites of each of these largest cities in their native languages. The websites were evaluated between

August of 2015 and February of 2016.

Rank	City	Green City index
5	Prague	49,78
4	London	71,56
1	Copenhagen	87,31
2	Amsterdam	83,03
3	Brussels	78,01

Table 2 – **Green City Index of European cities**, author's construction according to (Siemens.com, 2012)

Rank	City	Overall E-Governance Rankings
5	Prague	66,48
3	London	52,54
2	Copenhagen	48,31
4	Amsterdam	54,36
1	Brussels	36,19

Table 3 – **Overall E-Governance Ranking of European cities**, author's construction according to (Spaa.newark.rutgers.edu, 2015)

Cities in Europe ranking by GDP. GDP is an indicator that determines the economic advancement of European cities and their success in the concept of SMART CITIES.

Rank	City	Number of registered cars per 1,000 population
5	Prague	541
3	London	294
1	Copenhagen	177
2	Amsterdam	257
4	Brussels	451

Table 4 – **Number of registered cars per 1000 inhabitants**, author's construction according to ( European towns and cities, 2011)

Rank	City	GDP (\$BN) 2014
5	Prague	89.2
1	London	835.7
4	Copenhagen	127.0
2	Amsterdam	320.6
3	Brussels	254.3

Table 5 – **GDP of European cities**, author's construction according to (Eurostat, 2014)

#### Mobility Index

To determine the mobility index is necessary to link several factors that affect it. Fares in individual cities, the number of stations for bike sharing, modal split in cities and number of car per 1 000 inhabitants or number of cycle lines.

Cities in Europe ranking by number of registered cars per 1 000 inhabitants.

Cities in Europe ranking by fares.

Rank	City	Price of travel-metro or bus ride (EUR)
1	Prague	1,19
3	London	2,78
5	Copenhagen	3,24
4	Amsterdam	2,83
2	Brussels	2,02

Table 4 – **Price of travel**, author's construction according to (Price of travel, 2016)

Cities in Europe ranking by number of stations of Bike Sharing.

Rank	City	Bike sharing (number of stations)
4	Prague	6
1	London	772
3	Copenhagen	90
5	Amsterdam	4
2	Brussels	346

Table 5 – Number of stations of bike sharing, author's construction according to (Bikesharingmap.com, 2016)

Number of cycle lines in European cities.

The final value of Mobility Index includes fares in individual cities, the number of stations for bike sharing, modal split in cities and number of car per 1 000 inhabitants and number of cycle lines.

City	Bike sharing	Cycle lines	Fares	Number of registered cars per 1,000 population	MOBILITY
Prague	4	5	1	5	3,75
London	1	1	3	3	2
Copenhagen	3	3	5	1	3
Amsterdam	5	2	4	2	3,25
Brussels	2	4	2	4	3

Table 6 – Value of Mobility Index, author's construction

The final table was compiled as the sum of the individual indices that aim to evaluate the result of the success of the concept of SMART cities in various European cities. Total ranking is compiled from the lowest values of all indexes. The town with the lowest value for all indexes is also the city with the best mastered the concept of SMART cities.

City	Economy	Ecology	Mobility	Urbanism	E-Governance	TOTAL	TOTAL RANKING
Prague	5	5	3,5	5	5	23,5	5
London	1	4	1,5	1	3	10,5	1
Copenhagen	4	1	2	3	2	12	2
Amsterdam	2	2	2,25	2	4	12,25	3
Brussels	3	3	2	4	1	13	4

Table 7 – Total ranking of selected European cities, author's construction



## 7 CONCLUSION

For the correct determination of concept development of SMART cities in the Czech Republic it is important to know the concepts of other European cities and compare them with the current development in the Czech Republic. Prague has stood at many factors with high scores, for example, is among the cities with the cheapest fare. Unfortunately, in other factors should our capital city has a lot to learn from the comparison of European capitals. Due to the fact, that almost 80% of the EU citizens live in cities, is the development of SMART cities essential. In general, to lower the negative impacts from city transport on the life of people, it is possible to make some modifications regarding current motor vehicles modes. This means to have more preferences in sustainable transport, i.e. walking, bicycles, using public transport, making a lower number of journeys with a shorter distance. The examples of a good public transport strategy and its application can be seen in large European cities such as London, Amsterdam, Copenhagen, and also cities of a medium size in the Czech Republic like Zlin or Brno. The position of individual transport is getting stronger but on the other hand the position of public transport is getting weaker. It's important to say that Prague has failed in ecological factor which means – air pollution, noise and in general decline of life quality.

Compare analysis shows that the feature of SMART cities in the Czech Republic is strongly connected with the government. It was proved that the mobility ranking is really important for the concept of SMART cities in future. The idea of the future is image consists from sharing vehicles (car-sharing, bike-sharing), personal data protection, the development of parking systems and systems that help to detect vacant parking spaces, but it is also full of new cycle lines or cycle motorway that are safe and connect people with interesting places. London and Amsterdam are demonstration of a good practice of mobility. With more than 7 hundred kilometers of cycle lines are these cities superpowers in cycling. The Czech Republic, however, is not far behind and planned security measures and expanding its cycling zones. Innovation Index shows that Copenhagen and Amsterdam are on aligned position and Brussels and Prague as well. The Czech capital is thus well on track to catch up with the rest of the world and become one of the superpowers of SMART cities.

The Czech Republic has a lot to learn. An example of the proper implementation of SMART cities are European cities. These examples can serve as a prediction of the correct use of the SMART cities in the Czech Republic. Great example of transport in SMART city Houston, USA is reducing a CO2 emissions by using train as a transportation subject. Freight railways continue to play an important role in the United States' economy, especially for moving imports and exports using containers and for shipment of coal and oil. Rail's share of the American freight market is above 40 % - the highest for any rich country. Transport by train is far more sustainable than transport by cars and truck. While showing the way forward within freight traffic, passenger traffic still has a huge potential for reducing CO2 emissions in the United States. (Google Earth, 2017) The shipping is a theme of many conferences all around the world. The harbor in Hamburg is highly automated with opportunities for the direct transfer of containers from ships to trains. If the Arctic Ocean melts, permanent routes for container ships can be established connecting Europe and Asia: This is one of the few positive effects of climate change, as transport distances, CO2 emissions and transport time at sea will be reduced significantly. (Google Earth, 2017) Close to 100 000 containers are handled in the port of Singapore every day and the containerships have to wait to be granted entrance and moorage in the harbor. The container has become a universal standard module, which can be transported on ships, trains, trucks and planes, and has thus been one of the main prerequisites for the globalization of production and workplaces. Globalization is an important factor that equals level of knowledge, wages and availability of resources. If somebody want to minimize CO2 emissions, thinking locally will be increasingly important. (Digital Globe, 2017)

Another example could be a SMART strategy of Copenhagen, Denmark which is a city famous for it's bicycles. By improving conditions for bicycles, limiting parking and introducing a new metro system and separate bus lanes, the competition has changed. Choosing sustainable modes of transport is now the fastest, cheapest and most convenient option for most people in the city. More than 30 % of global CO2 emissions

come from the transport sector, so there is considerable potential in encouraging biking and collective transport systems. (Google Earth, 2017) On the other hand there is the example of the transport system in Tokyo, Japan. Japan's transportation sector stands out for its energy efficiency. It uses less energy per person compared to all other countries, thanks to a high share of rail transportation. Transportation in Japan is very expensive in an international comparison, reflecting high tolls and taxes, particularly on automobile transport. Transit Oriented Development is integrated in the development of the city, with high density real estate developments and department stores located next to stations. Some 250 high-speed Shinkansen trains connect major cities and all trains are known for punctuality, making it an attractive alternative to private use of cars.

Europe is the model for the rest of the world to learn from. Like Copenhagen the cycling rates here are off the charts. In fact, Amsterdam may be the only city in the world that has more problems with pedestrian and cycling traffic congestion than vehicle congestion. 67 % of all trips are done by cycling or walking. In fact, on a daily basis there are 10 000 bikes parked anywhere a space can be found adjacent to the central train station. Vienna is also testing out a range of electric mobility solutions from expanding their charging network from 103 to 440 stations by 2015 to testing car sharing and electric bike rentals.

## References

Arentze, T., & Timmermans, H. (2007) Congestion pricing scenarios and change of job residential location: Results of a stated adaptation experiment. *Journal of Transport Geography*. Elsevier, London: Elsevier

Hájek, O. (2005) Sborník referátů z odborné konference na téma "Dopravní obslužnost a technologie ve vztahu k regionálnímu rozvoji": 27. května 2005 ve Zlíně. Univerzita Tomáše Bati.

Hutton, B. (2013). *Planning sustainable transport*. London: Routledge, Taylor & Francis Group.

Marada, M. (2010) *Doprava a geografická organizace společnosti v Česku*. Praha: Geographica.

Mojžíš, V., Graja, M., & Vančura, P. (2008) *Integrované dopravní systémy*. Praha: Powerprint.

Schmeidler, K. (2010). *Mobilita, transport a dostupnost ve městě*. Brno: Novpress.

Schwartz, S. I. (2015) *Street SMART: the rise of cities and the fall of cars*.

Shapiro, J.M. (2006) *SMART Cities: Quality of Life, Productivity, and the Growth Effects of Human Capital*: *Rev. Econ.*

Townsend, A. M. (2014) *SMART cities: big data, civic hackers, and the quest for a new utopia*.

Tranos, E. & Gertner, D. (2012) *SMART Networked Cities?* *Innov.: Eur. J. Social Sci. Res.*

Weiszer, M., Fedorko, G., Molnár, V., & Strohmandl, J. (2015) Optimization of parameters of transport systems using simulation methods. Zlín: Tomas Bata Univerzity in Zlín, Faculty of Logistics and Crisis Management

## ELECTRONICAL REFERENCES:

Bikesharingmap.com. (n.d.). Retrieved January 24, 2017, from [www.bikesharingmap.com](http://www.bikesharingmap.com)

Cyklodoprava.cz (n.d.). Retrieved January 24, 2017, from <http://www.cyklodoprava.cz/>

Dazahra, M. N., Elmariami F., Belfqih, A., Nazha, Ch., (2015) Decentralized Control of Substations in Smart Cities. Retrieved January 24, 2017, from [https://www.researchgate.net/publication/309691799\\_Decentralized\\_Control\\_of\\_Substations\\_in\\_Smart\\_Cities\\_-\\_SCOPUS\\_Indexed](https://www.researchgate.net/publication/309691799_Decentralized_Control_of_Substations_in_Smart_Cities_-_SCOPUS_Indexed)

Digitalglobe.com (n.d.). Retrieved January 24, 2017, from <https://www.digitalglobe.com/>

Epomm.eu. (n.d.) Retrieved January 24, 2017, from [http://www.epomm.eu/tems/result\\_city.phtml?city=591&list=1](http://www.epomm.eu/tems/result_city.phtml?city=591&list=1)

Eurostat (2016) Metropolitan regions. Retrieved January 24, 2017, from <http://ec.europa.eu/eurostat/web/metropolitan-regions/data/database>

Globalinnovationindex.org (n.d.) Retrieved January 24, 2017, from <https://www.globalinnovationindex.org/>

Googleearth.com (n.d.) Retrieved January 24, 2017, from <https://www.google.com/earth/>

Gui, Y., Hangbing L., Ling, L., Songlin, Ch. (2017) Research on the key technology of process-level network switch of smart substation. Retrieved January 24, 2017, from [https://www.researchgate.net/publication/283433794\\_Research\\_on\\_the\\_key\\_technology\\_of\\_process-level\\_network\\_switch\\_of\\_smart\\_substation](https://www.researchgate.net/publication/283433794_Research_on_the_key_technology_of_process-level_network_switch_of_smart_substation)

Innovationcities.com (n.d.) Retrieved January 24, 2017, from <https://www.innovation-cities.com/>

Joseph, Stephen. (2016) Why other cities should copy Nottingham's revolutionary parking levy. City Metric. Retrieved January 24, 2017, from <http://www.citymetric.com/transport/why-other-cities-should-copy-nottinghams-revolutionary-parking-levy-2382>

Priceoftravel.com. (n.d.) Retrieved January 24, 2017, from [www.priceoftravel.com](http://www.priceoftravel.com)

Report of SIEMENS (2012) Siemens. Retrieved January 24, 2017, from [https://www.siemens.com/entry/cc/features/greencityindex\\_international/all/en/pdf/gci\\_report\\_summary.pdf](https://www.siemens.com/entry/cc/features/greencityindex_international/all/en/pdf/gci_report_summary.pdf):

Scmagazine.cz (n.d.) Retrieved January 24, 2017, from <http://www.scmagazine.cz/>

Serviceihned.cz (2016) SMART CITY (n.d.) Retrieved January 24, 2017, from <http://service.ihned.cz/smartcity/>

Spaa newark rutgers (2016) Digital governance and municipalities. Retrieved January 24, 2017, from [https://spaa.newark.rutgers.edu/sites/default/files/files/EGov/Publications/Digital%20Governance%20in%20Municipalities%20Worldwide%20\(2015-16\).pdf](https://spaa.newark.rutgers.edu/sites/default/files/files/EGov/Publications/Digital%20Governance%20in%20Municipalities%20Worldwide%20(2015-16).pdf)

### **Contact information**

Mgr. Iva Honzková

Tomas Bata University in Zlín, Faculty of Management and Economics

Mostní 5139, Zlín 76001, Czech Republic

(+420) 736778206

[honzkova@fame.utb.cz](mailto:honzkova@fame.utb.cz)

# INSIGHTS AND PRACTICES FROM BRANDING IN DESTINATION MANAGEMENT

*Monika Hýblová*

## **Abstract**

The article is focused on the topic of a destination branding. It explains the basic concepts and specifics in the Czech Republic, then there follow the findings from a previously conducted foreign scientific work through critical literature review and examples of successful branding from foreign countries. Branding in practice is shown with two different successful approaches.

The concept of branding in destination management is a relatively new idea, that is gradually tested in practice in each destination. The importance of marketing and branding has increased with transport development, but still 10 main destinations are visited by 70 % of the visitors. The tourism is a major source of income in many countries in the world.

The tourism formed nearly 3 % of GDP and employed 225 000 persons in the Czech Republic in 2014. The total internal tourism consumption in the Czech Republic amounted to 238 bln. CZK in 2014. The incoming tourism generated almost 61 % of the consumption (144 bln. CZK). The average daily expenditure of foreign visitors amounted to 4,880 CZK, while the Czech tourists spent only 1230 CZK. This statistics shows, how the tourism is important. The Czech Republic is not a typical touring country, but its benefits from tourism are considerable and the importance of tourism in other countries is even increased with higher tourist popularity.

*Keywords: branding, destination management, tourism*

## **1 INTRODUCTION**

The components of branding are used in companies these days as a part of company marketing. The use of branding in tourism is not very common, it can be found only rarely in the field of destination management. The methods of branding can still be used successfully in tourism management it could even become a competitive advantage.

The concept of tourism is very old – the people were travelling since the beginning of their existence. Ancient tribes were wandering for many reasons, the main ones were food, water, territory and many others. After satisfying their basic needs for survival, the people began to be more interested in the culture. At that time the new kind of tourism appeared – the same one we know in present. Now we have the possibilities to travel around the world in a few hours and discover every part of the world. With this fast progress, the marketing started to be very important in this growing economic sector.

Destination characteristics in the Czech Republic, is focused on the division of the territory into individual parts, with the possibility of creating a destination of a region, area or city. This division is based on a natural and cultural condition and tradition of the destination. The destination management can use the same principles, that are used by companies and business sector, only with some necessary adjustments for this specific conditions.

Marketing is very important tool for communication with customers, to address them and keep in touch with them. An advertising presentation is a main tool for gaining new customers for a lot of companies. Every destination or area can also use these marketing presentations as their products are individual. It is a specific sector of economy, because it does not offer a particular product or service, but it offers the whole destination and its services.

This article is focused on a knowledge of branding in destination management, clarification of terms and a description of first use of branding in destination management. A literature review is formulated with emphasis on using branding in practice of destination management.

## **2 THEORETICAL BACKGROUND**

### **2.1 Branding**

The term "brand" has a very long history and its origin is anglo-saxon, with original meaning – to burn. First brands were owned by farmers and it was a symbol of quality of their farm animals and for differentiation from other farmer's animals. Another advantage was, that these animals could not be stolen, everybody could recognize them. The brand was burned on animal's skin, so this meaning is a metaphor for branding, how we understand it today. Brands are burned into mind of customers. (Cliffton, Simmons, 2003)

Branding is a way, that could change the customer's opinion, it can become part of their life. Brands are not used only in business sector for each product, but also in non-profit organizations, political parties or zoos, they all have their own brand. (Keller, 2007, Kotler, 2007)

A brand is not only a logo, it contains expectations of customers, their emotions. It is necessary to build the brand, give it a value and invest money in it. Nowadays, a successful company brand is seen as an asset - a property of the company. (Aaker, 2003)

### **2.2 Branding and marketing**

Brand awareness is an important part of brand building and at the same time it is the goal of significant investments in marketing. This awareness can have two types - passive and active. An active awareness is a situation, where the target group of the brand can actively think about it when choosing what to buy from a category of products. In contrast to this, passive awareness is typical for commercial communication when the target group just identifies the brand. (Healey, 2010, Příbyl, 2005)

A branding should precede and underlie any marketing effort. It represents the expression of the essential truth or value of an organization, product, or service. It is a communication of characteristics, values, or attributes, which show what the brand is and what it is not. The strongest brands use their understanding of the difference between branding and marketing to build marketing campaigns that work hand in hand with their brand positioning strategy. A brand is in your mind associated with a product, service, or organization. The brand is what determines if you will be a loyal customer or not. The marketing persuades people to buy a specific product, but the brand determines whether the product will have a longterm success. (Brand Marketing, 2012, The Difference Between Marketing and Branding, 2011, Whats the difference between marketing and branding, 2017)

### **2.3 Destination**

A destination is specified, according to the World Tourism Organization, as a place with attractions, facilities associated with them and the tourism services, that the guest chooses for his visit and that the providers bring to the market. (Destination Management)

In general, a destination is a spot that is an aim for the tourists. There are plenty of tourist services, which are provided in response to local attractions. (Palatková, 2006a)

A destination is a regional unit of supply, that is internationally competitive and strategically managed on the international market. Destinations are trying to meet expectations of their clients and offer appropriate products. (Palatková, 2011)

## **2.4 Destination management**

Destination management is a form of management of certain areas and its task is to increase the effectiveness of activities related to tourism and its sustainable development. Its goal is to coordinate all stakeholders in the promotion of their interests, in developing of strategic plans or implementing marketing activities. Together, they want to create and manage a destination that is competitive in the market. Among the interest groups we primarily include service providers, local residents, environmentalists, non-profit organizations, investors, entrepreneurs and public authorities. (Ryglová, Burian, Vajčnerová, 2011, Holešinská 2010)

We can define a destination management also as techniques, tools and measures that can be used for planning, organization, communication and decision-making in the area. The aim of destination management is a set of sustainable and competitive tourism products, that share its main characteristics as a logo, quality, reservation system or pricing policy among all partners. (Zelenka, Pásková, 2012)

## **2.5 Marketing of tourism destination**

This term means the process of harmonizing resources of the destination with the market situation. The main part of it is the destination analysis, planning, organization, management and strategy control of the area. All this activity leads to strengthening of its competitive position. From this perspective branding in tourism does not adhere to the underlying assumption of traditional product and service brand management that the whole process of creation and management of the brand is controlled by and within an individual organization. The destination brand is a powerful tool with the ability to create emotional appeal and a brand image is considered crucial to the marketing success of a tourism destination. (Jakubíková, 2012, Janečková, Vašítková, 1999)

For the effectiveness of destination marketing is necessary to take into account also the time and place limitations of product realization and purchase, high share of emotions and the importance of personal recommendations. Good image and communication skills of all partners are also essential. It is necessary to support a communication between supply and demand, as well as among the various stakeholders. (Palatková, 2006b)

*A Destination Brand is a name, symbol, logo, word mark or other graphic that both identifies and differentiates the destination; furthermore, it conveys the promise of a memorable travel experience that is uniquely associated with the destination; it also serves to consolidate and reinforce the recollection of pleasurable memories of the destination experience. (Blain, 2005)*

The definition is composed from two parts, with first part pointing to identification and differentiation of a brand. The second part is very important, the main part is experience. (Blain, 2005)

A branding in destination management is the brainchild of the past 20 years. The first academic conference on this topic took place in 1996. At the end of the 20th century began to appear the scientific articles addressing this issue. The first book on the subject was published in 2002 postulating a bright future for the branding of destinations. (Pike, 2005)

## **2.6 Destination management in the Czech Republic**

Czech Republic is, according to the organization CzechTourism, divided into 40 destinations, as can be seen on image 2, instead of tourism regions on image 1. They are all very different in manner of area and attractions. (CzechTourism)



Figure 1 Touristic regions in the Czech Republic (CzechTourism)

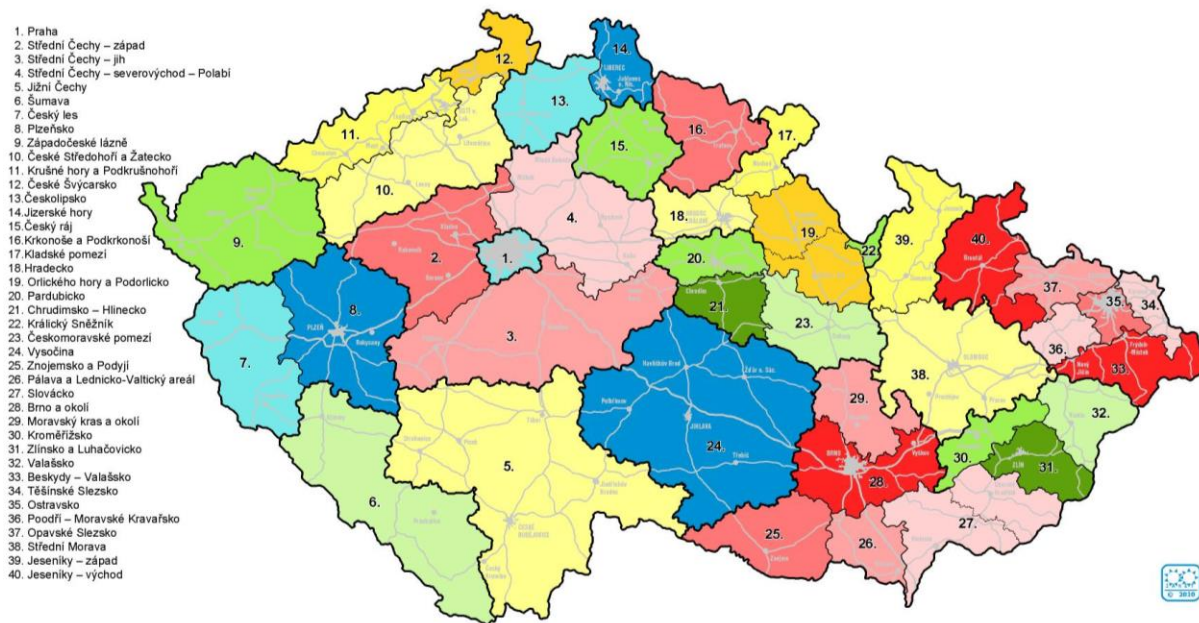


Figure 2 Touristic destinations (CzechTourism)

Destination management leading company is focused on the development and proactive sales of major products, it coordinates and manages the creation of tourism products, as well as pricing policies and active destination sale. It is very often supported or created by major service providers in the area. The main task of destination management is to merge legally independent providers of tourism services such as hotels, guest houses, businesses, infrastructure facilities and other service providers into unions, which can perform

many tasks. The public authorities can play strong or even dominant role in these societies at the local and regional level. These authorities have several basic tasks: planning, supply, marketing and representation of interests. (CzechTourism)

It is estimated that nearly 80 % of the territory of the Czech Republic is suitable for recreational purposes. The country has a large number of historical, cultural and technical monuments. There is very dense network of well-marked hiking trails and paths in the Czech Republic. There is also developing a new offer of tourism products - eg. urban tourism, congress, cycling, cultural tourism, agro-tourism, or even Czech traditional spa tourism. (CzechTourism)

A lack of organization and management concept is one of the main barriers to the tourism development in the country. There are implemented only simple cooperation activities focused primarily on promotional activities. The problem is the underestimation of the importance of this sector for the development of the Czech Republic. There is not supported a large multiplier effect of tourism, and despite the importance of tourism to the national economy, it is getting only low political support. Furthermore, there is lack of private subjects involving in tourism management. Only public-law entities are involved in concept making processes, the business sector gets involved only marginally. The importance of tourism is not much appreciated even in regions. The problem is in very low efficiency of cooperation of micro-regions and voluntary associations of municipalities, already existing micro-regions lack the concept and sufficient funding for tourism management. The concept of creating micro-regions and DSO is also missing. These micro-regions and DSO originated rather spontaneously to obtain grant funding. There is also lack of strong interest and lobbying groups of businessmen in tourism, whose task would be to promote the interests of its business members. The number of experts is also insufficient as well as the legislative and taxation system. (CzechTourism)

Low cooperation is not only within the business sector of tourism but also between public and private spheres. As a key development issue in this sector is considered an immaturity of interest and professional groups with great influence on the tourism destinations management. (CzechTourism)

### **3 APPLYING BRANDING IN DESTINATION MANAGEMENT**

The first use of branding in destination management was in 1998 in North America. Branding became a powerful tool and a reputable component of marketing. First examples were Brand Oregon, Branding of Canada, Brand of Texas, Missouri, New Orleans or Hawaii. (Ekinci, 2003)

At first, the branding in destination management was intended as a support of marketing efforts. Many of the destination management organizations just created a logo for their better presentation. This could be the reason, why some destination managers understand branding only as a logo or a catchword. Effective branding in practice is a process with three-stages. This process outlines image 3. (Ekinci, 2003, Clifton 2003)



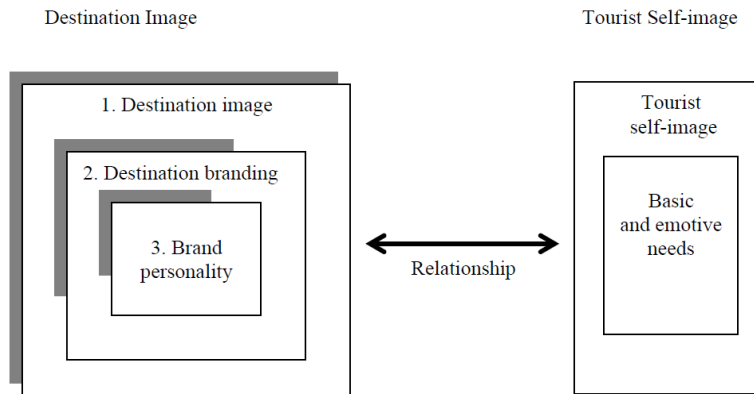


Figure 3 Destination image and destination branding (Yuksel Ekinci)

Surveys and interviews are used to determine, how the current branding of destination looks in practice. This research has some downsides - the results show, that organizations, that did not reply, do not have any logo, so they decided not to answer. About 30 % of organizations, that did not reply, had this kind of attitude. (Ekinci, 2003)

Logos are still the main part of branding in destination management. Organizations use their logo on printed materials in 98 % of cases, on goods in 73 % of cases and they display the logo also in videos with 68% share. Logos are usually presented in media, which help to build consistent and distinctive image of the organization. (Ekinci, 2003, Healey, 2010)

The main reason, why tourism destinations have a logo, is to support the image of its area. Other reason is to provide a label that describes the destination and differentiates it from other places. Some DMOs have not involved any local organizations of tourism services (in 35 %) or visitors (in 40 %) in the logo design process to any extent. A lesser percentage of DMOs have substantially involved local tourism businesses (in 29%) or visitors (in 26%) in creating a logo design. Logos are in 87 % of cases a work of external consultants, because they can improve the logo design process due to their expertise. Only 32 % of destination organizations, which asked external consultants for help, involved tourism businesses or visitors in the logo design process. A shocking information also was a fact, that nearly 40 % of organizations did not test their new logo at all before publishing it, just one quarter of them tested it extensively. (Ekinci, 2003, Pike, 2005)

It was also found out, that the process of destination branding begins, when the evaluation of a destination image includes a strong emotional attachment. A tourist destination may have a name, but not necessarily a brand name. Branding often presents emotions, that are typical for the destination. It means, that a brand emphasises the human side of the brand image. In practical terms, a brand personality uses human personality traits to describe a destination image. For example, Paris or Venice are typical romantic cities, on the other hand Las Vegas is a symbol for gambling, naughtiness and fun. It was found out, that it is beneficial to connect a place with human's emotions, it is helpful for the brand. The result of a successful marketing is, that a brand differentiates itself from other ones, like a human being is different from other people. (Ekinci, 2003, Pike, 2003, Glińska, 2013)

A successful example of brand building is the case of the '100% pure New Zealand' brand, where the destination was positioned as an appealing niche player in today's global tourism industry. (Morgan, 2003)

The process of destination branding can be divided into three parts as shows image 4. At first, the destination benefits have to be found, then the names and association are determined. The third part is an aesthetic one. This part provides a satisfaction of customer's aesthetic needs. That can bring a great benefit, but it is very difficult to obtain it. (Ritchie, 1998)

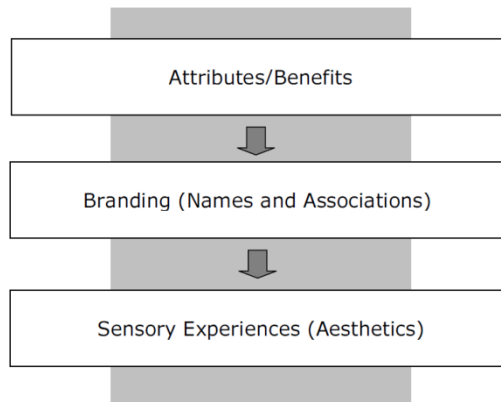


Figure 4 Evolving focus of marketing approaches (Ritchie)

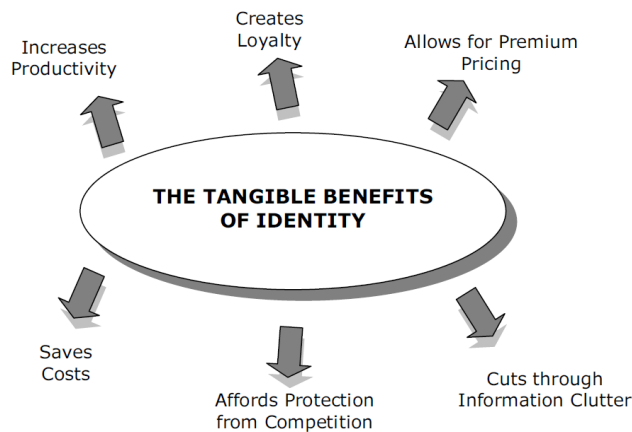


Figure 5 Tangible benefits (Ritchie)

#### 4 DIFFICULTIES OF BRANDING IN DESTINATION MANAGEMENT

The praxis also shows some other specifics of branding of destination management. It is very difficult to transfer and use some branding in different destinations. Borrowing or adaptation of a brand causes problems and therefore a caution is necessary when trying to set a branding in this manner. The main difference between a traditional production and a destination management is that the product in destination management is usually sold by a group of companies, which have common interests and characteristics. A destination is very diverse and complex product, which is delivered by many different companies. That means, a brand of a destination is a collective phenomenon. That is one big problem, because destination management organizations have to find a collective agreement. It is problematic to find an ideal image. The process can cause an ambiguity and inefficiency. In this discussion the residents have more idealistic ideas than the companies. Brand has to capture the essence of the pleasure dimension, not only the functional dimension. It is affected by symbols and logos. It is hard to make an agreement for many products and services. Because of this a family of brands is used sometimes. (Ritchie, 1998, Cliton, 2003, Chan, 2016)

A family of brands can also cause some problems, for example a disparity among the brands, when one brand is considered the main brand. This situation happens in Orlando, Florida where the Disney Corporation is dominant and its concept is prominent in all aspects of the destination. (Ritchie, 1998)

Difficulty of branding in destination management is also related to time. The final product consists of many small parts and services that can change over time. Sometime there is a time difference between a moment when a client buys the service and a moment when he consumes the service - for example a hotel services are usually booked in advance. A cycle of branding is observable in different seasons of the year. It is different to visit a place in summer or in winter. A political or a social situation can also change over time. (Ritchie, 1998, Cox, 2014)

## **5 MEASURES OF EFFECTIVENESS**

Based on a previous research, destination managers and other participants want to see, if their brand of destination provides higher turnover. The research describes five primary roles of a destination brand. These are identification, differentiation, anticipation, expectation and reassurance. These roles are layered on themselves. That means, that every ply covers the previous one. The identification represents a degree of recognition or association. The differentiation is a distinction among destinations, products or services. The anticipation includes a desire to visit the destination. The expectation describes the nature and importance of benefits, which a visitor expects and the reassurance is the feeling of a visitor, that everything will go well during his visit in the destination. (Ritchie, 1998, Marzano, 2009)

Then the visitor has a post-experience, a recollection. The recollection has two layers - a consolidation and a reinforcement. A consolidation represents the ability of a brand to unite all parts of memories of the destination and the reinforcement is a conversion of memories into experience. These layers make a holistic memory of the experience. The effectiveness of a brand is therefore dependent on how thoroughly it performs each of those roles. (Ritchie, 1998)

The research and praxis show also some less important roles of branding. A brand works like a coordinating symbol for a broad range of community development and promotion efforts. It could help to enhance the status of tourism within a community. A brand can also earn money from selling promotional items with a brand or a destination name. A brand also helps to reduce the number of thefts of materials or equipment that belong to the destination. (Ritchie, 1998)

## **6 EXAMPLE OF BRANDING IN DIFFERENT PARTS OF THE WORLD**

The first examples were Brand Oregon, Branding of Canada, Brand of Texas, Missouri, New Orleans or Hawaii. The first global branding campaign took place in New Zealand in 1999. The branding in New Zealand is a very successful example, this destination managed to defeat such a big destination like Australia. New Zealand is divided into five macro regions, 12 regional councils, 26 regional tourism organisations and numerous district tourism organisations. That is the reason, why it is important to have unanimous agreement from local authorities. This big achievement was reached with slogan "100% Pure New Zealand" and just with minimal costs, minuscule 0.01 per cent of worldwide advertising presence. The slogan was then modified into a few other mottos, every time with the part "100%". New Zealand gained a portion of popularity because of the movies based on J.R.R. Tolkiens book "The Lord of the Rings", whose fantasy world of Middle-earth was filmed in New Zealands nature. (Morgan, 2003)

We can find another example of successful use of branding in Catalonia. This region is very popular, nearly 11 % of its GDP comes from tourism and almost 17 % of the working population is employed in the service

sector. Their branding strategy is different from the one used in New Zealand. Catalonia has an umbrella brand for the whole destination and some sub brands for smaller parts of this destination. One of the reason to have more brands is the fact, that each part can have its own visions and objectives. There are four brands in the Barcelona province and one individual brand for Barcelona city. The provinces of Tarragona and Girona have two brands each, while Lleida has three brands. The Pirineus also has a special logo, where one half of the logo shows a picture of the main Catalonia brand. In fact, the few tourist destinations, that have defined their brand, describe it with its basic characteristics and attributes. (Datzira-Masip, 2014)

## 7 OVERVIEW OF DESTINATION MANAGEMENT RESEARCHES

Table 5 Research in destination management

Author	Research topic	Research	Result
CHAN, Chung-Shing a Lawal M. MARAFA	Difference of the green resource brand between local residents and visitors	Questionnaire, interview	Residents generally rated the "green potential" elements more highly than visitors, results represent a lack of recognition of green resource elements and their potential to be transformed into an important brand element for Hong Kong
MORGAN, N. J., A. PRITCHARD a R. PIGGOTT	Destination branding and the role of the stakeholders	explore the context and creation of the New Zealand brand	New Zealand tourism stepped from the shadows of Australia with a new branding
DATZIRA-MASIP, Jordi a Alessio POLUZZI	Brand in local or top level	Analysis of tourism information	one side is government at the top level could define a methodology to apply to all the destinations of the territory, other side brand should be developed at local level, because in order to be effective, brand strategy must be shared by those who are intending to implement it
GLIŃSKA, Ewa a Magdalena FLOREK	The differences between the set of city attributes used in the process of building the desired image of the city	Questionnaire (the respondents are municipal office managers), factor analysis	The representatives of the municipal self-governments declare that they base branding strategies on the attributes of cities, marketing policy implemented by the municipal self-governments clearly separates the municipal sphere of the city

## 8 CONCLUSION

The travelling itself is a very old theme, but branding in destination management is quite a new topic. A branding was used for the first time in the United States. There is an effort to find out a measurement of branding effectivity and prove the influence of branding for a destination. The main problem of destination branding is the inapplicability of the same theme in different locations around the world. A brand has to show a specification of a particular destination, present its history, traditions, events, services and everything, what the visitor can see, when he decides to visit the place.

A branding in destination management could be a competitive advantage. Researches show that 10 main world tourism destinations attract 70 % of travellers. That is one of the reasons, why public and private sectors should cooperate. An article represents two totally different ways of branding. The first one is represented by an example of New Zealand. New Zealand branding was founded on a slogan "100% Pure New Zealand". This slogan has some auxiliary slogans, but they are all based on the "100 %" theme. The branding in New Zealand was successful, but they did not measure its effectiveness. The movies "The Lord of the Rings" had also a considerable influence on the popularity of New Zealand, because they were highly popular and they showed an unspoilt beauty of New Zealand's landscape. An another way of branding was used in Catalonia. The main brand was complemented by a sub brand for each smaller destination. This could help to show a specific feature of every destination. This style is better for the presentation of each destination independently, but like a unit Catalonia looks a little bit disorganized. It is typical for Spain, which is united state with a very complicated division. This is the reason for a different presentation, every participant has a different opinion and wants to enforce its own interests. Catalonia is with this kind of branding fairly successful as it is a very popular tourism destination, it is the second most visited area in Spain last year, behind the Canary Islands on first place. The tourism generates more than 10 % of a gross domestic product of Spain and it is the second largest economic sector after the automotive industry.

### References

- Aaker, D. A. (2003). *Brand building: budování značky: vytvoření silné značky a její úspěšné zavedení na trh*. Brno: Computer Press, Business books (Computer Press). ISBN 80-7226-885-6
- Blain, C. (2005). Destination Branding: Insights and Practices from Destination Management Organizations. *Journal of Travel Research* [online]., 43(4), 328-338 [cit. 2017-01-10]. DOI: 10.1177/0047287505274646. ISSN 0047-2875.
- Brand Marketing. (©2012) *Marketing schools* [online]. USA: Marketing-schools, [cit. 2017-02-20]. Dostupné z: <http://www.marketing-schools.org/types-of-marketing/brand-marketing.html>
- Chan, Chung-Shing & Lawal, M. Ma. The green branding of Hong Kong: visitors' and residents' perceptions. *Journal of Place Management and Development* [online]. 2016, 9(3), 289-312 [cit. 2017-02-01]. DOI: 10.1108/JPMD-02-2016-0008. ISSN 1753-8335. Dostupné z: <http://www.emeraldinsight.com/doi/10.1108/JPMD-02-2016-0008>
- Clifton, R. & John S. (2003).. *Brands and branding*. London: Profile Books, ISBN 18-476-5000-7.
- Cox, N. Gyrð-Jones R & Gardiner. S. Internal brand management of destination brands: Exploring the roles of destination management organisations and operators. *Journal of Destination Marketing & Management* [online]. 2014, 3(2), 85-95 [cit. 2017-01-18]. DOI: 10.1016/j.jdmm.2014.01.004. ISSN 2212571x.
- CzechTourism* [online]. Praha, ©2005-2013 [cit. 2016-12-20]. Dostupné z: <http://www.czechtourism.cz/>
- Datzira-Masip, J.i & Alessio P. (2014) Brand architecture management: The case of four tourist destinations in Catalonia. *Journal of Destination Marketing & Management* [online]., 3(1), 48-58 [cit. 2017-01-18]. DOI: 10.1016/j.jdmm.2013.12.006. ISSN 2212571x.

Destination Management & Quality Programme. *World tourism organization* [online]. 2002 [cit. 2017-01-20]. Dostupné z: <http://destination.unwto.org/content/conceptual-framework-0> Dostupné z: <http://linkinghub.elsevier.com/retrieve/pii/S2212571X13000784>

Ekinci, Y. (2003). From destination image to destination branding: An emerging area of research. *E-review of Tourism Research*, 1.2: 1-4.

Glińska, E. & Florek, M. (2013). In searching for town brand distinguishing features – local leaders' inner perspective. *International Journal of Academic Research* [online]. 5(4), 200-205 [cit. 2017-02-04]. DOI: 10.7813/2075-4124.2013/5-4/B.30. ISSN 20754124. Dostupné z: [http://www.ijar.lit.az/pdf/ijar/2013\(24B-30\).pdf](http://www.ijar.lit.az/pdf/ijar/2013(24B-30).pdf)

Healey, M., (2010).. *What is branding?*. Mies: RotoVision, ISBN 2888931354.

Holešínská, A. (2010) *Destinační management jako nástroj regionální politiky cestovního ruchu*.. Brno, Masarykova univerzita.

Jakubíková, D. (2012). *Marketing v cestovním ruchu: jak uspět v domácí i světové konkurenci*.. 2., aktualiz. a rozš. vyd. Praha: Grada, ISBN 978-80-247-4209-0."

Janečková, L. & Vašítková M. (1999). *Marketing měst a obcí*. Praha: Grada, Města a obce. ISBN 80-7169-750-8.

Keller, K. L. (2007). *Strategické řízení značky*. Praha: Grada, Expert (Grada). ISBN 978-80-247-1481-3.

Kotler, P. (2007) *Marketing management*.. Praha: Grada, ISBN 978-80-247-1359-5.

Marzano, G. & Scott. N. POWER IN DESTINATION BRANDING. *Annals of Tourism Research* [online]. 2009, 36(2), 247-267 [cit. 2017-01-28]. DOI: 10.1016/j.annals.2009.01.004. ISSN 01607383.

Metelková, P. (2005). *Destinační management v České republice*. Brno,

Morgan, N. J., Pritchard, A., & Piggott, R. Destination branding and the role of the stakeholders: The case of New Zealand. *Journal of Vacation Marketing* [online]. 2003, 9(3), 285-299 [cit. 2017-01-22]. DOI: 10.1177/135676670300900307. ISSN 1356-7667.

Palatková, M. (2011) *Marketingový management destinací: strategický a taktický marketing destinace turismu, systém marketingového řízení destinace a jeho financování, řízení kvality v destinaci a informační systém destinace*..Praha: Grada, ISBN 978-80-247-3749-2.

Palatková, M. (2006a). *Marketingová strategie destinace cestovního ruchu: jak získat více příjmů z cestovního ruchu*.. Praha: Grada, Manažer. ISBN 80-247-1014-5.

Palatková, M. (2006b). *Prolínání destinací a destinační partnerství*.. Praha,

Pike, Steven. (2005) Tourism destination branding complexit. *Journal of Product & Brand Management*.,14(4), 258-259.

Pike, S., Gentle, J. Kelly, L. & Beatson, A. Tracking brand positioning for an emerging destination: 2003 to 2015. *Tourism and Hospitality Research* [online]. , - [cit. 2017-02-08]. DOI: 10.1177/1467358416646821. ISSN 1467-3584.

Příbyl, M. (2012) *Branding - značka a její budování*..Znojmo,

Ritchie, J. R. B. & Ritchie, R. J. B. (1998). THE BRANDING OF TOURISM DESTINATIONS: PAST ACHIEVEMENTS & FUTURE CHALLENGES. Marrakech,

Rygllová, K. Burian, M. & Vajčnerová, I. *Cestovní ruch - podnikatelské principy a příležitosti v praxi*. 2011. Praha: Grada Publishing, ISBN 978-80-247-4039-3.

The Difference Between Marketing and Branding. Tronvig Group [online]. NY: TRONVIG GROUP, 2011 [cit. 2017-02-20]. Dostupné z: <http://www.tronviggroup.com/the-difference-between-marketing-and-branding/>

Whats the difference between marketing and branding. (©2017) *Microarts* [online]. Greenland: MicroArts Creative Agency, [cit. 2017-02-20]. Dostupné z: <https://microarts.com/insights/whats-the-difference-between-marketing-and-branding/>

Zelenka, J. & Pásková M. (2012). *Výkladový slovník cestovního ruchu*. Kompletně přeprac. a dopl. 2. vyd. Praha: Linde, ISBN 978-80-7201-880-2.

### **Contact information**

Monika Hýblová

Tomas Bata University in Zlín, Faculty of Management and Economics

Mostní 5139, 760 01 Zlín

+420 777 332 119

[mhyblova@fame.utb.cz](mailto:mhyblova@fame.utb.cz)

# EVALUATION OF BUSINESS PERFORMANCE IN SLOVAK REPUBLIC BY ECONOMIC VALUE ADDED

*Monika Jančovičová, Kristína Kováčiková*

## **Abstract**

To evaluate the economic performance of the company in a simple and fast way is the main wish of investors and owners of companies. From their perspective, it is important to find out whether the company is able to increase its value and to provide a corresponding return on their investment. In the Slovak Republic prevalent classical approach for assessing the performance of the company is relying on the observation of the characteristics of traditional financial analysis. Gradually, however, there is a shift towards the evaluation of business performance through value creation. It is a new value criteria based on the concept of value management, which emphasizes the maximization of added value for owners. Recently intensively is enforced the indicator EVA – economic value added. The aim of paper is define economic value added and point out process of calculation of this indicator and its complications.

*Keywords: Economic value added, profit, performance*

## **1 INTRODUCTION**

In the most general sense, the notion of performance is used for the definition of the very essence of existence of the company in the market environment, its success and future survivability (Fabiánova, 2002). In the literature and economic practice the notion of performance is widely used and there are many definitions of its meaning. These definitions are most often related to output – the result of work.

## **2 BUSINESS PERFORMANCE**

Veber provides a clearer and wider definition of the performance stemming from the technocratic idea. The performance is a general measure of the efforts of individuals or groups (Veber, 2011). In simple terms, the performance is seen as an evaluation of the input scarce resources in the final output. The concept of performance can be imagined as the amount of work done per unit of time or the amount of output produced in a given time period.

Wagner sees the performance as a characteristic that describes the way the studied entity carries out an activity, based on the similarity with the reference method of implementing this activity. Performance encompasses two dimensions – efficiency and effectiveness (Wagner, 2009). Care is taken not to equate these two concepts. Effectiveness is doing the right things, while efficiency means using the correct way for the activity. Performance analysis usually takes the form of financial analysis, credibility model of individual structural units. Hardly any performance analysis respects a dynamic and comprehensive modern management view of the performance.

Approaches to measuring business performance have undergone a significant development from traditional performance indicators to the preferred market value of the company. Even informational efficiency of capital markets has evolved, which is increased by the efficient allocation of capital. The new concept of financial management is based on value management for owner called Shareholder Value, which is based on the modified financial indicators that allow to successfully and better identifying processes and activities that enhance shareholder and company value in the long term (Dluhošová, 2006).

### **2.1 Modern approaches to the evaluation of business performance**

The current trends are towards to assessing business performance through the creation of value for the owners. Gradually it is going to reduce the importance of the traditional goal – the profit and it is gradually



being replaced by new goals, which gives the ratio of the profit to the cost incurred sources. This concept is called as Value Based Management and its aim is unify objectives, strategies and methods of management decisions with the interests of shareholders (ŠULÁK, VACÍK, 2003). The basis of this concept is the theory of value management - shareholder value, which was established in the 80s of the 20th century in the United States. If the company successfully manages value, it means that there is an efficient use of capacity and effective investment. The market price of the shares then reflects its intrinsic value and there is no reason for a potential takeover.

### **3 ECONOMIC VALUE ADDED (EVA) AS A FINANCIAL INDICATOR**

In 1991, the New York consulting firm Stern Stewart & Co developed a fully integrated framework for financial management and incentive pay. The heart of this framework is economic value added "EVA®". It is a registered trademark of Stern Stewart company, but in our thesis EVA® is displayed without the ® symbol, but it continues to be seen as a registered trademark of Stern Stewart & Co (Maříková, Mařík, 2005).

EVA is a measure of value creation for shareholders. Performance of value for shareholders of a company is a decisive factor in determining whether an enterprise can succeed or not. It is also an excellent metric for tracking profitability and using of the company's capital. As a result, the indicator EVA was soon accepted as one of the most useful analytical tools for assessing company's financial performance. EVA has been widely adopted by the management to decide on increasing the productivity, where to invest new capital and which non-performing assets to liquidate (Stewart, 2013).

According to the Eva indicator the main objective of the company is to maximize economic profit, not the accounting one. The principle of the economic value added is based on economic profit, which is the difference between revenues and costs, and the costs are considered ordinary expenses and cost of capital. The cost of capital includes not only the cost of debt but also the cost of equity.

Economic value added means the value added by economic activities of enterprises above the cost of capital, which is bound in their assets. Economists and the EVA method therefore recognize the achievement of real profit to the level when it reaches the minimum required rate of return for all investors, therefore, creditors and equity holders.

EVA talks about how much the company has produced above the minimum requirements of the owners. Therefore, it helps to determine whether the enterprise earns income only for the survival or even increases its value.

The concept of economic value added is then used because of the value generated beyond these demands; a company can invest in its further development and thus in increasing its value (Zikmund, 2011).

#### **3.1 Calculation of the EVA indicator**

EVA measures the economic profit, which is formed by the difference between the return on capital and economic costs, which include not only the accounting costs but also the opportunity costs. This difference and thus economic profit can be expressed as follows:

$$EVA = NOPAT - WACC \times Capital$$

where

NOPAT = Net operating profit after taxes

WACC = Weighted average cost of capital (cost of equity and cost of debt),

C = invested capital

At first sight it is a simple-looking indicator, but problems arise at a closer look at the individual components of the formula. For correct construction of this indicator, it is necessary to correct identify these components.

### 3.2 Quantification of the NOPAT

Net operating profit (NOPAT) is an operating profit after tax, which company generates from main business activities. In determining the NOPAT, this should be considered:

what profit will be considered as the initial one, while the most appropriate one in our circumstances is considered the economic profit or loss and the ordinary profit or loss. In order to use the economic profit or loss and the ordinary profit or loss in quantifying the value of EVA, it is necessary to take into account only the items that have operating characteristics, which often depends on the subjective opinion of the analyst (expert),

what tax rate to use – it is recommended to use the effective tax rate, which represents the share of income tax on gross profit.

### 3.3 Quantification of the average cost of capital

Determining the amount of the average cost of capital is quite difficult. This is mainly because the average cost of capital includes not only the cost of debt, but also the cost of equity. In Slovakia, the calculation of the average cost of capital (WACC) is used in the following structure (Decree no. 492/2004):

$$WACC = (1 - DS) \cdot N_{PK} \cdot \frac{PK}{CK} + N_{VK} \cdot \frac{VK}{CK}$$

$$TC = D + E$$

where

DS = income tax rate, which is established under the law on income tax for valuation of companies. The income tax rate is appointed in decimal form in the calculation,

N<sub>pk</sub> = costs associated with the use of debt capital as a percentage, that is, interest and other expenses paid by the lender. The costs are appointed in decimal form in the calculation,

D = the amount of debt capital in euros. It consists of the components of foreign liabilities, which are for the purpose of calculating the interest rate, long-term bank loans, conventional bank loans, borrowings, issued bonds, notes, leases, rents payable and other liabilities,

N<sub>vk</sub> = cost of equity as a percentage, that is expected and acquired profit share by owner for capital contribution to enterprise. The cost of equity is appointed in decimal form in the calculation.

E = equity volume in euros.

TC = total capital (the sum total of equity and debt capital).

When quantifying the cost of debt capital, the procedure is simple, as it is based on loan agreements and it is a weighted arithmetic mean of the interest expense calculated from all loans provided to company.

In calculating the EVA indicator, the problematic variable is the cost of equity capital. This is defined in decree as expected and acquired profit share by owner. In practice, it is not easy to determine the cost of equity capital. Literature provides us with several guides, how to quantify the cost of equity capital, but to

choose the right one depends on the particular enterprise, environment in which it is situated and general situation. The most used methods include modular models, the capital asset pricing model (CAPM), dividend discount model and the like (JAKUBEC, KARDOŠ, KUBICA, 2011).

### 3.4 Quantification of net operating assets

Net operating assets are the assets which companies need for their main economic activities. The starting point for the calculation of net operating assets is the balance sheet, of which:

must be excluding non-operating assets,

must be activating the items not reported in the balance sheet, at market prices,

must be reducing the assets by non-interest bearing debt capital.

Most modern methods of evaluating business performance, including the method of economic value added tries to bring the entries in the books of their real value. The starting point for the calculation of economic value added as the accounting model based on data and values from the balance sheet and profit and loss account. Traditional accounts are unsuitable, because accounting is focused primarily on the needs of creditors.

The economic value added has been developed in terms of the US and therefore adjustments based on generally accepted accounting principles in the US (US GAAP). To be useful, it is necessary to know the basic differences between them and the Slovak accounting regulations.

Stern Stewart & Co. is using a list of modifications which includes more than 160 items. A complete list of modifications, however, is a trade secret of the company. Treatment generally can be summarized into four types of conversions:

operational conversion - operating profit and capital must be free of costs and benefits, which do not serve to achieve and maintain revenues from core business

conversion of financial resources - defining sources of financing used to invest

tax conversion - based on the fact that foreign funding has to be taken into account only the cost of capital

shareholder conversion - in the calculation of net operational assets is calculated with the assets which are not included in the balance sheet (MARÍKOVÁ, MARÍK, 2005).

Required values indicator EVA in practice:

$EVA > 0$  Firstly, it is important that the values of the indicator moved in the positive. If the EVA is greater than zero means that the company creates value, which is reflected in the growth of Shareholder Value. Net operating profit after tax cost of capital thus not only covers, but even exceeds them. The pattern is as follows:

$$\frac{NOPAT}{NOA} > WACC$$

$EVA = 0$  In this case, the net operating profit after tax covers full capital requirements in the form of cost.

$EVA < 0$  The cost of capital exceeds the profit from operational activities, the costs are not fully covered by earnings. It destroying enterprise value monster.

Despite extensive elaboration of issues at a theoretical level, many businesses still does not have the information whether constitutes value and what their actual cost of capital is. Through calculating EVA can be not only the management company, but also its owners, work towards finding whether the invested capital acceptable rate of return, or can stakeholders learn to what extent the company value form or vice versa, it destroys. Economic value added is used in a number of areas where its calculation requires a number of adjustments to obtain relevant input data. After reaching concrete results from the calculation of quantities EVA, it comes the important part management - managing the value of this indicator. If you are in business actions within the application of value-oriented management done correctly, the company can deliver a substantial improvement in its performance and a long successful existence in a competitive environment.

## 4 CONCLUSION

Performance and competitiveness are nowadays the most important words among companies. They are indispensable for the survival of the company, if the company is not competitive in the market, it will not generate sufficient performance to satisfy its shareholders. The companies measured their performance using traditional performance measures for years. In 1982, a new concept of economic value added was introduced, which offered a new way to create value for shareholders. It gives shareholders a better way to measure the real economic performance of the company and to bring a closer alignment of management and shareholder objectives. It is mainly used as an alternative way in comparison with the traditional methods of financial analysis. Its quality implies the possibility to remove deficiencies in methods, which have been used so far for these purposes.

### Acknowledgement

This contribution is the result of the project VEGA (1/0857/16) Zvyšovanie konkurencieschopnosti malých a stredných podnikov prostredníctvom zavádzania inovácií v globálnom hospodárskom prostredí, in extent 50% and the project VEGA (1/0404/16) Finančné výzvy po poslednej finančnej kríze a možnosti rozvoja slovenského kapitálového trhu.

### References

- Dluhošová, D. (2006). Finanční řízení a rozhodování podniku. 1. vyd. Praha: EKOPRESS, ISBN 80-86119-58-0.
- Fabiánová, E. (2002). Identifikácia sa zamestnancov s podnikom v kontexte podnikovej kultúry : Prešov: FF PU,
- Jakubec, M., Kardoš, P., & Kubica, M. (2011). Riadenie hodnoty podniku. Bratislava : Iura Edition, ISBN 978-80-8078-379-2.
- Maříková, P., & Mařík, M. (2005). Moderní metody hodnocení výkonnosti a oceňování podniku. 2. vyd. Praha : Ekopress, ISBN 80-86-119-61-0.
- Růčková, P. (2008). Finanční analýza : metody, ukazatele, využití v praxi. Praha : Grada Publishing, ISBN 978-80-247-2481-2.
- Stewart, B. (2013). Best-Practice EVA: The Definitive Guide to Measuring and Maximizing shareholder value. Wiley, ISBN 1118639383.
- Šulák, M. & Vacík, E. (2003) : Měření výkonnosti firem. 1. vyd. Plzeň : Západočeská univerzita v Plzni., 138 s. ISBN 80-7043-258-6.

Veber, J. (2011) . Management. Základy, moderní manažerské přístupy, výkonnost a prosperita. 2. aktualizované vydání Praha: Management Press,. ISBN 978 -80-7261-200-0.

Vyhláška č. 492/2004 Z. z. o stanovení všeobecné hodnoty majetku v znení neskorších predpisov

Wagner, J. (2009). Měření výkonnosti. Jak měřit, vyhodnocovat a využívat informace o podnikové výkonnosti. Praha: Grada Publishing, ISBN 978-80-247-2924-4

Zikmund, M. (2011). [EVA \(Economic Value Added\) – moderní ukazatel "rentability"](http://www.businessvize.cz/financni-analyza/eva-economic-value-added-moderni-ukazatel-rentability) [online]. Dostupné na internete: <<http://www.businessvize.cz/financni-analyza/eva-economic-value-added-moderni-ukazatel-rentability>>

### **Contact information**

Ing. Monika Jančovičová

Ekonomická univerzita v Bratislave

Fakulta podnikového manažmentu

Katedra podnikovohospodárska

Dolnozemska cesta 1

852 35 Bratislava

Phone: +421 902 535 750

e-mail: [jancovicova.monikaa@gmail.com](mailto:jancovicova.monikaa@gmail.com)

Ing. Kristína Kováčiková

Ekonomická univerzita v Bratislave

Fakulta podnikového manažmentu

Katedra manažmentu

Dolnozemska cesta 1

852 35 Bratislava

Phone: +421 904 382 998

e-mail: [kristinakovacikova.kk@gmail.com](mailto:kristinakovacikova.kk@gmail.com)

# SOCIO-ECONOMIC DETERMINANTS OF INTERNACIONAL MIGRATION: EVIDENCE FROM PAKISTAN

*Mohsin Javed, Masood Sarwar Awan*

## Abstract

This research study has examined and explored different socio-economic determinants of migration at the household level, in tehsil Toba Tek Singh, Pakistan. A household survey has been conducted to gather data regarding determinants of migration. Results of logit model explored that agricultural land before migration, business of household head before migration, number of adult females, and friends & relatives in the destination country are the significant determinants of migration at the household level.

**Keywords:** *International Migration, Remittances, Pakistan*

## 1 INTRODUCTION

In the previous few years, the matter of migration and remittances has become of crucial importance for Pakistan as a result of the large inflow of remittances and increasing rate of migration. It is an important tool to increase income, poverty alleviation and development, particularly in developing countries (Alfieri & Havinga, 2006).

United Nations (2013) indicates that 232 million people in the world live outside their countries of birth, compared with 175 million in 2000 and 154 million in 1990. The remittances received by developing countries are three times the size of official development assistance. Figure 1 shows that there is rising trend of overseas remittances in Pakistan. Pakistan received US\$ 5.5 billion in 2006-07 with the remarkably rising trend in coming years. The inflow of overseas remittances showed recorded increase of 21.8 percent from \$6.4 billion in 2007-08 to \$7.8 billion during 2008-09. In 2009-10, Pakistan received \$8.9 billion of remittances. In 2010-11, \$11.2 billion remittances have received while in 2011-12, Pakistan ranks 10<sup>th</sup> in the world by receiving \$13.2 billion. In the financial year 2012-13, Pakistan received \$13.92 billion of international remittances. The Same rising trend of international remittances remained to continue in the financial year 2013-14 by receiving \$15.83 billion. Currently, Pakistan received about \$19.9 Billion in the financial year 2015-16. (State Bank of Pakistan, 2017).

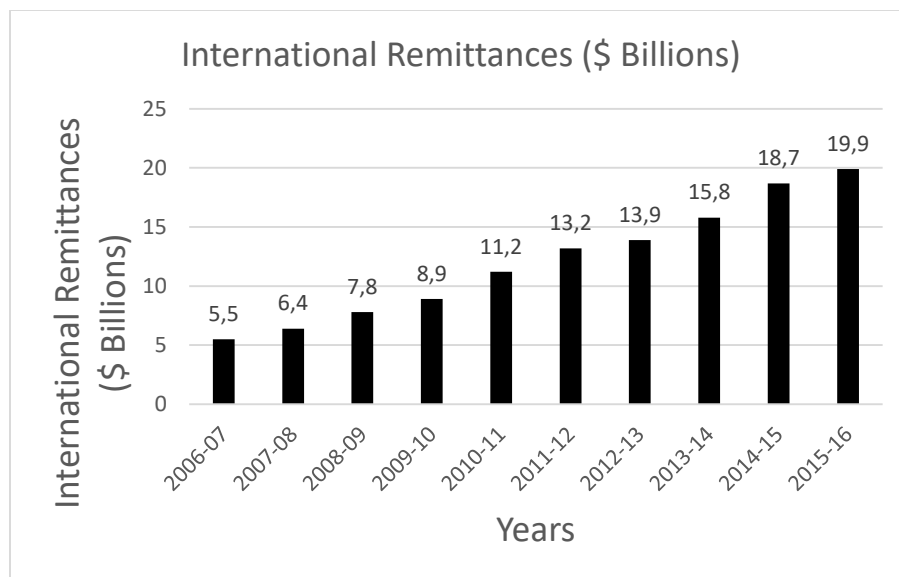


Figure 1: Rising Trend of Overseas Remittances of Pakistan (\$ Billion) (Source: State Bank of Pakistan, 2017)

The above statistics show that there is rising inflow of remittances with the passage of time. In this regard, the role of overseas Pakistanis is commendable in terms of remittance inflows as it showed resistance in deteriorating economic situation after exports and foreign direct investment. Pakistani diaspora is rising in Saudi Arabia and UAE so impressive growth of remittances inflow has observed from these two countries. Apart from this, in these countries, Pakistanis are settled with established businesses, successful joint ventures and number of jobs.

Around 3.5% population of Pakistan (6.3 million out of 180 million) living in different countries of the world to earn their livelihoods, most of them are residing in the Middle East, Europe, and North America. Remittance inflows from USA, UK, and GCC countries have made a significant contribution but the remittances received from Canada, Australia, Switzerland, Japan and other countries were not significant even less than a \$ billion.

Overall, Pakistani expatriates are playing their vital role in the economic development of their resident country as well as boosting their level of earnings and a big source of foreign exchange earnings for the country as well as there are substantial benefits at household level to raise family income, to build reserves for adverse shocks and in providing shield at exorbitant prices.

Keeping in view the significant importance of migration and remittances, the issue of considerable interest arises regarding the important factors which contribute to the migration decision. The literature showed work on this issue at the macro level and about determinants at the household level. Many researchers worked on determinants of migration in different aspects and scenarios. Some earlier studies in this regard are of Sjaastad (1962), Todaro (1969), Harris & Todaro (1970). Sjaastad (1962) developed a hypothesis about the reasons of human migration, which was a theoretical study. While treating migration as an investment, he found that migrants move with a view to maximize net real incomes. Other two theoretical papers by Todaro (1969) and Harris & Todaro (1970) have based their models on the neoclassical framework. In addition to Sjaastad's hypothesis, they include that migration occurs from differences in rural-urban expected earnings not necessarily wage differentials.

In recent studies, Cattaneo (2006) found that wage, new opportunities, and search of better quality land are primary pushing factors with the important point that more educated migrants move to enjoy economic gains and they succeed, on average due to higher return to personal characteristics. Another study about social and economic determinants is of Garip (2006) in which he modeled migration decision and remittance behavior jointly and found that common set of social and economic factors influence both migration and remittances in line with 'New Economics of Migration' that villagers send remittances if they are deprived relative to other households while altruism and social factors are main motives to migrate. Like Cattaneo (2006), Shehaj (2012) used migration and remittance behavior as interrelated events and combined under a single framework. The study found that relationship between household income and migration is insignificant. The age and marital status of the head of household are significant while gender is not significant. The human capital variables have significant effects that households with more educated heads have fewer propensities to migrate and remit. The presence of chronic disease and relative deprivation played an important positive role in determining migration and remittances.

Mayda (2007) using panel data worked on determinants of international migration in perspective of bilateral flows. She found that push effect becomes more positive and push effect to turn negative in the years when a host country's immigration laws become less restrictive. While in push-factors, improvements in the mean income increased emigration significantly, distance also played a negative and significant role but the share of the young population in the origin country represented a significant determinant of emigration. In another study about determinants of migration of Nang Rong, Thailand, Mahinchai (2010) found that demographic and household characteristics are in line with the human capital theory and migration selectively differs significantly by migrant destination. Another study of Panzaru (2013) explored determinants of international migration and came up that economic and non-economic factors have little influence on migration, as workers are low-skilled and their profile mismatch for an entrepreneur so they prefer to work

abroad at lower wages. Similarly, non-economic factors influence less the decision to migrate because of the absence of workplace at home. One more study of Sprenger (2013) addresses the same issue of determinants of international migration in the European Union. He found that economic factors are significant in migration flows. People migrate to improve their material conditions. Then, similar culture, language and physically close distant countries are significant determinants of migration. A paper about the determinants of international migration by Haas (2011) is unique in the sense that he found evidence, why migration policies are contested and fail to achieve their objective and came with conclusion that mostly results are inconclusive due to fundamental methodological and conceptual limitations which can only be overcome by embedding the multi-method, longitudinal analysis of policy effects in a more comprehensive framework.

## 2 DATA AND METHODOLOGY

The study is carried out by designing a questionnaire and interviewing 250 households in 10 villages of tehsil Toba Tek Singh, district Toba Tek Singh in the year 2012. Due to budgetary and time constraints, several villages have been selected where migration prevalence was higher. For this purpose, key informant interviews were administered to travel agents and private manpower exporting agencies in tehsil Toba Tek Singh. These key informant interviews identified 25 such villages with higher migration prevalence. From this list of 25 villages, 10 villages<sup>2</sup> have randomly selected to obtain information about different social and economic determinants.

As outcome variable is binary so logit model has used to assess different factors affecting migration. In logit model, we transform probabilities to log odds. The reason is that it is usually difficult to model a variable with restricted range problem such as probabilities so, it's a way to get around from this restricted range problem. As probabilities ranging between 0 and 1 while log odds ranging from negative infinity to positive infinity (Stock & Watson, 2006).

More formally,

Let Y be the binary response variable with values 0 and 1, representing failure and success respectively.

'P' represents the probability of Y to be 1.

$$P = \text{Prob}(Y=1)$$

Let  $X_1, X_2, \dots, X_{11}$  represents different predictor variables.

The logistic regression will be the following equation with parameter values estimated via maximum likelihood method.

$$\text{Logit}(p) = \log\left(\frac{P}{1-P}\right) = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_{11} X_{11} \quad (1)$$

In terms of probabilities, the equation above can be translated into

$$P = \frac{\exp(\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_{11} X_{11})}{1 + \exp(\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_{11} X_{11})} \quad (2)$$

Then odds ratios found by raising e to the power of the logistic coefficient to observe their effect and percentage change.

---

<sup>2</sup> These key informant interviews identified 25 such villages. From this list of 25 villages, 10 villages have selected randomly which are Chak No.324 JB, Chak No.297 GB, Chak No.517 GB, Chak No.330 GB, Chak No.336 GB, Chak No.342 G.B, Chak No.331 GB, Chak No.341 GB, Chak No.332 GB and Chak No.349 GB.



(3) Odds Ratios  $(p/1-p) = e^{\beta}$

This logit transformation is a way to get around the restricted range problem of 0 and 1. Now, log odds can take values from minus infinity to positive infinity. In order to determine factors of international migration, following variables have been included, prima facie which play the main role in the decision of international migration.

Outcome Variable=1; If a household has a migrant member.

Outcome Variable=0; Otherwise.

Predictor Variables:-

Home Area before migration

Agricultural land before migration

Number of adult males

Number of adult females

Adult males with primary education

Adult females with primary education

Education level of head of household

In addition to the above continuous variables, the study used following dummy variables.

Business of household head before migration

(Non-agricultural = 1)

(Otherwise = 0)

Household head occupation before migration

(Wage laborer = 1)

(Otherwise = 0)

Friends & Relatives in the destination country

(Yes = 1)

(No = 0)

### 3 RESULT AND DISCUSSION

Table 1 shows the result of estimations of logit probability model. Each estimated coefficient depicts the expected change in the log of odds of being in a migration status for a unit change in the corresponding variable holding other variables constant at a certain level.

Logit model results better to interpret with the help of odds ratios because they give the more meaningful interpretation. By interpreting variable Home area before migration in terms of odds ratios, holding other variables at a fixed value, the odds of getting into a migration state are 1.007 times than no migration state for one unit change. In terms of percentage, which can be found by subtracting 1 and multiplying by 100, it shows that holding other predictor variables at fix value, we observe 0.7 percent increase in the odds to be in migration state for one unit increase in Home area before migration. The ratio for 'Business of household head before migration' depicts that odds for non-agricultural business is 72 percent lesser than otherwise. If 'Household head was a wage laborer before migration' then odds for wage laborer are 146

percent higher than otherwise. The ratio of 'Friends and Relatives in the destination country' is much higher, depicts that if the household has friends and relatives in the destination country then odds are 685 percent higher than if they don't have such social network.

Talking about the significant determinants of migration status, as depicted from the value of z-statistic; agricultural land before migration, the business of household head before migration, the number of adult females, friends and relatives in the destination country are significant determinants of migration, while adult females with primary education is significant at 10 percent only. The value of Likelihood ratio (LR) statistic, which shows the explanatory power of the model, that together all the explanatory variables have a significant impact on migration status, as the LR statistic is 87.40.

## **4 CONCLUSION**

The basic purpose of this study was to explore different social and economic determinants at household level in tehsil Toba Tek Singh, district Toba Tek Singh. In order to address the objective of this study, a research questionnaire has designed and fielded a migration-focused survey. The study came with few important insights. First, agricultural land before migration played a significant role in the decision to migrate, a household with more agricultural land was less likely to migrate. Secondly, the business of household head also played a significant role in migration. If the business of household head was non-agricultural then there were lesser chances to migrate as returns from the non-agricultural business were higher. Thirdly, if a number of adult females in a household were more they were less likely to migrate due to social protection issues and if adult females were primary educated then migration chances increased somewhat as the z-statistic value was significant at 10 percent level of significance. Fourthly, as compatible with previous literature, friends and relatives played a significant role in the process of migration in terms of job information, financing cost and till the adjustment in a new environment.

Table 1: Determinants of Migration Status (Logit Probability Model) (Dependent Variable= Migration Status)

Variables	Coefficients	Standard Errors	Z-Statistic	Odds Ratios
Home Area Before Migration	.007564	0.0299883	0.25	1.007593
Agricultural Land Before Migration	-.112173	0.0367724	-3.05**	.8938896
Business of Household Head Before Migration (Non-agricultural = 1) (Otherwise = 0)	-1.302978	0.3620114	-3.6**	.2717214
Household Head Occupation Before Migration (Wage laborer = 1) (Otherwise = 0)	.9021878	0.5662341	1.59	2.46499
Number of Adult Males	.5112275	0.4352198	1.17	1.667337
Number of Adult Females	-.6548888	0.3242658	-2.02**	.5194998
Adult Males with Primary Education	-.0099467	0.4240652	-0.02	.9901026
Adult Females with Primary Education	.5866417	0.321352	1.83*	1.79794
Education Level of Head of Household	.0288991	0.0571017	0.51	1.029321
Education Level of Spouse				
Friends & Relatives in the Destination Country (Yes = 1) (No = 0)	2.061174	0.3381319	6.1**	7.855187
_cons	-2.739042	0.7371265	-3.72**	

No. of Observations=250, Likelihood Ratio (LR) Statistic=87.40

Note: Asterisk (\*) and double asterisk (\*\*) denote variables significant at 10% and 5% respectively.

## References

- Alfieri, A., & Havinga, I. (2006). Definition of remittances. Department of Economic and Social Affairs, Statistics Division, United Nations.
- Cattaneo, C. (2006). The determinants of actual migration and the role of wages and unemployment in Albania: An empirical analysis. Liuc Papers No. 196, Serie Economia e Impresa, 50.
- Garip, F. (2006). Social and economic determinants of migration and remittances: An analysis of 22 Thai villages. Department of Sociology, Princeton University.
- Haas, H. D. (2011). The determinants of international migration, conceptualizing policy, origin and destination effects. International Migration Institute Working Paper No. 32.
- Harris, J. R., & Todaro, M. P. (1970). Migration, unemployment and development: A two-sector analysis. *American Economic Review*, 60(1), 126-142.
- Mahinchai, M. (2010). Determinants of migration: A case study of Nang Rong, Thailand. Duke University, Durham, North Carolina.
- Mayda, A. M. (2007). International migration: A panel data analysis of the determinants of bilateral flows. Centre for Research and Analysis of Migration, Discussion Paper Series No. 07/07.
- Panzaru, C. (2013). The determinants of international migration. A panel data analysis. *Journal of Politics and Law*, 6(1), 142-148.
- Shehaj, E. (2012). The determinants of migration and remittances in Albania. *International Journal of Scientific & Engineering Research*, 3(4).
- Sjaastad, L. A. (1962). The costs and returns of human migration. *Journal of Political Economy*. 70 (5):87
- Sprenger, E. (2013). The determinants of international migration in the European Union: An empirical analysis. IOS Working Paper No. 325.
- State Bank of Pakistan (2017). <http://www.sbp.org.pk/ecodata/homeremmit/index2.asp>. Accessed on 05 April 2017.
- Stock, J. H., & Watson, M. W. (2006). *Introduction to Econometrics*. New York, NY: Addison Wesley.
- Todaro, M. P. (1969). A model of labor migration and urban unemployment in less developed countries. *American Economic Review*, 59(1), 138-148.
- United Nations (2013). UN News Centre, New York. <http://www.un.org/apps/news/story.asp?NewsID=45819#.UleA3IZkNSk>. Accessed on 11 October 2013.

**Contact Information:**

Mohsin Javed, Ph.D. Scholar

Address: Department of Enterprise Economics

Faculty of Management and Economics, Tomas Bata University in Zlin

Phone: +420 777 593127

Email: [mohsin1fcc@yahoo.com](mailto:mohsin1fcc@yahoo.com), [javed@fame.utb.cz](mailto:javed@fame.utb.cz)

Masood Sarwar Awan, Ph.D.

Address: Chairman & Professor, Department of Economics,

University of Sargodha, Sargodha, Pakistan

Email: [awan811@hotmail.com](mailto:awan811@hotmail.com)

# CORPORATE REPUTATION VS. FINANCIAL PERFORMANCE

*Mária Kozáková*

## **Abstract**

Corporate reputation as kind of intangible asset allows the company to manage the expectations and needs of its stakeholders. It is playing an increasingly important role in terms of the propensity of business to build and sustain market, mind, and heart shares of customers and publics all over the world. Corporate reputation significantly impacts share value, and on the ability of businesses to attract and retain excellent employees. The aim of this paper is to review the empirical literature analyzing the relationship between corporate reputation and financial performance and summarize the state of corporate reputation and its impact on shareholder value measured by Reputation Dividend Report in U.S. and U.K.

**Keywords:** *corporate reputation, financial performance, shareholder value, performance measurement, financial performance effects .*

## **1 INTRODUCTION**

The current business environment shows that the company must be part of society and play an active role. Corporate reputation is built over time and it is the result of complex interactions and relationships between the company and its stakeholders. This means that the reputation is based on past actions, experiences and reactions of stakeholders, so the corporate reputation is based on the overall perception of stakeholders. A good reputation is a valuable source that allows the company to achieve long-term profitability or sustainable superior financial performance. Companies with better reputation can raise prices, they are able to attract more high-quality managers and employees, as well as strategic partners and investors.

Defining the relationship between corporate reputation and financial performance includes the answers to two questions: whether the company's reputation influences the financial performance or financial performance influences the corporate reputation.

Positive effects of corporate reputation have a financial impact and lead to more profits, more stable and less vulnerable cash flows, and it influences on the firm's value, which is ultimately its market capitalization (shareholder value).

The aim of this paper is to illustrate how a positive reputation can influence financial performance and summarise the state of corporate reputation and its impact on shareholder value measured by Reputation Dividend Report. It combines measures of reputation strength with financial metrics to explain the economic impact and thereby the financial worth of each company's reputation asset.

## **2 LITERATURE OVERVIEW**

Reputation is identified as a key intangible asset that adds value to a company. However, it should be noted that intangible assets almost never create that value alone, but in combination with other company's resources (Hall, 1993).

Strong corporate reputation can serve as a defense against market rivals, in a way that complicates their situation when competitors try to imitate the characteristics of companies with a superior reputation. Therefore, it does seem likely that the reputation of a company affects its financial performances. However, it should be noted that, when a company achieves outstanding financial performances, these performances can also have a positive impact on company's reputation (McGuire, Schneeweis, Branch, 1990).

Company's reputation affects the its relationship with other stakeholders, such as, for example, potential employees. A company with a good reputation can attract competent people. In addition, a good reputation can reduce transaction costs, because it allows company to save on the cost of writing a

contract. On the other hand, the suppliers of a company will have lower costs of monitoring (Bromley, 2002). The Stakeholder Reputation Matrix shows the various stakeholder groups and other influencers that can impact a company's reputation.

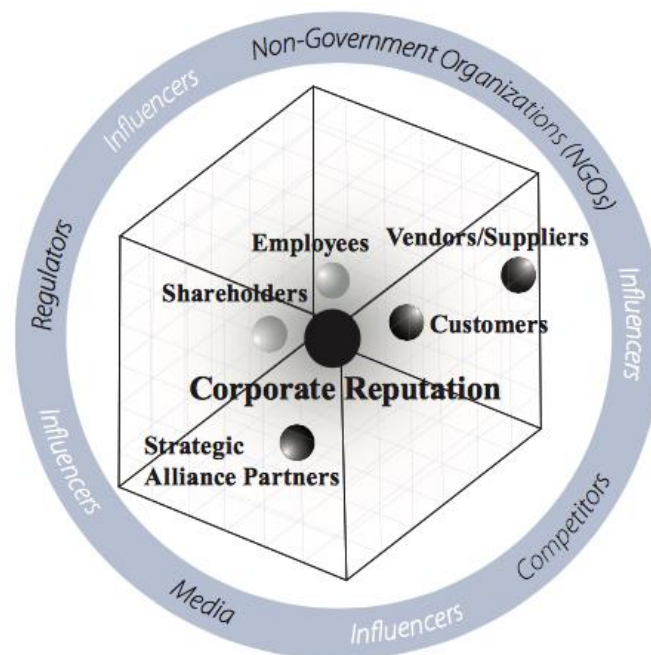


Figure 1 - Stakeholder Reputation Matrix. Source: Resnick (2004).

Many researchers have examined the relationship between corporate reputation and financial performances, and have found that there is a strong and a non-linear relationship between corporate reputation and financial performances. Determining the relationship between reputation and financial performances means responding two questions: 1. Does company reputation have an impact on financial performance? 2. Do financial performances affect reputation? Good financial reputations, induced by, for example, high accounting profits, should create immediate value for investors because such signals are easily observed and processed. Investors should be more willing to buy and hold stocks of firms.

The issue of an interrelationship between financial performance and reputation is noted by Roberts and Dowling (2002). Their data sample is based on a Fortune's report of America's Most Admired Corporations. They found that firms with superior corporate reputations have a greater chance of sustaining superior financial performance over time

Anderson and Smith (2006) also use Fortune's Most Admired Companies list to test whether a great company – they define as “great” all companies listed there – is a great investment by comparing the market performance with the S&P 500 index. They find that portfolios of stocks from higher- reputation companies mentioned in Fortune's list significantly (both economically and statistically) outperformed the index, regardless of whether the stocks were purchased on the publication date or 5, 10, 15, or 20 trading days later .

Wang and Smith (2008) focused on determining “if a market value premium is associated with reputation and an evaluation of whether the market value premium, if it exists, is derived from superior financial performance or lower risk” and they found that “indeed high reputation firms do enjoy a market value premium”. They concluded that the behavior of reputable organizations creates intangible assets that are as valuable as would distinguish them from their peers in the industry.

Rose and Thomsen (2004) has examined the relationship between company's reputation and financial performances in Danish firms. They found that corporate reputation does not impact firm value (the market-to-book value of equity) whereas corporate financial performance improves corporate reputation.

Eberl and Schwaiger (2005) explore the relationship between corporate reputation of the company and future financial performances by using the data of German companies. They come to two important conclusions. The first one, financial performances in the past are only one component which affects reputation. The second one, the reputation is a "cognitive component" that has a positive impact on future financial performances, while there are strong evidences that "affective component" has a negative impact.

Sobol and Farrell (1988) revealed the potential impact of financial performance on reputation. They conducted study and introduced earnings per share ratio, price earnings ratio and dividend per share for the ten-year period of time. The results showed that the relevance of financial performance varies according to different attributes of Fortune survey and varies from company to company. During the second part of the study, the above mentioned authors presented possible crucial factors that affected the reputation.

Dunbar and Schwalbach (2000) also explored the relationship between reputation and financial performance, but based on the research in 63 German companies in the ten-year period. They found that the financial performances in the past had a strong impact on the future reputation. They gave more support for size and property concentration as factors that favor corporate reputation.

A pioneering study setting forth a wider concept of reputation was that of Fombrun and Shanley (1990), who regarded reputation as the overall perception of a firm's performance by its various stakeholders. The final aim of their study was to illustrate the diversity of information sources used by stakeholders to evaluate and establish the reputation of firms. Among the several variables they selected, the most significant signals were accounting variables, profitability and risk during the previous period, followed by market valuation.

Sabate and Puente (2003) pointed out that the relationship between reputation and financial performances included the answers on two questions, whether the relationship was positive or negative and whether the reputation had an impact on financial performances, or vice versa. They pointed out that, in developed countries, the positive impact of financial performances on corporate reputation had always been confirmed. Moreover, they suggested that a positive relationship between corporate reputation and financial performances would contribute to increased competitiveness.

## **2.1 Corporate reputation and shareholder value**

A good corporate reputation influences stakeholders' decision-making processes because it helps create a closer relationship between the firm and its stakeholders, creates value for the stakeholders, and increases their satisfaction and willingness to be involved with the company.

Corporate reputation has a market impact, for example higher market shares, premium prices, lower remuneration of employees, that strengthens the firm's market position. Possessing a high reputation is also valuable for firms regarding specific stakeholder groups: customers of more reputable companies show not only increased confidence in products and services, as well as advertising claims, but also a lower level of cognitive dissonance.

Understanding the relationship between corporate reputation and shareholder value requires knowledge about the various paths that explain how reputation influences investors: although reputation can have a direct impact on investors, certain effects cannot be directly linked to stock prices. This indirect path includes effects on stakeholder behaviour. Depending on how investors use information about corporate reputation as a value-relevant signal, either the direct path, in which investors react immediately to changes in reputations and adapt their willingness to buy and hold a stock, or the indirect path, in which investors underestimate the signal strength of reputation, becomes more important.



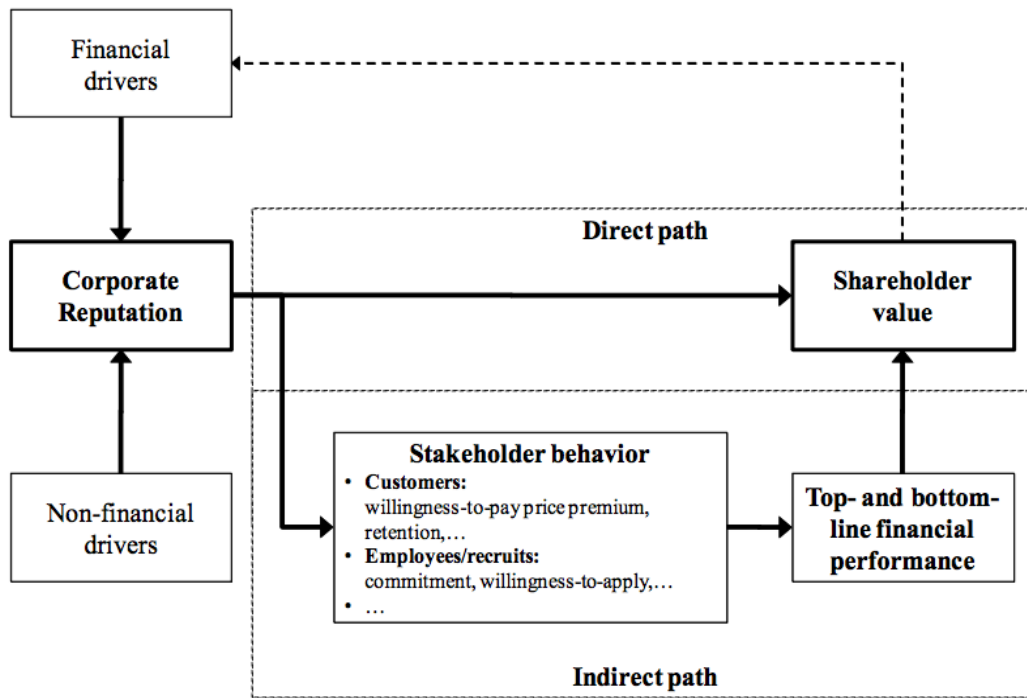


Figure 2 - Effects of corporate reputation on investor behaviour. Source: Raihel (2012).

Schwaiger et al. (2011) described three basic effects associated with any piece of (potentially) value-relevant information (metric) and their relationship to stock price movements: announcement effect, occurrence effect and mispricing effect.

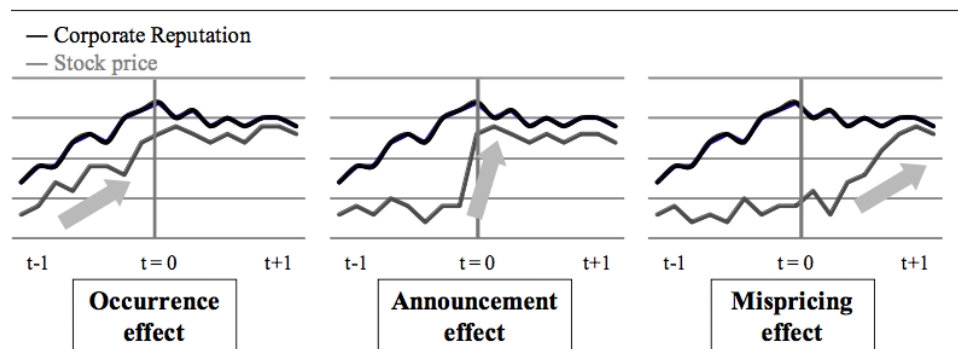


Figure 3 - Financial performance effects associated with corporate reputation. Source: Raihel (2012).

Investors react immediately to unanticipated information caused by discrete events such as the metric announcement. They react to unanticipated events correlated with metric realization. Therefore, investors have already formed expectations about the outcome of an event, such as the metric announcement. This expectation means the stock price incorporates the announcement effect before the announcement actually occurs. Investors, not fully appreciating the long-term value implications of corporate reputation, adapt their initial under- or overreaction to the metric announcement using, for example, unanticipated information ‘caused’ by higher/lower corporate reputation, such as unexpected higher/lower sales and profit.

## 2.2 Methodology

Corporate reputation values were calculated by modelling the influences on investor behaviour impacting on share price. Analysis is a two-stage process. To start with, the main factors that influence the investment community, and thus the market capitalisations, of individual listed companies as a whole are identified. This is achieved by means of statistical regression analysis of hard financial metrics. The financial data were sourced from Factset and Bloomberg. The data comprised reported and consensus forecasts from relevant industry analysts including:

EBITDA and EBIT

EPS

Return on Assets

Dividend yield

Beta – company and sector

Assets

Liabilities

Earnings per share

Stock liquidity

Reputation measures as taken from Management Today's 'Britain's Most Admired Companies' and Fortune's 'World's Most Admired Companies' reports. From there, a combination of metrics are calculated, including the gross economic benefit shareholders are deriving from the reputation asset, the location of value across the individual components of the company's reputation, the extent to which investment in reputation building will produce returns in value growth, and the relative value potential of individual messaging opportunities. It combines headline measures of reputation strength with financial metrics to explain the economic impact of each individual company's reputation asset. This is the Reputation Contribution – the proportion of the company's market capitalization that is directly attributable to the confidence instilled by its reputation.

## 3 MEASURING THE FINANCIAL PERFORMANCE EFFECTS OF REPUTATION

The relationship between a firm's reputation and its financial performance is complex. There are various reasons for this complexity. The first reason is that it takes profit to have the funds to invest in socially responsible activities. A second reason for this complexity is explained through stakeholder theory. The third reason is that corporate reputation often represents stakeholders' perception of the quality of the firm's management. Consequently, corporate reputation should be positively linked to the (expected) future value of a firm.

Reputation has long been recognized as a cornerstone of corporate value. The impact of reputation varies considerably from company to company. In the majority of cases, it drives real 'tangible' benefits and create positive shareholder value but in the remainder, they are so poor as to be damaging confidence and in that, destroying value.

In March 2015, reputations accounted for an average of 18.2% of market capitalization across the S&P 500, a year later, in March 2016, Reputation Contribution - the proportion of market capitalization attributable to the confidence inspired by their reputations increased by 2.5% points, to an average of 20.7% across the index \$584bn better off.

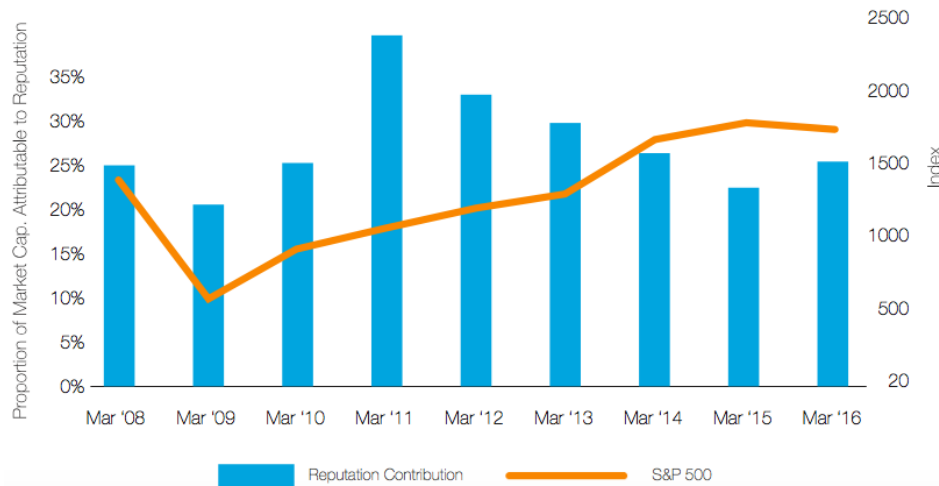












Figure 4- Reputation Contribution Development. Source: The 2016 US Reputation Dividend Report

In US, Apple held on to the top spot with the most economically effective corporate reputation in the S&P 500. Walt Disney was second while Alphabet (Google) moved ahead of ExxonMobil to third place. Starbucks' 11% rise in Reputation Contribution to 47% elevated the company from 16th to 7th position. Boeing, the only other company to break into the top ten, benefitted from a nearly 8% point increase in its Reputation Contribution to 44%.

Tab. 1 The Most Economically Impactful Reputations in the US 2016. Source: The 2016 US Reputation Dividend Report

Company	Reputation Contribution	Reputation Value	2015 Rank	Change in Rep Cont vs 2015
	55.9%	\$313,971m	1	6.4%
	52.0%	\$81,944m	2	2.6%
	51.6%	\$260,834m	4	4.4%
	51.2%	\$177,216m	3	2.6%
 NIKE, INC.	47.3%	\$48,976m	7	6.6%
	47.1%	\$150,089m	10	7.7%
	47.0%	\$40,711m	16	11.0%
	46.3%	\$81,890m	6	5.2%
	45.0%	\$131,118m	8	4.5%
	44.3%	\$35,145m	14	7.8%

In the UK, corporate reputation contributed £790 billion of shareholder value at the start of 2016, equivalent to 35% of the market capitalisation of the FTSE 350.

By the start of 2016 corporate reputations were supporting investor confidence to the extent that they were accounting for close to £790bn of shareholder value across the two main indices - 38% of market capitalisation in the FTSE 100 and 25% in the FTSE 250. Up from 30% and 16% over the year

respectively. All signs point to the fact that reputation played a substantial part in mitigating downward pressure on share prices and stemmed otherwise larger falls in the indices in the latter half of the year.

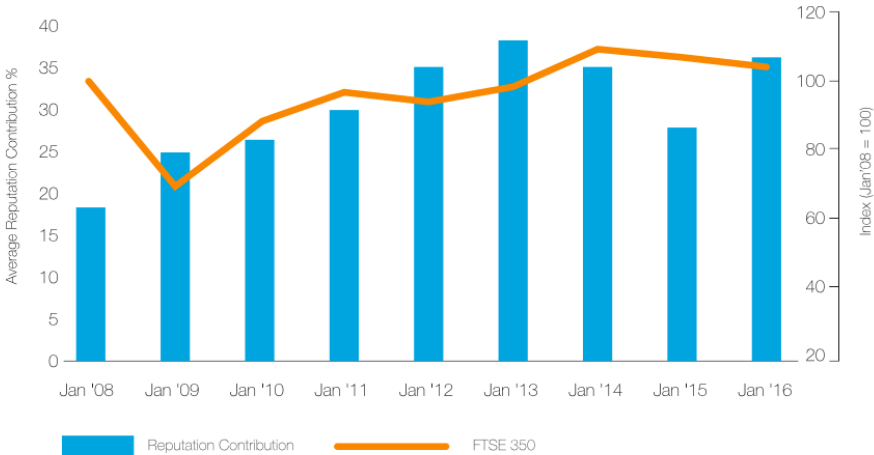











Figure 5 - The Changing Impact of Corporate Reputation. Source: The 2016 UK Reputation Dividend Report

Unilever held on to its position at the top of the table for the second year in a row and it has the most economically impactful reputation, with important gains see at Shell and Reckitt Benckiser, in second and third places respectively. Pharmaceutical company Shire joins top 10 for first time.

Tab. 2 The Most Economically Impactful Reputations in the UK 2016. Source: Source: The 2016 UK Reputation Dividend Report

Company	Reputation Contribution	Reputation Contribution change (% points)	2015 Rank	Reputation Value (Jan 2016)
 Unilever	57.8%	8.1%	1	£48,356m
 Shell	53.8%	8.5%	8	£62,061m
 Reckitt Benckiser	48.3%	2.3%	7	£20,302m
Johnson Matthey	47.5%	0.1%	5	£2,181m
 AstraZeneca	47.4%	7.1%	13	£25,198m
 easyJet	46.2%	-0.1%	6	£2,855m
 sky	46.2%	1.3%	10	£8,056m
 bhpbilliton	44.7%	28.7%	119	£14,897m
 Shire	44.3%	8.1%	23	£10,845m
 nationalgrid	44.1%	9.3%	30	£15,450m

## 4 CONCLUSION

Good company reputation is a distinctive competitive ability, which inevitably leads to a better market position. Superior corporate reputations can have strategic value for firms. The results of many studies have shown there is an impact of the reputation on financial performance, and vice versa. The company has more chance to keep superior performances over time if it has a relatively good reputation. Companies with good corporate reputation have better access to capital markets, which decreases capital costs and lowers procurement rates. Moreover, for private investors a higher reputation of a company leads to a stronger weighting of the company's stocks. This emphasizes the importance of strengthening the reputation. Good reputation makes it easier for companies to maintain a good financial performances over time. And good financial performances allow the company to sustain its reputation, and then contribute to the growth of its market value. The paper summarizes the current state of corporate reputation and how it impacts shareholder measured by Reputation Dividend Report in U.S. and U.K. It shows how reputation value is created when recognised strengths and qualities of individual companies coincide with investor interest.

### Acknowledgement

This article is one of the partial outputs of the currently solved research grant APVV no. APVV-15-0511 entitled "Research of the issue of Online Reputation Management (ORM) of subjects from automotive industry".

### References

- Anderson, J., & Smith, G. (2006). A great company can be a great investment. *Financial Analysts Journal*, 86-93. doi:10.2469/faj.v62.n4.4189
- Bromley, D. B. (2002). An examination of issues that complicate the concept of reputation in business studies. *International Studies of Management & Organization*, 32(3), 65-81. doi:10.1057/palgrave.crr.1540163
- De la Fuente Sabaté, J. M., & De Quevedo Puente, E. (2003). Empirical analysis of the relationship between corporate reputation and financial performance: A survey of the literature. *Corporate Reputation Review*, 6(2), 161-177. doi:10.1057/palgrave.crr.1540197
- Dunbar, R.L. & Schwalbach, J. (2000). Corporate Reputation and Performance in Germany. *Corporate Reputation Review* 3(2), 115-123. doi:10.1057/palgrave.crr.1540106
- Eberl, M., & Schwaiger, M. (2005). Corporate reputation: disentangling the effects on financial performance. *European Journal of Marketing*, 39(7/8), 838-854. doi:10.1108/03090560510601798
- Fombrun, C., & Shanley, M. (1990). What's in a name? Reputation building and corporate strategy. *Academy of management Journal*, 33(2), 233-258. doi:10.2307/256324
- Hall, R. (1993). A framework linking intangible resources and capabilities to sustainable competitive advantage. *Strategic management journal*, 14(8), 607-618. doi:10.1002/smj.425014080
- McGuire, J. B., Schneeweis, T., & Branch, B. (1990). Perceptions of firm quality: A cause or result of firm performance. *Journal of management*, 16(1), 167-180. doi:10.1177/014920639001600112
- Reputation Dividend (2016). The 2016 UK Reputation Dividend Report. Retrieved from: [http://www.reputationdividend.com/files/7814/5441/0391/UK\\_2016\\_Reputation\\_Dividend\\_report.pdf](http://www.reputationdividend.com/files/7814/5441/0391/UK_2016_Reputation_Dividend_report.pdf)
- Reputation Dividend (2016). The 2016 US Reputation Dividend Report (2016). Retrieved from: [http://www.reputationdividend.com/files/9114/7634/1581/US-2016\\_Rep\\_Div\\_Report.pdf](http://www.reputationdividend.com/files/9114/7634/1581/US-2016_Rep_Div_Report.pdf)
- Resnick, J. T. (2004). Corporate reputation: managing corporate reputation—applying rigorous measures to a key asset. *Journal of Business Strategy*, 25(6), 30-38. doi:10.1108/02756660410569175

Roberts, P. W., & Dowling, G. R. (2002). Corporate reputation and sustained superior financial performance. *Strategic management journal*, 23(12), 1077-1093. doi:10.1002/smj.274

Rose, C., & Thomsen, S. (2004). The Impact of Corporate Reputation on Performance:: Some Danish Evidence. *European Management Journal*, 22(2), 201-210. doi:10.1016/j.emj.2004.01.012

Sobol, M. G., & Farrelly, G. (1988). Corporate reputation: A function of relative size or financial performance?. *Review of Financial Economics*, 24(1), 45.

Schwaiger, M., Raithel, S., Rinkenburger, R., Schloderer, M., Burke, R. J., Martin, G., & Cooper, C. L. (2011). Measuring the impact of corporate reputation on stakeholder behaviour. *Corporate Reputation. Managing Opportunities and Threats*, 61-86.

### **Contact information**

Ing. Mária Kozáková

Univesity of Economics in Bratislava, Faculty of Business Management

Dolnozemska cesta 1/b, 852 35 Bratislava

0908 036 568

maria.kozakova@euba.sk

# EVALUATION AND EFFICINECY OF ADDITIONAL TRAINING IN CZECH COMPANIES IN THE CONTEXT OF FINANCIAL RESOURCES

*Ladislav Kudláček*

## **Abstract**

This paper has described the approach to measurement of additional training in Czech companies which have been financed from the European Social Fund (ESF) or from the Labour Bureau (LB) as a part of employee policy. In the context of ESF and additional training subvention is the issue of evaluation and training measurement underestimated in the Czech Republic. The evaluation of additional training and its output as well as the whole educational process is very important aspect of human resources management. Evaluation methods and their impact on efficiency of additional training could be influenced by financial resources. The donors have no methods how to measure economic efficiency of supported project. Moreover, training evaluation is an issue which does not have a simple solution. Still some Czech companies do not take enough interest in systematic evaluation of their training process or they make random or partial evaluation only or even no evaluation at all. Co-financing of additional training has influence on the shape of market and competition and has impact on quality and structure of companies, which offer additional trainings. Also the swing in incoming public resources has the impact on the shape as well as structure and intensity of additional training among Czech companies. Additional training has impact on companies and their profit as well as satisfaction on the market. (see Storej and Westhead: 1997). The paper has described the research which wants to find solution and general methods of additional training evaluation and measurement and compare the impact of investment money resources on the trainings' quality. The main goal of the research is hypothesis verification that the way of financing of additional training from external or internal resources has significant impact on outputs and quality of training process and has also influence to the overall company effectiveness in the category of small and medium size enterprises (SME). The research goal is evaluate and measure whether the additional training financing by own resources is more efficient and generate better company (in category of SME) productivity or not. It will also compare with the training financing from the public subvention from ESF. It can also show if this ESF policy reach the convergence's goals. Particular goal of the research is to find and statistically argue the utility of training in the way of company productivity according to ROI (Return of Investment) criteria in the selected sample of SME which do or do not invest to additional training from own resources or subvention. The result of the research will find the possible method for the donors which shows the efficiency of the subvention to additional training in the Czech Republic. It also will display if the quality of additional training depends on financial resources and whether the subvention has positive influence to the quality of additional training.

**Keywords:** *additional training, lifelong training, training evaluation, training efficiency European funds, ESF, European social fund, training measurement, human resources management, human resources development, education*

## **1 INTRODUCTION**

This paper has described the research about the approach to measurement of additional training in Czech companies which have been financed from the European Social Fund (ESF) or from the Labour Bureau (LB) as a part of employee policy. The evaluation of additional training and its output as well as the whole educational process is a very important aspect of human resources management. Evaluation methods and their impact on efficiency of additional training could be influenced by financial resources. There is a hypothesis that the funding education from external resources changes the emphasis on training outputs and the quality of training process from the view of human resources management. There are the causalities and impact on the efficiency of training outputs and assessing methods of training evaluation. The problem is enlarging by evaluation training depending on the financial funds – external or internal financial resources. Czech donors' agencies and European funds [ESF, Ministry of Labour and Social Affairs (MPSV), Labour Bureau] provide large amounts of money to the additional

education and training. However, they do not require the real efficiency of these projects inside the companies as beneficiaries or acquired knowledge or competence benefits of the employees. The donors have poor methods of measurement. It is not systematic and cannot give complete overview of the real funds effectiveness. Training evaluation is an issue which does not have a simple solution. Still some Czech companies do not take enough interest in systematic evaluation of the training process or they make random or partial evaluation only or even no evaluation at all.

The main goal of the research is hypothesis verification that the way of financing of additional training from external or internal resources has significant impact on outputs and quality of training process and has also influence to the overall company effectiveness in the category of small and medium size enterprises (SME). The research goal is evaluate and measure whether the additional training financing by own resources is more efficient and generate better company (in category of SME) productivity or not. It will be also compare with the training financing from the public subvention from ESF. It can also show if this ESF policy reach the convergence's goals.

## **2 THEORETICAL BACKGROUND**

Theoretical background based on the assumption that the additional training as well as education or training is able to measure. In the context of the research is additional training understand as a part of lifelong training. It can be define as addendum to formal and informal education (it means of lifelong training). The outputs from the measurement are able to show the efficiency of training according the financial resources – own resources or the subvention.

Measurement of training should give the method how to evaluate training. It means if the training was successful for the company goal and brings profit and the investment to additional training was returned. It is efficiency of training. Generally there are other methods how to measure trainings such as satisfaction questionnaire from reaction of training participants (compare Mann 1996), but the research will focus more on profit measurement from investment such as ROI – return of investment. Both approaches are possible to find in the as well as in Czech companies but according to Pindea the trends prefer ROI. (compare Pindea 2010: 674)

### **2.1 Czech context of training evaluation and trainings' funds**

In the context of financing of additional training in Czech companies has been prepared the research project. It will find the influence of financial resources and their source on additional training. It means that the research will focus which money for training are from the company own financial resources or from the EU funds as well as Active employment policy (APZ) subvention.

The issue of evaluation and efficiency of additional training depending on the way of financing according to the internal or external resources (subvention) is very actual in present time. The reasons for that are:

- 1) Existence of support of additional training as subvention from the resources of European Structural funds – especially from the OPZ to the year 2020 or from the domestic state subvention (as a part of APZ).
- 2) Assumption of the economic growth of the Czech Republic and its gross domestic product (GDP), which according to PPP will be in near future over 75 % of average GDP (PPP) all 28 EU members in particular Czech regions NUTS 2. These convergence regions in the Czech Republic will be characterised as transit regions in new programming period [in the case that they will not reach the 75 % average GDP (PPP) of EU-15]. We can expecting in next programming period the change of structure of the project as well as the change of co-financing the additional trainings projects in companies. Depending of this evolution we can await echo also in the market of additional training.
- 3) Co-financing of additional training has influence on the shape of market and competition and has great impact on quality and structure of companies, which offer additional trainings. Also the swing in incoming public resources has the impact on the shape as well as structure and intensity of additional training in the Czech companies. Especially the resources from ESF constitute the main part of financial



funds which go to the additional training. [e.g. in OPZ is the funds dominantly concentrate (about 61 %) to the priority 1 – “The support employment and working forces adaptability” where is primary supported additional and lifelong trainings (ESF: 2015)]. It has increased rapidly the share of people who take part of the additional training process.

4) In the UK exists studies which evaluate the influence of additional training on SME and also its effect on small companies' development. (e.g. compare Storej and Westhead: 1997) From this view is good to verify what kind of attitude dominate among the Czech companies and how big is the hypostatical effect on its competitiveness when the subvention from ESF will finished. It is also interesting look at the studies about effect of convergence policy on employment in supported regions and on their GDP growth (compare Beckera, Eggerb, and Ehrlich: 2010). This study work is not exist any verifiable impact between ESF expenditure and increasing employment. According to this study it does not exist. It is very important according to goals of convergence and ESF programme and its plans for the funds allocation in the next programming term. On the other hand there is verifiable impact on the speed of GDP growth especially in the countries, which use ESF after entering EU. This statement has been based on comparison of development of NUTS regions which were very similar to each other according their GDP (PPP), but one region was near over 75 % average GDP of EU and second was near under the level. (Beckera, Eggerb, and Ehrlich: 2010) This attitude is possible to applicate also in the Czech Republic, especially, when we compare the development in NUTS 2 and NUTS.

## **2.2 Training evaluation in companies**

According to Philips (Phillips, and Phillips 2016: 5) the present global trends in evaluation of company training are based on increasing cost to training measurement and evaluation. The average spending is about 3 to 5 % of the human resources development (HRD) budget. This is also based on the preferences of companies which are moving up the value chain, away from measuring reaction and learning to measuring application, impact, and ROI (Return of Investment). Companies also integrate measurement and evaluation plans and methods to their training programme. It is very integral part of the training now.

These are very important trends which also shows radical shift of managers' thinking around the world. According to Mann (Mann 1996: 14) who 20 years back wrote that companies did not collect the information to determine the utility of their own training programmes and the most common form of evaluation is the reaction of training participants at the end of the training programme.

If we understand that training is an investment, it must be held accountable like other investments which has been done by the company, and must demonstrate that the decisions and actions taken are relevant and profitable. It means that the actual impact made by training to the companies' results need to be discovered. Evaluation is the key tool for this purpose. (Pindea 2010: 674)

According to my own experience as well as for example Mann (Mann 1996: 14), must to say that there is very high number of organization in the Czech Republic as well as in the world which do not focus on training evaluation and measurement and do not collect any information to conclude the utility of their additional trainings.

It can be seen that the similar negative trends in the Czech Republic and their supporting additional training and lifelong training programmes which are the part of European structural funds – especially from the OPZ to the year 2020 (and OP LZZ in previous programming term) or from the domestic state subvention (as a part of Active employment policy). Donors' agencies such as Ministry of Labour and Social Affairs or its agency Labour Bureau do not have really significant tool for evaluation and measurement of training which they manage, support and financing. They do not really measure application, impact, and ROI. In the Czech contexts is relevant project “Koncept” which try to find the system for measurement of quality of additional training. The result was the proposal of the system of training institutes evaluation as the holders of the quality. (see Bezděková 2012) There is some links to the Czech law (code 179/2006 Sb.) but there is not really the practical effect on relevant part of additional training in Czech companies. The material has more theoretical than practical effect.

### **2.3 Subvention to additional training and their potential impact**

The data from the years 2013, 2014 and 2015 are able to show potential impacts on the additional training market and quality of additional training when projects of additional training from the ESF funds were gradually finishing in 2015 and the other programming term had not started. In that time the share of the persons in the age 25-64 years who finished any type of lifelong training decreased from 10 % in the year 2013 on 9.6 % in the year 2014 and finished on 8.5% in the year 2015. In comparison with EU is the Czech Republic under average rate 10.7 % in the year 2013 and 2015 (10.6 in the year 2014). (Statistická ročenka České republiky 2016: 786) It shows that EU money have influence on intensity of additional (or lifelong) training. The real impacts would be noticeable in the year 2016 when OPZ's projects in the new programming term started and the intensity of financing was very low. Moreover, there is a potential gap between private and public training cost in the year 2016 which would be able to show the positive or negative impact to additional training as well as lifelong training. Therefore, there is no real systematic evaluation or measuring which is able to show it.

## **3 RESEARCH OF EVALUATION AND MEASURING OF ADDITIONAL TRAINING**

All what was mentioned above is the base for the assumption as well as the hypothesis which are the main part of the research project to describe and find the situation in Czech companies. The main goal of the research is hypothesis verification that the way of financing of additional training from external or internal resources has significant impact on outputs and quality of training process and has also influence to the overall company effectiveness in the category of small and medium size enterprises (SME). It is limited by manufacturing industry – according to section C of CZ-NACE). The research goal is evaluate and measure whether the additional training financing by own resources is more efficient and generate better company (in category of SME) productivity or not. It will be also compare with the training financing from the public subvention from ESF. It can also show if this ESF policy reach the convergence's goals.

Particular goal of the research is to find and statistically argue the utility of training in the way of company productivity according to following criteria:

- 1) What is the revenue and ROI development on the selected sample of SME when do not invest to the additional training except obligatory trainings.
- 2) What is the revenue and ROI development on the selected sample of SME when invest mainly own resources to additional training of their employees over the frame of obligatory trainings.
- 3) What is the revenue and ROI development on the selected sample of SME when invest from subvention (mostly ESF subvention) to additional training over the frame of obligatory trainings.

Measuring additional training through ROI development is fundamental method which is able to use over the enterprises as well as economic sectors. Other approaches for measuring as questioning trainings' participants, lectors' feedback or knowledge verification are not able to use as general methodology with comparable numbers (outputs).

Hypothesis verification has been planned to period of the years from 2012 to 2017.

### **3.1 Solution methods**

The way of solution and methods of the research is primary built on statistical survey based on primary resources gained from SME which will be belonged to statistical sample. The sample will be built on multistage structural random selection. The sample will be structured according to category of table CZ-NACE in the section C – Manufacturing Industry according second space of mentioned classification.

Statistical survey discovery on selected sample of SME following information:

- 1) In the sample of SME will be found out by the questionnaire whether SME invest to additional training over the frame of obligatory training and in what amount of money.
- 2) On the base of public database of ESF will be found out whether SME obtain the subvention form ESF on additional training and what the amount of money was.
- 3) the base of published financial outputs (revenue and ROI measurement) in particular years will be found on the sample of SME the revenue development and the ROI development.

The three category of division, respectively three areas of partial goals division as well as three categories of companies as a part of partial goals 1, 2, 3 will help to make incoming variable verification according to training financing.

The outputs will be divided according SME categories (according to sphere, size and ownership).

Definition of small and medium size enterprise, on which is the survey based, is given by the size of company according to number of employees:

Small enterprise: 1-49 employees

Medium size enterprise: 50 – 249 employees

Type of ownership bases on the companies owned by forfeiting capital – it is owned by individual or corporate body more than 50 % from abroad.

Type of ownership bases on the companies owned by domestic capital – it is owned by individual or corporate body more than 50 % by domestic hands

Multistage structural random selection / sample will be designed for SME in the way of representativeness. The determinative deviation must be acceptable and the sample and the selection must eliminate risk of refusal from the respondents. It will eliminate other negative influence to the outputs – respectively the growth of determinative deviation.

The size of the sample will be set up according the number of companies which received any kind of ESF subvention. In planned three categories would be the same number of companies.

Ad 1)

The data resources will be mostly primary data directly gain from the sample of SME which do not get any subvention to the additional training from ESF resources. They will have not been realised any training project financing from ESF.

Data will be collected from structural questionnaire with the help of telephoning or emailing as well as personal interview with the companies. It would be expecting 5 % of returning questionnaire. In that context will be planned the number of connected companies.

Ad 2)

The data resources will be mostly from public database administrated by MPSV, which as a managing body collect the information about projects and companies which has gotten financial support / subvention to the additional training from ESF (OP LZZ, OPZ) together with the information about the amount of the subvention.

Ad 3)

The data resources will be the economic results in final accounts in years from 2012 to 2017 published by the companies from the sample in the Czech public business list.

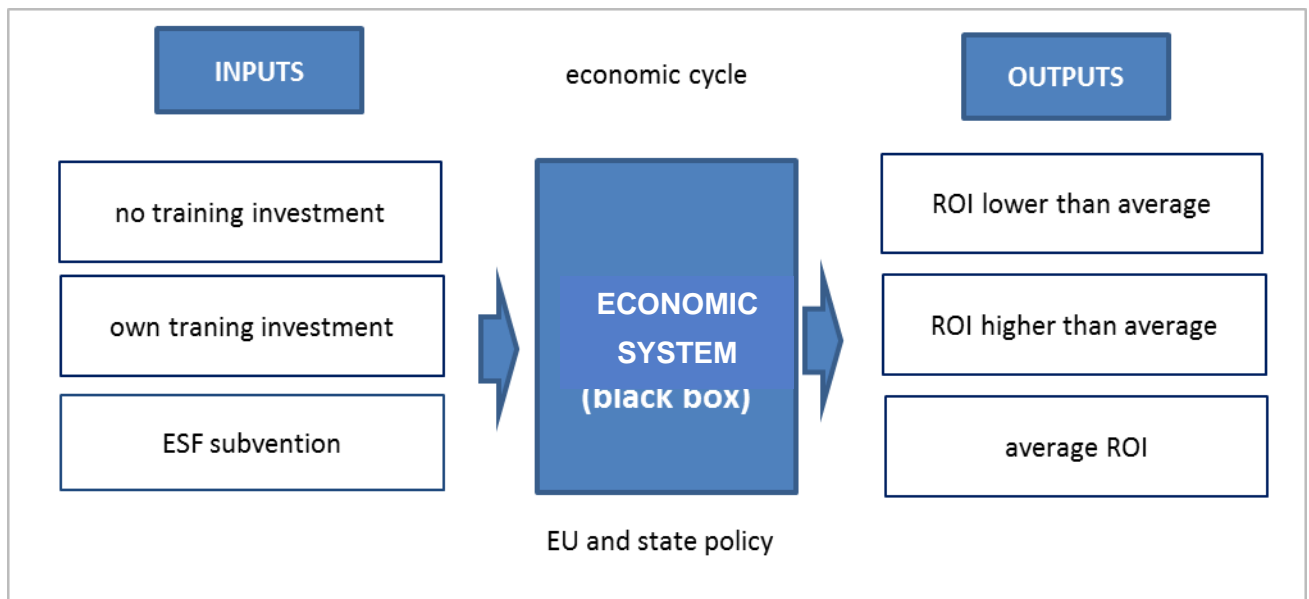


Figure 1 – Framework of the Research Inputs and Outputs

Overview of the inputs and outputs framework is showed in the figure 1. The research plan should eliminated independent and middle variables as much is possible by good selection of the research sample by random selection. There will be elimination of middle variable such as economic growth and EU and state policy in additional training and subvention by sample grouping and selected period for the survey. The outputs will show ROI compare to average in manufacturing industry sector among SME. It will show if the training or the resources for training financing are relevant to ROI development.

#### 4 CONCLUSION

Described research is very important in the context of the EU funds efficiency in the Czech Republic as well as in other EU members' states. Secondary it is also evaluation of EU policy of convergence and its success. OPZ and its programme for additional trainings is one of the biggest one among ESF in the Czech Republic. There are no real methods of measurement of its success for the companies as well as for the whole agenda. As was mentioned there is modern trend of training evaluation and measuring which focus on ROI. It is not new method but it gives better comparison among companies than others. It is one fundamental method which is able to use over the enterprises as well as economic sectors. Other approaches for measuring as questioning trainings' participants, lectors' feedback or knowledge verification are not able to use as general methodology with comparable numbers (outputs). These methods have bigger depending on economic sector structure, employee structure, education structure as well as cultural aspects. There is one effort in project "Koncept" (see Bezděková 2012) to find quality of training but it is focus more on quality of education than effectiveness. "Koncept" gave the way through measuring and comparing the training companies by their grading. Described research above which wants to find the solution and find the general methods of additional training evaluation and measurement and compare the impact of investment money resources on the quality of training. The main goal of the research is hypothesis verification that the way of financing of additional training from external or internal resources has significant impact on outputs and quality of training process and has also influence to the overall company effectiveness in the category of small and medium size enterprises (SME). The research goal is evaluate and measure whether the additional training financing by own resources is more efficient and generate better company (in category of SME) productivity or not. It will also compare with the training financing from the public subvention from ESF. Particular goal of the research is to find and statistically argue the utility of training in the way of company productivity according to ROI criteria in the selected sample of SME which do or do not invest to additional training from own resources or subvention. The research want to show the way of measuring for donors (MPSV,

LB) as well as for the Czech companies which also searching for the method for their HRD efficiency measuring.

## References

- Bezděková, K. (2012). Kvalita dalšího vzdělávání - koncepční část. NUOV. Retrieved from [http://www.nuov.cz/uploads/koncept/k\\_diskusi/Kvalita\\_DV\\_Analyticko\\_koncepcni\\_studie.pdf](http://www.nuov.cz/uploads/koncept/k_diskusi/Kvalita_DV_Analyticko_koncepcni_studie.pdf).
- Beckera, S. O., Eggerb, P.H. & Ehrlich, M. (2010). Going NUTS. The effect of EU Structural Funds on regional performance. *Journal of Public Economics*, vol. 94, no 9-10 (October 2010), pp. 578-590.
- Blundell, R., Dearden, L., Meghir, C. & Sianesi, B. (1999). Human Capital Investment: The Returns from Education and Training to the Individual, the Firm and the Economy. *Fiscal Studies*, vol. 20, no. 1 (March 1999), pp. 1-23.
- Chaplowe, S. G. & Cousins, J. B. (2015). *Monitoring and Evaluation Training: A Systematic Approach*. Los Angeles, SAGE Publications, Inc.
- Dellmuth, L. M. & Stoffel, M. F. (2012). Distributive politics and intergovernmental transfers: The local allocation of European Union structural funds. *European Union Politics*, vol. 13, no. 3 (September 2012), pp. 413-433.
- ESF (2014). Výroční zpráva o provádění operačního programu Lidské zdroje a zaměstnanost za rok 2014. Retrieved from <http://www.esfcr.cz/file/9113/>.
- ESF (2015). Operační program zaměstnanost 2014-2020. Retrieved from <http://www.esfcr.cz/file/9079/>.
- Gallo, J., Dall'Erba, S. & Guillan, R. (2011). The Local versus Global Dilemma of the Effects of Structural Funds, Growth and Change, vol. 42, no 4 (December 2011), pp. 466-490.
- Lynch, L. M. (1994). *Training and the private sector: international comparisons*. Chicago: University of Chicago Press, NBER Comparative labor markets series.
- Mohla, P. & Hagenc, T. (2010). Do EU structural funds promote regional growth? New evidence from various panel data approaches. *Regional Science and Urban Economics*, vol. 40, no. 5 (September 2010), pp. 353-365.
- Nicolson, A. (2010). Vocational education and training – an engine for economic growth and a vehicle for social inclusion?. *International Journal of Training and Development*, vol. 14, no. 4 (December, 2010), pp. 251–272.
- Pindea, P. (2010). Evaluation of training in organisations: a proposal for an integrated model. *Journal of European Industrial Training*, Vol. 34, Iss 7, pp. 673-693.
- Phillips, P. P. & Phillips, J. (2016). *Handbook of Training Evaluation and Measurement Methods*. 4th edition, New York, Routledge.
- Phillips, P. P. and Phillips, J. (2015). *Real World Training Evaluation*. New York, Association for Talent Development.
- Statistická ročenka České republiky 2016. Statistical yearbook of the Czech Republic 2016. (2016), Praha, Český statistický úřad.
- Storej, J. D. & Westhead, P. (1997). Management training in small firms – a case of market failure?. *Human Resources Management Journal*, vol. 7, no. 2 (April 1997), pp. 61-71.
- Mann, S. (1996). What should training evaluations evaluate?. *Journal of European Industrial Training*, Vol. 20 Iss: 9, pp.14 - 20.

**Contact information**

Ing. Mgr. Ladislav Kudláček

Tomas Bata University in Zlín, Faculty of Management and Economics

Mostní 5139

760 01 Zlín

Phone: 732424777

Email: kudlacekl@seznam.cz

# SUSTAINABLE TOURISM DEVELOPMENT - A CASE OF PHU QUOC ISLAND, VIETNAM

*Vu Minh Hieu, Ngo Minh Vu*

## **Abstract**

As tourism is one of the fastest growing industries today. Thus, sustainable tourism development become more and more important to a destination which make it to be more competitive and ideal Tourism can also be one of the most effective drivers for the development of regional economies. Phu Quoc – an island district of Kien Giang Province of Vietnam, with great potentials not only for the economic development but also for tourism development, face with many challenges and drawbacks. A holistic study is required to be done to help Phu Quoc become an ideal destination in the sustainable member. This is to provide a scientific study through proposing research questions to develop and examine a conceptual framework for sustainable tourism development which addressing the integration of social, economic, and ecological elements. The findings are useful for the island or other destinations with similar contexts in practice and fill a notable gap in the literature of sustainable tourism development for the island in theory. The proposed methodology used in this study is the triangulation method.

*Keywords: Sustainable Tourism Development, Destination Management, Phu Quoc Island, Vietnam.*

## **1 INTRODUCTION**

Tourism industry becomes one of the largest and fastest growing economic sectors in the world (WTO, 2012). In many countries and regions, it has been chosen as a priority for their prosperity, especially in poor, less developed countries, tourism is captured as a lifebuoy for developing, maintaining or improving the economy. The rising potentials of tourism sector has been noticed to all Southeast Asian countries for years (Kimura, 2011) and sustainable tourism has become part of sustainable development. From the publication of Brundtland Report (Our Common Future) in 1987, the sustainable development became famous worldwide. The importance of sustainable development was recognized in the Brundtland Report, in 1987 (World Commission on Environment and Development 1987) and in the United Nations Conference on Environment and Development in Rio de Janeiro in 1992, and for the World Summit on Sustainable Development in Johannesburg in 2002. The sustainable development requires the harmonization the economic development, the social development and the environmental development. To date, sustainable development has become an avoidable trend in the evolution of human society.

Vietnam is a developing country and also considered as the most peaceful and favorite destination in Asia and endowed with great potential for tourism development. In Vietnam, Vietnam does not stay outside the global trend of following tourism for a flourishing economy. The Vietnam tourism position has improved significantly on the world tourism map and Vietnam becomes an attractive destination. Therefore, in the strategy on Viet Nam's tourism development until 2020, vision to 2030 has been made and tourism is decided to be a key economic sector. However, Vietnam tourism revealed the inadequacies in the development process.

Phu Quoc – an island district of Kien Giang Province, it is the largest island of Vietnam which located in the Gulf of Thailand with great potentials for the economic development and especially for tourism development. Phu Quoc owns a long coastline, beautiful beaches, numerous islands, coral reefs, beautiful and pristine beaches on the planet with clear blue water, white and smooth sand, diverse ecosystem, historical-cultural relics, life styles and habits in the island residents, craft villages. Phu Quoc is also named as a Pearl Island, by the mysterious beauty. However, Phu Quoc island faces several hidden drawbacks by a (too) fast growth and showing challenges of transport, infrastructure, tourism, accommodation facilities, qualified human resources, etc. In addition, the awareness regarding environmental problems is very low (<http://baothainguyen.com.vn/tin-tuc/khoa-hoc-cn/he-sinh-thai->

[bien-phu-quoc-dang-bi-de-doa-25728-99.html](http://bien-phu-quoc-dang-bi-de-doa-25728-99.html)). (<http://baotintuc.vn/bien-dao-viet-nam/phu-quoc-phat-trien-du-lich-bien-20150917155249237.htm>). This issue is currently underestimated and not corresponding with the exploitation. As known, the quality is a must in the service industry and tourism industry is not excluded. Tourism service quality must be upgraded. Vietnam government and local authority have strategic decisions to Phu Quoc being the Special Economic Administrative Region and a master plan for tourism development. This is to facilitate Phu Quoc's development of tourism industry to be a key pearl island in Vietnam.

To mitigate weaknesses and strengthen the positive impacts of tourism, it is necessary and essential to develop tourism in a more sustainable manner. As a consequence, Phu Quoc is more likely to become an ideal destination and is the competitor of many destinations in ASEAN and in the world. The scientific and systematic studies for finding solutions and recommendations as well as promoting the development of tourism in Vietnam are required as an urgent task. However, the holistic study of sustainable tourism development for Phu Quoc is not existed. For fulfilling this gap, this study intends to provide a scientific study through proposing research questions to develop and examine a conceptual framework for sustainable tourism development. This focuses on “making tourism more sustainable” of which results deliver valuable information and furthermore a concrete delineated roadmap for all destinations in same cases.

## **2 LITERATURE REVIEW**

### **2.1 Concepts on tourism development**

As the development nature, it is a process of change and may be explained in a variety of ways. Harrison (1992) and Woodcock & France (1994 - cited in *Tourism and development: Concepts and Issues*, Richard Sharpley & David J. Telfer, 2105). In the literature, approaches to development ranges from the laissez-faire to diffusionism, dependency and sustainability, although any approach has not ever attained absolute dominance.

Mai (2009) and Thong (2006), tourism development requires certain conditions and local authorities are responsible for creating and ensuring those conditions. Those two kind of conditions include the general and the specific. The general is for the tourism activity development such as population's leisure time, high living standards and cultural level, traffic development, stable politic, etc. and the specific conditions are tourism resources, socio-economic and humanistic resources and tourist reception willingness. Also, Gunn & Var (2002) further points out that the causes of travel to a destination are grounded in the destination's resources, natural and cultural, and the attractions that relate to them. Tourism development in the future is based the location and quality of the natural resources. (Gunn & Var, 2002).

Liu (2003) states that tourism development is both supply-led and demand-led and the provision of tourist facilities and services may arise as a response to growing demand or aim to stimulate tourist demand. Also, Liu (2003) some argue that tourism is a resource industry and very dependent upon natural environment assets and maybe that is why sustainable tourism has focused on the preservation and conservation of natural resources. But as Liu also states (2003) tourism requires three levels of resources; 1) the attractions of tourists including natural, cultural, and purpose-built, 2) the infrastructure and superstructure to support tourist activities and 3) the physical and social settings including the hospitality of the community. Last but not least the tour operators or agencies that may package everything and promote the whole destination (Liu, 2003).

### **2.2 Definitions of tourism destination management**

WTO (1999, 2007), a tourist destination is “an important place visited by tourists which represents the basic unit of analysis in tourism”, and destination management is “the coordinated management of all the elements that make up a destination (attractions, amenities, access, marketing and pricing)”. Besides, with destination management, it requires to have a strategic approach to link-up all or some separate entities to gain the better management of the destination. (WTO, 2007)



Franch & Martini (2002:5) define destination management as “the strategic, organizational and operative decisions taken to manage the process of definition, promotion and commercialization of the tourism product [originating from within the destination], to generate manageable flows of incoming tourists that are balanced, sustainable and sufficient to meet the economic needs of the local actors involved in the destination”. According to Geić (2011) states destination management as the process of creation, guide and adjustment of all the factors to produce a unique tourist product of a destination in which individuals work together and effectively realize established socio-economic goals. In practice, for managing a tourist destination, that is a long-term process which ensure the destination competitiveness and to achieve a higher quality of life standard for local inhabitants and the cultural identity preservation of the whole tourist destination (Blažević, 2007).

As this aspect, some scholars such as Sheldon and Park according to Bartoluci, (2013), Krešić (2007), Magaš, (2003) also comment. The first thing to do in the destination management is for its competitiveness and sustainability. This is to create long-term insurance of the competitiveness of the destination and also reach the main goal of the tourist organization management (Sheldon & Park according to Bartoluci, 2013).

### **2.3 Definitions of sustainable tourism**

With Butler (1993) and Wheeller (1993), there are many interpretations of the term of sustainable tourism in which all are appropriate or accepted. Liu (2003) says origins of the concept of sustainability are from the environmentalism that has developed in the 1970s. Probably, the common definition of sustainable development is from the Brundtland Commission Report which defined as “meets the needs of the present without compromising the ability of future generations to meet their own needs” (WCED, 1987). WTO (2005) defined “Tourism that takes full account of its current and future economic, social and environmental impacts, addressing the needs of visitors, the industry, the environment and host communities”. From that point of view, sustainability principles concern to the environmental, economic, and socio-cultural aspects of tourism development, and a suitable balance must be established between these three dimensions to guarantee its long-term sustainability. Also, sustainable tourism is firmly sticky to the sustainable development principles where keep the three dimensions’ balance as the basic principle to ensure a long-term of development; equity in society and reducing poverty are center point of development. In tourism context, fulfillment of tourists’ demands is also taken into account as an element for a viability of this sector. The conceptual definition of sustainable tourism refers to sustainable tourism development guidelines and management practices that are applicable to all forms of tourism in all types of destinations, including mass tourism and the various niche tourism segments (WTO, 2013) and this is also considered as the standard model for sustainable tourism development researches.

According to Butler (1993), sustainable tourism is “tourism which is in a form which can maintain its viability in an area for an indefinite period of time”. Furthermore, Butler claims that the most common-used definition of sustainable tourism is: “tourism which is developed and maintained in an area (community, environment) in such a manner and at such scale that it remains viable over an infinite period and does not degrade or alter the environment (human and physical) in which it exists to such a degree that it prohibits the successful development and well being of other activities and processes (Butler 1993, p. 29). However, Butler states “the key problem is the current inability to define to the satisfaction of all, or even most, of the stakeholders in tourism, exactly what is meant by sustainable tourism” (Butler, 1999a). With Blancas et al. (2011), sustainable tourism is “not a specific form of tourism but more an approach that can be used to make all types of tourism more environmentally, socially and economically beneficial”.

In the Vietnamese Law on Tourism, the sustainable tourism concept seems tightly faithful to the sustainable development definition of BRUNDTLAND (1987) that “sustainable tourism means development of tourism that meets the needs of the present without harming the ability of the future to meet tourism needs.” (Nasrv, 2005).

Coccosis (1996) have suggested that there might be four ways to link sustainable development with tourism; economic sustainability of tourism, an ecological viewpoint of tourism, the long-term viability

of tourism. Butler refers to Bramwell (Bramwell, 1996, cited in Butler, p. 23) in the review of principles and practice of sustainable tourism management. There is several dimensions of sustainability as environmental, cultural, political, economic, social, managerial and governmental. They also points out that each of decision makers and researchers will have different interpretations of the concept upon on each different dimensions.

In Liu (2003), some of the main aspects of sustainable tourism is persevering cultural heritage, maintaining traditional values and providing authentic experiences for tourists. Liu (2003) believes that most socio-cultural changes brought into the community by tourism development is beneficial and the fact that tourism is promoting modern values, social progress and cultural evolution should be appreciated. This is argued by that societies in developing countries needs changes and input from the rest of the world. Should the less developed world keep its traditional culture in the sake for the tourists who wish to seek exotic and authentic experience? Liu (2003) states that for many tourist destination s the key attraction to tourists is their exoticness or primitiveness, whether it is reflected in the forms of how they live, traditional crafts or pristine environment. Clarke (1997) created a framework of approaches to sustainable tourism and four positions, chronologically sequenced according to the understanding of sustainable tourism a possession or goal was proposed.

Hobson & Essex (2001) states that: “it is very challenging to monitor the impact of tourism industry on the environment since “the environmental impacts of tourism are not simply those related degradations caused by the volume of visitors, but the resource implications resulting from the operation the tourism-related businesses such as transportation pressures and pollution, energy and water consumption, waste generation and purchase strategies. Beioley (1995, cited in Hobson and Essex, 2001, p.135) includes four aspects of sustainable tourism; first, it has to respect the economic well – being and social and cultural concerns of the host communities. Second, it has to respect the local environment. Third, it has to reduce impacts on natural resources and pollution. Forth is has to provide the visitor with good experiences.

Garrod & Fyall (1998 cited in Liu, 2003, p. 465) speak of two approaches to sustainable tourism: the macro and the micro approaches. The macro approach includes the use of environmental balance sheets to measure sustainability conditions, while the micro approach includes the use of social cost-benefit analysis at the level of the individual tourism development project.

To avoid such misconception, the usage should change to the term “sustainability in tourism” or to use always the version with focus on development: “sustainable tourism development” (Steingrube, 2013a). To do so, sustainable tourism development requires the informed participation of all relevant stakeholders, as well as strong political leadership to ensure wide participation and consensus building. Achievement of sustainable tourism is a continuous process and requires constant monitoring of impacts, introducing the necessary preventive and/ or corrective measures whenever necessary.

## **2.4 Definitions of sustainable tourism development**

In tourism, many definitions are for sustainability and sustainable development (Butler, 1999b; Page & Dowling, 2002). Caribbean Sustainable Tourism Policy Framework (2008) defined sustainable tourism development as the optimal use of social, natural, cultural and financial resources for national development on an equitable and self-sustaining basis to provide a unique visitor experience and an improved quality of life through partnerships among government, the private sector and communities.

Bramwell & Lane (2000, cited in Liu, 2003, p.467) says that “sustainable tourism development is a process where one need to align the needs of the tourists, the tourist businesses, the host community and the need for environmental protection”. Furthermore, Inskeep (1988), sustainable tourism development meets the needs of present tourists and host regions while protecting and enhancing opportunities for the future. It is envisaged as leading to management of all resources in such a way that economic, social, and aesthetic needs can be fulfilled while maintaining cultural integrity, essential ecological processes, biological diversity, and life support systems. Butler (1993) defined sustainable tourism development remains viable over an indefinite period and does not degrade or alter the environment (human and physical) in which it exists to such a degree that it prohibits the successful development and well-being

of other activities and processes. These concepts received high agreement of other authors such as Murphy (1994), Mowforth & Munt (2003).

According to Tosun (1998a), sustainable development is considered in the context of this article as maintenance of the determined principles of development indefinitely without leaving future generations with poorer prospects and greater risks than our own. In a similar manner, sustainable tourism development is accepted as all kinds of tourism developments that make a notable contribution to or, at least, do not contradict the maintenance of the principles of development in an indefinite time without compromising the ability of future generations to satisfy their own needs and desires. Addition to this concept, Hens (1998) pointed out sustainable tourism development requires stakeholders' attention concerning to resources' management in different ways to explore and deliver wide range of tourism products to meet economic, social and aesthetic needs which is remaining cultural identity, ecosystem diversity and life safety for future generations.

WTO (2001) defined sustainable tourism development meets the needs of present tourists and host regions while protecting and enhancing opportunity for the future. It is envisaged as leading to management of all resources in such a way that economic, social, and aesthetic needs can be fulfilled while maintaining cultural integrity, essential ecological processes, biological diversity, and life support system". In other words, sustainable tourism development is ecologically sustainable, economically viable as well as ethically and socially equitable. It respects the fragile environmental balance that characterizes many tourism destinations, particularly in environmentally sensitive areas; and it is based on a long term perspective.

The concept of sustainable development (variously described as eco-development, self-sustaining development or suspensory development). Sustainable development is based on three pillars: economic development, environmental protection and social development. Recently the term "social development" is being replaced as the "socio-cultural development". This concept assumes properly and consciously shaped relationship between the pillars, which are intended to ensure intra- and inter-generational economic, environmental and social balance (Meyer & Milewski, 2009). Currently concepts of sustainability are included in the vast majority of regional development strategies; the term appears even in the Polish Constitution. Sustainable tourism is defined as all forms of activities, management and development of tourism that preserve natural, economic and social integrity and guarantee maintenance of natural and cultural resources.

Sustainable tourism development guidelines and management practices are applicable to all forms of tourism in all types of destinations, including mass tourism and the various niche tourism segments. Sustainable tourism development requires the informed participation of all relevant stakeholders, as well as strong political leadership to ensure wide participation and consensus building. Achieving sustainable tourism is a continuous process and it requires constant monitoring of impacts, introducing the necessary preventive and/or corrective measures whenever necessary. Sustainable tourism should also maintain a high level of tourist satisfaction and ensure a meaningful experience to the tourists, raising their awareness about sustainability issues and promoting sustainable tourism practices amongst them.

Sustainable tourism concerns particularly important aspects such as competitive and socially responsible tourism businesses, the opportunity to participate in tourism for all citizens, good employment opportunities in the sector and benefit from tourism activities for the local community. This requires the preservation of cultural integrity and the integration of environmental protection and cultural heritage resources in programs related to tourism. Extensive attempts to implement the principles of sustainable tourism development are made both at the regional level and at the level of tourism enterprises

Through above definitions, as authors' viewpoints, sustainable tourism is the development of tourism activities to meet current needs of tourists and local residents with interests to the preservation, restoration and promotion of cultural values and tourism resources as well as creation of the political and social environment stability and security for the tourism development. In addition, sustainable tourism development is the development process focusing on all four aspects: economy, politics, society and the environment with interests to the preservation, restoration and promotion of cultural values and tourism resources. Whereas the definition of tourism development only concerns to the practical

economic, political and social benefits without its mention to the preservation, restoration and promotion of cultural values and tourism resources for tourism development for the current and the future.

### **3 THE CURRENTS ON PHU QUOC ISLAND**

In 2006, Kien Giang island and marine coastal, including Phu Quoc are nominated by UNESCO as Biosphere Reserves Site. As its nature, the climate in Phu Quoc island is in the tropical monsoon area (hot and humid, rainy, ...), and, due to its unique location in the Gulf of Thailand, it should be less affected by natural disasters. Phu Quoc has been an invaluable resource as tropical forests, where there are many varieties and endemic. More of that, other resources such as marine resources, land resources, water resources, etc. create great potentials for the economic and tourism development. In addition, Phu Quoc island owns a long coastline, beautiful beaches, numerous islands, coral reefs of which many beaches have been voted by many American and European magazines as the beautiful and pristine beaches on the planet, with clear blue water, white and smooth sand. Also, the beautiful resort island also has an extremely rich and diverse ecosystem with mountains, rivers, streams and the historical, cultural and Vietnamese traditional and fresh cool climate all year round. Furthermore, tourism products are bound to find out the various types of historical-cultural relics, life styles and habits in the island residents, the fishing and traditional villages, especially for natural ecosystem study. People not only in Vietnam but also in the world know Phu Quoc in the name of the Pearl Island. This name is set such by its mysterious beauty. According to tourism experts, there is no island in the Asian region in general, in particular in Vietnam gaining better conditions for the tourism development in comparison with Phu Quoc. The present form of tourism industry in Phu Quoc seems to run well. Despite of the seeming success, very simple and general observations indicate several weaknesses of the current situation and risks for the future tourism development. Phu Quoc island is facing several hidden drawbacks, which are generated by a (too) fast growth and incommensurate with its potential tourism through some challenges such as the transportation, the infrastructure, accommodation facilities, the shortage of qualified human resources, the environmental protection and biodiversity, tourism products, entertainment services especially of night-life services, etc. Local inhabitants gain benefits from the tourism on a very low level. Only very few locals earn a lot of money by their tourism business. That means the distribution of the benefits is highly disproportional. The general problem of economic disproportion is known and tourism is designated as a leading factor to foster the economic in the region. Also, the environment of Phu Quoc island is being threatened by tourism development. This issue is currently underestimated and not corresponding with the exploitation.

According to the literature reviews and the current situation in Phu Quoc in term of sustainable tourism development, there are the notable gap between the expectations and the practices. Apparently, the tourism development in Phu Quoc is not well-organized toward sustainable purpose but the economic driver is dominant currently. This issue raises a urgent task for drawing attentions of all the stakeholders which in charge of Phu Quoc tourism development to the sustainable purpose. At first, an exploratory study needs to use a conceptual framework for sustainable development in tourism industry in Phu Quoc context to discover which the most problematic issues are in the Phu Quoc tourism development. In this research, we propose the conceptual model for tourism sustainable development and highlight the key research questions to investigate sustainable problems in Phu Quoc case.

### **4 RESEARCH METHOD, RESEARCH MODEL, RESEARCH QUESTIONS AND OBJECTIVES**

This study is totally based on secondary data collected from different sources. For this extant literature related to the topic from different databases, websites and other available sources were collected. Apart from these, data has been taken different Books, Journals, Research Papers and other online and print media by using the following keywords: tourism development, sustainable development, destination management, Phu Quoc island. Later, a systematic review of collected literature and the meta-analysis were done to reduce bias through comprehensive literature searches. Based on this, publications were found relevant and usable for this study. The present study was undertaken to propose a conceptual model of sustainable development in the tourism industry applying to Phu Quoc Island.

This study aims to develop and examine a conceptual framework for sustainable development in tourism industry context to address the integration of social, economic, and ecological elements of sustainable development and the contextual nature of sustainable development. In addition, it is also to develop guidance on how to make tourism more sustainable in an already mass tourist destination. As of an academic study, it is surely focusing on its objectives which need a scientific background and techniques and it completely cannot solve all mentioned and existing problems. The proposed research model for the study is from the model of World Tourism Organisation which is the most well-known and basic model for most of countries, regions and sectors in the world (figure 1).

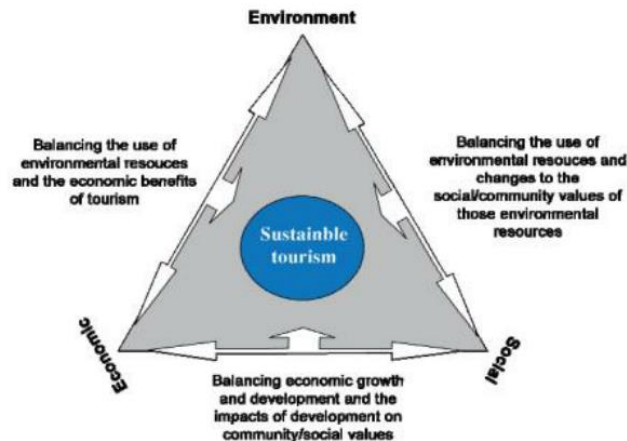


Figure 1: Triangle of Sustainable Tourism Source: Dredge and Jenkins (2008)

This then raises questions:

What are the current situations of tourism management in Phu Quoc? What important factors affect to the sustainable tourism management in Phu Quoc?

What are the criteria for sustainable tourism development in Phu Quoc island?

What should be the policy guidelines to support and promote the sustainable tourism development and management in Phu Quoc?

Is there any new factor or model which can guide sustainable tourism development in the future for Phu Quoc?

The research interest identifies the results that lead to the development of sustainable tourism. This research studies main areas

To clarify basis foundations and transfer the knowledge and experience on sustainable tourism development from developed countries to Phu Quoc island.

Based on scientific surveys, to provide the solid and reliable information about tourism development in Phu Quoc. Several surveys with stakeholders, local people, etc. shall be implemented by the quantitative and qualitative method to identify problems hindering sustainable tourism development.

To provide recommendations, suggest a model (if possible) to Phu Quoc Island towards sustainable tourism development, which can be used as a general pattern for other destinations and also find limits of destinations for which these indicators are applicable.

To find key factors and measurable sustainable tourism development indicators for island as a destination.

#### 4.1 Suggested research methodology for further research

In general, there are two very different approaches namely quantitative and qualitative procedures (Kothari 2009 and UNAIDS 2010). Sabina & Khan (2012), triangulation is used to combine the advantages of both the qualitative and the quantitative approach. Each method offers specific advantages as well as disadvantages. More of that, tourism is considered as among the most complex topics in social

science and researcher, who study this phenomenon, look at it from many different perspectives and they use many different tools to collect and analysis data (Smith, 2010). Presently, tourism researchers have often used both qualitative and quantitative methods and the most recognized are literature review, documentary, in-depth interview, focus group, observation, case-study, and questionnaire survey (Walle 1997; Riley & Love 2000; Lohfeld & Brazil 2002 – cited by Tinh 2009: 66).

This study is in the field of sustainable tourism development. The researcher's objective is covering three principle dimensions regarding to social, economic, environmental aspects. This also means diverse information is requiring and accordingly different methods need to be employed. Therefore, this study uses a methodological triangulation. The research data-gathering methods: literature reviews - secondary data and semi-structured interviews are all used to gain insights into the core research questions. Each method feeds into and is strengthened by the others and their combination. All serve to get more detailed information and to create a clear perspective about the concept of sustainable tourism development. The detailed methods are as following:

Secondary data collection relies on a vast contemporary scientific literature, studies, documentations and projects connected to the sustainable tourism development. They are from the grey literature, traditional analog paper versions and digital information, etc. All theories and literatures from Batta 2000, WTO, and others. Besides, official and up-to-date statistical data and information from governmental departments concerning general demographic, social and economic facts and furthermore specific data regarding tourism and environment - are also collected and used in this study. They will focus on the three factors of sustainable tourism development as natural condition, human resources, basic infrastructure (Street, power, water, and telecommunication systems...); touristic infrastructure and tourism planning and regulatory structures the current and the estimated plan.

Estimated primary search consists of a questionnaire, expert discussions, field observation and semi-structured and in-depth interviews surveys conducted in Phu Quoc and Kien Giang province. They are as follows

Questionnaire to households' survey and visitors by the face-to-face and others.

Expert discussions (at the beginning and the end) to explore a general idea about tourism in the region, weaknesses and problems and visions of future development

Field observation to learn how the locals behave when they serve in tourism, guest's behaviors & their activities and etc.

Semi-structured and in-depth interviews to different stakeholders as hotel owners, restaurant establishment owners, agriculture stakeholders, fishery stakeholders, craft stakeholders, and local authorities, etc.

## **5 CONCLUSION**

The study is useful for Phu Quoc and the theory of the sustainable tourism development. For the theoretical contributions, this study not only set out to examine them to sustainable tourism development from the scientific knowledge and selective experiences in developed countries with special reference to Vietnam but also made to the literature lies in the detailed discussion and conceptualization for an island in sustainable tourism development in the island context. As a consequence, from the analyze and findings from the literature, any impact factor may be found and add to model of sustainable tourism development in the island context. As for the practical aspect, in Vietnam, there are some studies on the sustainable tourism development but the study for an island sustainable tourism development like Phu Quoc has not existed. And of course, this will be useful and applicable to Phu Quoc island of Kien Giang province for its sustainable tourism development. Although this is a case study and its results may deliver valuable information for all same destinations in a similar context. It serves as a beginning step to discover a sustainable development strategy for tourism not only for Phu Quoc but many other destinations as well.

## References

- Alain Decrop. (1999). Triangulation in qualitative tourism research. *Tourism Management* (20), 157 – 161
- Bartoluci, M. (2013). *Upravljanje razvojem turizma i poduzetništva*. Zagreb: Školska knjiga.
- Batta, R. N. (2000). *Tourism and the Environment: A Quest for Sustainability: with Special Reference to Developing Countries, and Policy Analysis on Himachal Pradesh*. Indus Publishing.
- Blancas, F. J., Lozano O., González, M., Guerrero, F.M., & Caballero, R. (2011). How to use sustainability indicators for tourism planning: the case of rural tourism in Andalusia (Spain). *The Science of the total environment*. 412-413, 28-45.
- Blažević, B. & Peršić, M. (red.) (2009). *Turistička regionalizacija u globalnim procesima*, Sveučilište u Rijeci, Fakultet za menadžment u turizmu i ugostiteljstvu, Opatija.
- Blažević, B. (2007), *Assessing the Kvarner Tourism Offering*. *Tourism and Hospitality Management*, 13 (1), 1-435.
- Brundtland, G. H. (1987). *Report of the World Commission on Environment and Development: Our Common Future*. Retrieved from [http://iwr.tuwien.ac.at/fileadmin/mediapool-ressourcen/ARA\\_Lectures/ARA\\_Lectures\\_Brundtland.pdf](http://iwr.tuwien.ac.at/fileadmin/mediapool-ressourcen/ARA_Lectures/ARA_Lectures_Brundtland.pdf)
- Butler, R. W. (1993). *Tourism an evolutionary perspective*. In J. G. Nelson, R. Butler, and G. Wall (eds), *Tourism and sustainable development: monitoring, planning, managing*, 26-43. Waterloo: Heritage Resources Centre. University of Waterloo.
- Butler, R. W. (1999a) *Problems and issues of integrating tourism development*. In D.C. Pearce and R.W. Butler (eds) *Contemporary Issues in Tourism Development*, 65 -70. London: Routledge.
- Butler, R. W. (1999b). *Sustainable tourism: A state-of-the-art review*. *Tourism Geographies*, 1 (1), 7–25
- Clarke, J. (1997). *A framework of approaches to sustainable tourism*. *Journal of Sustainable Tourism*, 5 (3), 224-233.
- Coccosis, H. (1996). *Tourism and sustainability: Perspectives and implications*. In *Sustainable Tourism? European Experiences*, ed. G.K. Priestley, J.A. Edwards and H. Coccosis, 1-21. Wallingford. Oxford: CAB International.
- Geić, S. (2011), *Management of selective tourism forms*, University in Split, Split
- Gunn, C & Var, T. (2002). *Tourism Planning: Basics, Concepts, Cases 4th Edition*. Great Britain: Roytledde
- Harrison, D. (1992). *Tourism and the Less Developed Countries*. Wiley: Chichester.
- Hens, L. (1998). *Tourism and Environment*, Free University of Brussels, Belgium.
- Hobson, K. & Essex, S. (2001). *Sustainable tourism: A view from accommodation businesses*, *The Service Industries Journal*, 21 (4), 133–146. <http://dx.doi.org/10.1080/714005050>.
- Inskip, E. (1988). *Tourism planning: An emerging specialization*. *American Planning Association Journal*, 54 (3), 360-372.
- Kimura H. (2011). *Tourism, sustainable tourism and ecotourism in developing countries*, Paper for ANDA International Conference in Nagoya. March 5-7. 2011
- Korathi, C. R. (2009). *Research methodology: Methods and Techniques* (2nd revised eds). New Wiley Eastern Ltd., Delhi.
- Krešić, D. (2007). *Tourism destination attractiveness factors in the function of competitiveness*. *Acta turistica*, 19 (1), 45-82.

- Liu, Z. (2003). Sustainable Tourism Development: A Critique. *Journal of Sustainable Tourism*, 11 (6), 459-475.
- Magaš, D. (2003). Management turističke organizacije i destinacije. Opatija: Fakultet za turistički i hotelski menadžment
- Mai, T. T. (2006). An introduction to tourism (Vietnamese language). Labor – Society Publishing house. Vietnam
- Martini, U. M. & Franch, M. (2002). E-tourism Project Research Areas And Second-Year Results. Retrieved from <http://www.cs.unitn.it/etourism/>
- Meyer, B. & Milewski, D. (2009) Strategie rozwoju turystyki w regionie. Wydawnictwo Naukowe PWN.
- Mowforth, M. & Munt, I. (2003). *Tourism and sustainability: new tourism in the Third World* (2nd ed), London & New York, Routledge Publisher.
- Murphy, P. E. (1994). Tourism and sustainable development. in W.F. Theobald (ed.). *Global Tourism: The Next Decade*. 274-290. Butterworth-Heinemann. Oxford.
- NASRV (The National Assembly of Socialist Republic of Vietnam). (2005). Law on Tourism. Vietnam.
- Page, S. J. & Dowling, R. K. (2002). *Ecotourism*. Harlow: Prentice Hall
- Richard, S. & David, J., T. (2015). *Tourism and development: Concepts and Issues*, 2nd edition. Bristol. Channel view publications.
- Sabina Y. & Khan F. R. (2012). Triangulation' Research Method as the Tool of Social Science Research. *BUP journal*, 1 (1).
- Smith, S. L. J. (2010). *Practical Tourism Research*. ISBN: 978 1 84593 6327
- Steingrube, W. (2013). Strategy for a more Sustainable Tourism Development in the Baltic Sea Region. Presentation at 6th Baltic Sea Tourism Forum in Ringsted/DK at 25/26.9.2013.
- Thong, T. V. (2006). An introduction to tourism (Vietnamese language). Labour. HCMC National University Publishing house. Vietnam.
- Tinh, B. D. (2009). *Tourism Industry Responses to the Rise of Sustainable Tourism and Related Environmental Policy Initiatives: The case of Hue City, Vietnam*. Auckland University of Technology.
- Tosun, C. & Jenkins, C. L. (1998) 'The evolution of tourism planning in third-world countries: A critique'. *Progress in Tourism and Hospitality Research*, 4 (2), 101-114.
- Tosun, C. (1998a) 'Roots of unsustainable tourism development at the local level: The case of Urgup in Turkey'. *Annals of Tourism Research*, 19 (6), 595-610.
- UN (United Nations). (2010). *International Recommendations for Tourism Statistics 2008*. New York. Retrieved in 27 September 2016 from [http://unstats.un.org/unsd/publication/Seriesm/SeriesM\\_83rev1e.pdf](http://unstats.un.org/unsd/publication/Seriesm/SeriesM_83rev1e.pdf)
- UN (United Nations). (2012). Report of the United Nations Conference on Sustainable Development.
- UNEP (United Nations Environment Program) and WTO (World Tourism Organization). (2005). *Making tourism more sustainable: a guide for policy makers*. Retrieved in 27 September 2016 from <http://sdt.unwto.org/content/about-us-5>.
- UNEP (United Nations Environment Program). (2009). *Sustainable Coastal Tourism: An integrated planning and management approach*. Retrieved from [http://www.unep.org/pdf/DTIE\\_PDFS/DTIx1091xPA-SustainableCoastalTourism-Planning.pdf](http://www.unep.org/pdf/DTIE_PDFS/DTIx1091xPA-SustainableCoastalTourism-Planning.pdf)
- UNEP (United Nations Environment Program). (n.d.-c). SCP (Sustainable Consumption and Production) Publication: *Making Tourism More Sustainable - A guide for Policy Makers*.



Wendy, O. (2004). Triangulation in Social Research: Qualitative and Quantitative Methods Can Really Be Mixed. *Developments in Sociology*, 2004, ed. M. Holborn. Ormskirk: Causeway Press. Retrieved in 20 September 2016 from <http://www.federica.eu/users/9/docs/amaturo-39571-01-Triangulation.pdf>

Wheeler, B. (1993). Sustaining the ego. *Journal of Sustainable Tourism*. 1 (2), 121-129.

World Commission on Environment and Development. (1987). *Our Common Future*. New York: Oxford University Press.

WTO (1994). *Tourism Manual No.5 Finance and Tourism*. World Tourism Organization Publications.

WTO (1999), *National and Regional Tourism Planning*, International Thomson Business Press, London

WTO (2001). The concept of sustainable tourism. Retrieved in 20 July 2016 from <http://sdt.unwto.org/content/about-us-5>

WTO (2007), *A Practical Guide to Destination Management*, UNWTO, Madrid.

WTO (World Tourism Organization). (2012). *UNWTO Tourism Highlights 2012 Edition* (p. 16). Madrid, Spain. Retrieved from [http://dtxtq4w60xqpw.cloudfront.net/sites/all/files/docpdf/unwtohighlights12enhr\\_1.pdf](http://dtxtq4w60xqpw.cloudfront.net/sites/all/files/docpdf/unwtohighlights12enhr_1.pdf)

WTO (World Tourism Organization). (n.d.-a). *World Tourism Organization UNWTO: History*. Retrieved in 23 September 2016 from <http://www2.unwto.org/en/content/history-0>.

WTO (World Tourism Organization). (n.d.-b). *Understanding Tourism: Basic Glossary*. Retrieved 20 July 2016 from <http://statistics.unwto.org/sites/all/files/docpdf/glossaryen.pdf>

Young, P. (1968). *Scientific Social Surveys and Research*. New Delhi: Prentice Hall.

### **Contact information**

VU MINH HIEU

Mendel University in Brno, Faculty of Economics and Management

Czech Republic

Email: [hieuvu2000@gmail.com](mailto:hieuvu2000@gmail.com) (for correspondence)

NGO MINH VU

Tomas Bata University in Zlín, Faculty of Management and Economics

Czech Republic,

Email : [ngo@fame.utb.cz](mailto:ngo@fame.utb.cz)

# CULTURAL TOURISM AND THE TOURISM DEVELOPMENT IN PHU QUOC ISLAND, VIETNAM

*Vu Minh Hieu, Nguyen Tan Tai*

## **Abstract**

Culture and cultural attractions are important factors for the tourism development and Cultural tourism is presently considered as the fastest growing market in tourism. Cultural tourism is concerned with a country or region's culture such as the lifestyle, the history, the art, the architecture, the religion(s), and other elements. Cultural tourism represents an area of significant benefits to tourism industry. This paper is to review cultural tourism currents and potentials, then to formulate recommendations to the tourism development in Phu Quoc island. The data for this research come from two sources the secondary data as literature, papers and researches such as Google Scholar, Science Directs, Scopus, etc. and primary data from questionnaires and interviews. results will be as guidelines to develop the tourism industry in Phu Quoc island.

**Keywords:** *Cultural tourism, potentials, Vietnam (Phu Quoc), tourism development.*

## **1 INTRODUCTION**

Along with the globalization of the world's economy, tourism - an economic sector are also being globalised and the travel and tourism industry is one of the world's largest industries with a global economic contribution (WTO, 2012). Culture and cultural attractions have become crucial in the tourism development. Richards (2001) expresses at the global level, cultural attractions are considered as important streams of global culture but also at the national and/or local level, culture plays an important role in establishing and reinforcing people's unique identities. In addition, cultural attractions become as a significant source for the tourism development at the local, regional and international level (Richard, 2001)

Phu Quoc – a 593 km<sup>2</sup> area island district of Kien Giang Province is located in the Gulf of Thailand. Phu Quoc island is in the World Biosphere Reserve recognized by UNESCO in 2006 (<http://phuquocisland.gov.vn/vi-vn/chinhquyen/gioithieu/tongquanvephuquoc.aspx>). By its mysterious beauty, Phu Quoc island also has other name as Pearl Island. Tourism activities are stretching out from the land, ocean and aerial scopes such as hiking, scuba diving, fishing, trekking and snorkelling. As surrounding by sea, aside from beachside activities, Phu Quoc are also attracted tourists by traditional villages, expansive nature parks, pagodas, festivals and famous cuisines. The island's still-unspoiled natural spots are really worth seeking out and make Phu Quoc become undeniably one of the most attractive destinations not only in Vietnam but also in the Asian region. This paper reviews literatures of cultural tourism and its potentials for tourism development in Phu Quoc island, and to formulate recommendations on how to develop it in the tourism industry.

## **2 LITERATURE REVIEW**

### **2.1 Definitions of cultural tourism**

Cultural tourism is often seen as one of the fastest growing sectors of tourism industry (WTO, 2008; McKercher & Du Cross, 2002) and it has been growing relatively fast in recent decades (Smith & Richards 2013). The concept of cultural tourism has been in existence for a long time (Hughes & Allen, 2005), complex and gains long debate about its definition and conceptualization among scholars (Shackelford, 2001; Michalkó, 2004; Richards 2005) because two elements of 'culture' and 'tourism'

are included and in which of themselves are difficult to define by its dynamism of all types and sub-types of tourism practiced in or world. There are a great number of definitions of cultural tourism in use (City Tourism and Culture – The European Experience, 2005).

Cultural tourism is not all about visiting/ participating or consuming to museums and galleries, arts events and festivals, heritage attractions and sites, and other cultural experiences. Its essence is about encountering a destination's history and heritage, its stories, its people, its landscape, its townscape, its culture. It is about discovering what makes a destination distinctive, authentic, and memorable. That is about the experience of "a place" (Thorne, 2009). Cultural tourism is considered as a subdivision of tourism in concerning to the culture of an area or a country in specific geographical areas, the lifestyle, the art of those people, their religion, history and other factors of their lifestyle and it contains tourism in major and large and historical cities and urban areas, and their cultural facilities like theatres and museums (Prentice, 2001). Cultural tourism is a mean for individuals and societies to reach an opportunity to access and gain awareness of one another's places and pasts (Robinson & Picard, 2006). Therefore, it requires visits aim to see and experience to other peoples' traditions (Mbaiwa, 2005; Mugalavai, 2007; Jones, 2009; Nzama, 2010).

Medlik (1996) defines in the Dictionary of Travel, Tourism and Hospitality published in 1996, cultural tourism is a general term referring to leisure travel motivated by one or more aspects of the culture of a particular area. Also, in Charter of cultural tourism (1997) of ICOMOS -International Scientific Committee on Cultural Tourism, cultural tourism can be defined as that activity which enables people to experience the different ways of life of other people, firstly to understand customs, traditions, the physical environment, the intellectual ideas and those places of architectural, historic, archaeological or other cultural significance remaining from earlier times and its difference from recreational tourism is to seeks to the understanding or appreciation of the nature of the place being visited (ICOMOS Charter for Cultural Tourism, 1997).

By focusing on tourists' experiences. Australian Office of National Tourism defines tourism focuses on the culture of a destination - the lifestyle, heritage, arts, industries and leisure pursuits of the local population (Office of National Tourism 'Fact Sheet No 10 Cultural Tourism', 1997) and by focusing on experience during the trip, "Cultural tourism is an entertainment and educational experience that combines the arts with natural and social heritage and history." (Cultural Tourism Industry Group, <http://www.culturaltourismvictoria.com.au/>).

In general, cultural tourism can be regarded as the movement of individuals to cultural attractions away from their normal place of residence, with the intention to gather new information and experiences to satisfy their cultural needs (Richards, 1997; Smith, 2003). Cultural tourism involves visiting museums, artistic activities, galleries, cultural heritage zones; it also includes the lifestyles formed by beliefs, languages, religious activities, gastronomy, nutrition habits, dressing of people, architectural buildings, handworks, artefacts and related atmosphere (Craik, 1991; Mbiti, 1991; WTO, 2005). Thus, in tourism, culture can be represented as physical and/or material; tangible or intangible as well as the practices of everyday life (McCarthy, 1992; Keitumetse, 2005; Smith & Richards, 2013).

## **2.2 Nature - characteristics and contributions of the cultural tourism**

According to World Tourism Organization (WTO, 2012), this substantial feature reveals opportunities to improve the effectiveness of national and regional tourism through the development of cultural-historical tourism - through absorption and integration of cultural-historical resources in the regional tourism product and development on this basis of a regional tourism brand. Cultural tourism is based on the "cultural heritage" which includes intangible and tangible movable and immovable heritage. Under the law of Vietnam, (Law no. 32/2009/QH12 date 18/6/2009 on amending and supplementing a number of articles of the law on cultural heritages) ([http://www.moj.gov.vn/vbqpq/en/lists/vn%20bn%20php%20lut/view\\_detail.aspx?itemid=10463](http://www.moj.gov.vn/vbqpq/en/lists/vn%20bn%20php%20lut/view_detail.aspx?itemid=10463)), "intangible cultural heritage means spiritual products associated with related communities, individuals, objects and cultural spaces, which are of historical, cultural or scientific value, express the identity of communities, are constantly recreated and transmitted from generation to generation orally, through craft teaching, performing arts or in other forms" and "tangible cultural heritages are material

products of historical, cultural or scientific value, including historical-cultural relics, famous landscapes and beauty spots, vestiges, antiques and national precious objects". Under this concept, cultural tourism owns several sub-types a cultural ecotourism, indigenous cultural tourism; eco-cultural tourism and socio-cultural tourism (Brooker, 2003). Cultural tourism includes besides all the visiting of historical sites and sightseeing, providing the opportunity for enjoyment of past human achievements and as part of domestic tourism, visiting those places is an object of admiration, national pride and rediscovering the achievements of our ancestors.

In addition, cultural tourism is a tool for economic development achieving economic growth by visitors' attraction outside the community-host who are with their interests and overall/ partial motivation in the historical, artistic, scientific or related to lifestyle and traditions reality and facts of a community, region, group or institution. That travel is concentrated on the feeling of the cultural environment. Tourism is looking for ways to create "marketable tourism products" as well as environment for work and life. Cultural-cognitive tourism is an interaction between cultural, ethnic and historical components of the society or of the place to be used as resources to attract tourists and tourism development.

Cultural tourism contributes positively and negatively to the economic wealth of a region through its socio-economic effects which depends on the type of activity and the territorial features alike. The negative impacts are relating to risks of commodification of local traditions (MacCannell, 1976) and negative influence on cultural identities and self-understanding (Tomaselli, 2012) such as increased crime and degradation of morality, environment, etc... In addition, Mbaiwa (2011) emphasizes commodification of culture and commercializing traditional arts and craft can decrease the quality of cultural products.

In contrast, many advantages are created with cultural tourism (Minciu, 2004) like seasonal freedom, large attendance including all categories of tourists, the possibility of development in any area ensuring a good use of resources. As presented, activities of cultural tourism are to showcase the lifestyle of cultural and ethnic groups along with their history, artefacts and monuments, cultural events as exhibitions, competitions, carnivals, festivals, concerts that they have created (Jones, 2009; Silberberg, 1995; Smith, 2004). Therefore, from cultural tourism, local communities can take pride in their culture, strengthens community identity and ties and socio-economic urban regeneration from financed programmes (Mitchell & Ashley, 2010; Mugalavai, 2007; Saarinen, 2009; Smith & Richards, 2013; Sutherland, 2006). This is an essential in preservation and enhancement to national and local pride and spirit. Culture and heritage features are essential in building a country's image, thus cultural tourism can be on of the key instruments in developing a positive image of a country internationally.

Local products, artefacts as well as the host community in a certain locality are the main factors in cultural tourism, therefore, it can be viewed as a form of tourism that is built around cultural resources (Okech, 2009) and tourists can experience local cultures and reach opportunity to appreciate and improve their understanding of local cultures (Lenao, 2009; Nzama, 2010). Cultural tourism can provide a symbiotic relationship between local communities which results in satisfaction of the tourists and sustains the wellbeing of local people (Bob & Singh, 2007; Mbaiwa & Sakuze, 2009) and due to many participants and stakeholders in the development of the tourism industry particularly by tour operators and local communities in exploring and safeguarding cultural heritage, as a result, much interaction with the tourists are gained to which leave a lasting impression on tourists. (Lapeyre, 2011; Mugalavai, 2007). Local communities can benefit through poverty alleviation and job creation especially in historically disadvantaged communities (Lapeyre, 2011; Mitchell & Ashley, 2010; Moswete et al., 2009; Saarinen et al., 2014).

Generally, great potentials can be gained from the cultural tourism for the lives of local people (Zeppel & Hall, 1991) such as cultural exchange and understanding. Cultural tourism helps preserve the cultural and historical heritage. Tourism makes an important contribution to culture and historical heritage by providing means for keeping the traditions alive and finances the protection of heritage as well as increase visitor appreciation of that heritage. In short - more public interest and more funds for protection. Tourism interest in the heritage site can be the key in providing political support for the management and protection of the heritage in question. (e.g. music and art have long been called international languages) (McCarthy, 1992); stimulate conservation and heritage preservation efforts

(Mckercher & Du Cross, 2002; Zeppel, 2002); revitalize traditional building and craft industries; generate economic activity and local or regional development; and enhance community cohesiveness and pride in cultural identity (Richards, 1997; Smith, 2009; Sutherland, 2006). Cultural tourism is considered to be a catalyst for change, designed for stimulating economy through tourists which are generating social and economical benefits. Cultural tourism brings pride to local communities and at the same time creates cultural bondage and understanding between host and guest communities. (Sudipta et al., 2010)

### **3 METHODOLOGY**

The study aims to present findings from information collected from the secondary and primary data. Secondary data are collected from the literature, papers and researches such as Google Scholar, Science Directs, Scopus, etc. Primary data is from 200 questionnaires with tourists (including 80 international tourists) to Phu Quoc island and 20 interviews with craft villages' owners, the local authorities and cultural heritage management members. Later, the statistical method employed in this study to analyse the data. The questionnaires were distributed and collected to/from tourists by the tourist corporates. The questionnaire aims to explore

The tourists' concepts, expectations and feelings on the cultural tours.

Opinions of owners (craft villages) and cultural heritage management members on the issues of cultural tourism such as revenue and market, investment capital, human resources, local government supports.

Difficulties and advantages from the tour organisers

Viewpoints of local authorities on any present development plan or supportive policy applying this tourism.

### **4 FINDINGS AND DISCUSSIONS**

#### **4.1 Results from the survey.**

According to travel companies, they only organize separate/ private cultural tours under tourists' own orders and needs. About 98% of tour operators do not organize the private cultural tours. The Phu Quoc tours are the packaged tours including cultural sites. This is because tourists expect to experience with a variety of activities during the trip. Those result is consistent with tourists' responses. About 98% of tourists are interested in the "so-called" cultural tourism. As for domestic tourists - more than 87% would like to have the travel in which they can enjoy and experience a variety of activities because the travel will become monotonous if they are only for the cultural travel except they follow a group or company (organized or ordered by corporates where they employs).

However, the result shows the difference exists between domestic and international tourists, especially for tourists who are from Europe or America (called as westerners). With westerners, they are much interested in the cultural explorations of their travels. 95% of them are interested in discovering/ understanding about Vietnam's cultures like lifestyles, craft villages, gastronomy, history, artefacts and monuments, exhibitions, competitions, carnivals, festivals, concerts. Additionally, during their travels, they buy products of the traditional craft villages, enjoy the culinary arts as their experience and souvenirs.

Also from the survey result, most owners (craft villages) and those who are working in the field of cultural tourism do not really feel the importance and the development method and trend to promote to be the best as it can because they develop and produce traditionally. This is coming from the many constraints such as seasonal dependency, local government supports, market development, human resources, capital, technology, knowledge, etc...

From the viewpoints of the local authorities and management managers, by the un- synchronous development such as the preservation and conservation of the monuments or sites which are in the

direction of modern style or lose partly traditional factors makes tourists feel less interesting to visit to relics. This is sometimes due to the lack of financial resources and knowledge.

#### **4.2 The current potentials for cultural tourism development in Phu Quoc.**

In 2016, Phu Quoc received over 1.45 million tourists, exceeding 20.8% of the plan, up nearly 63% in comparison with 2015, of which 201,132 international tourists, an increase of 38, 5%. Total tourism revenue is over VND 8,920 billion, 32.4% up with the year 2015. (<http://vietnamtourism.gov.vn/index.php/items/22351>)

As planned from the government office for the tourism development, In 2017, Phu Quoc are striving to attract more than 1.8 million tourists to the island, increasing over 25.5% as of 2016, in which international tourists will be over 300,000, increasing about 42.7%. Total tourism revenue is more than 11,150 billion VND, up to 25% over 2016. In addition, there are around 220 projects invested in tourism (for 79% of investment projects in total in the province) valued VND 222,000 billion, of which 167 projects have been granted investment certificates with the total capital of VND 126.643 billion and 30 projects have been put into operation with an investment capital of more than VND 31 billion. (<http://vietnamtourism.gov.vn/index.php/items/22351>)

Furthermore, Phu Quoc is famous not only with beautiful natural sceneries but also with colorful folk culture with legends, folk songs and beliefs cultural historical relics, revolutionary history, customs and habits of island residents, fishing villages, traditional handicraft villages, natural ecosystems.

Many legends are existing in Phu Quoc island. Most of the tourist sites are in connection with a few legends, such as the legend of the birth of Cao daism, King Gia Long - Nguyen Anh, Nguyen Trung Truc – a Vietnam hero... Many unique traditional festivals in Phu Quoc lure tourists with their excellent performances and activities as Vu Lan festivals – Amnesty of Unquiet Spirits held during the seventh month of the lunar year; the music festival held twice a year which is lasting 14 days, Phu Quoc Green festival, Mother Goddesses festival, The Nghinh Ong (whale worshipping) Festival... There are many sacred pagodas/ temples and festivals for the worships to saints or deities and the heroes who blesses to the peace of the island and local inhabitants.

Ancient structured houses are a deniable and unforgettable place to tourists. These houses own all traditional and unique characteristics of the local inhabitants. At present, Phu Quoc has about 15 ancient houses. More of that, gastronomy is also a great cultural issue to all the tourists. There are many kinds of specialties. The Phu Quoc gastronomy is the interference of the processing ways of Vietnam – Chinese and Khmer (Cambodian). In the light of this matter, this make the unique flavor compared with other places. Travelling to Phu Quoc, tourists can not only enjoy a fresh seafoods which is cooked by very skillful and traditional chefs but visit craft villages to understand and experience themselves on how to produce, cook and make the craft products as well. Later, they can buy as their souvenirs. Phu Quoc is also a region with rich history from the French and American wars in Vietnam. Many historical relics associated with the anti-French and American wars, Coconut Tree Prison historical relics - a beautiful symbol on revolutionary heroism will be actually unforgettable experience.

#### **4.3 Recommendations for the cultural tourism development**

Tourism development must contribute to preserving and promoting Vietnamese cultural values and customs and tourism is the driving force, creating resources to promote cultural preservation/ conservation. Revenues from tourism aim to contribute positively to conservation/preservation. Tourism development must be along with the raise of local community standards both from the physicality and the mentality and the tourism development is also go with the development of Vietnamese cultural products, cultural characteristics of Phu Quoc via the heritage, relics, festivals, lifestyle, craft villages, gastronomy. Traditional culture should be combined with folklore and contemporary cultures in tourism products. The true value of tradition are respected. Also, the development of infrastructure, technical facilities should be emphasized such as restoration, conservation/ preservation, recognition and protection of monuments, heritages, religious relics and beliefs, traditional craft, etc.. Besides, cultural works which create attractiveness like entertainment centers, cultural and sport service establishments, etc., in service of tourist development.

Human resources is a key in light of the development. Professional cultural knowledge should be equipped to guide, interpret to visitors for their deep understanding to the local culture in private and Vietnam culture in general.

For the stakeholder-related supports, A master plan should be established as its urgent requirement. This helps to orient and develop the market, promote and develop brand through the study the culture and habits of each market in order to exploit and satisfy the demand and specific factors to promote, compete and create the brand name. More of that, investment and policy should be cared as proper investment in conservation, preservation of cultural values, investment in new cultural works; and International cooperation and enhancement of the international financial, technical support, recognition, protection and respect for cultural institutions and values especially to the promotion of cultural values which are well-recognized by UNESCO and honored to bring sustainable benefits to the generations of tourists.

## 5 CONCLUSION

Cultural tourism focuses essentially on the culture and cultural environments including landscapes of the destination, the values and lifestyles, heritage, arts, customs and values, industries and leisure pursuits of the local population and the host country and its beneficial contributions to the community are recognized. In Phu Quoc, the cultural tourism is existing (not a private/separate tour) in combination with other tourism types and it is not development as its potentials. Therefore, to develop it, some above mentioned recommendations as guidelines should be applied.

### References

- Bob, U. & Singh, U. (2007). The economic socio-cultural impacts of tourism development on Indian and African communities in Durban, KwaZulu-Natal, South Africa. In: M. E. Kloek and R. van der Duim (eds.), *Local communities and participation in African Tourism*. Thematic proceedings of ATLAS Africa Conferences, vol. 2, 59–69. Netherlands: ATLAS.
- Brooker P. (2003). *A glossary of cultural theory*. London: Arnold.
- Craik, J. (1991). *Resorting to tourism: Cultural policies for tourist development in Australia*. North Sydney: Allen and Unwin.
- Hughes, H., & Allen, D. (2005). Cultural Tourism in Central and Eastern Europe: The views of Induced Image Formation Agents. *Tourism Management*, 26(2), 173 -183.
- ICOMOS Charter for Cultural Tourism (1997). <http://www.icomos.org/tourism/>
- Jones, R. (2009). *Cultural tourism in Botswana and the Sexaxa cultural village: A case study ISP Collection*. [http://digitalcollections.sit.edu/isp\\_collection/725](http://digitalcollections.sit.edu/isp_collection/725)
- Keitumetse, S. (2005). *Sustainable Development and Archaeological Heritage Management: Local Participation and Monument Tourism in Botswana*. Unpublished PhD thesis, Department of Archaeology, University of Cambridge.
- Lapeyre, R. (2011). The Grootberg lodge partnership in Namibia: Towards poverty alleviation and empowerment for long-term sustainability. *Current Issues in Tourism*, 14(3), 221–234.
- Lenao, M. (2009). *The impact of cultural tourism on the authenticity of traditional baskets in the Okavango Delta: The case of Gumare and Etsha 6 villages*. Master's Thesis, University of Botswana.
- MacCannell, D. (1976). *The tourist. A new theory of the leisure class*. New York: Schocken Books
- Mbaiwa, J. E. (2005). The socio-cultural impacts of tourism development in the Okavango Delta, Botswana. *Journal of Tourism and Cultural Change*, 2(3), 163–185.
- Mbaiwa, J. E. (2011). Cultural Commodification and tourism: The Goo-Moremi Community, Central Botswana. *Tijdschrift voor Economische en Sociale Geografie*, 102(3), 290 - 301.

- Mbaiwa, J.E., & Sakuze, L. K. (2009). Cultural tourism and livelihood diversification: The case of Gcwihaba Caves and XaiXai village in the Okavango Delta, Botswana. *Journal of Tourism and Cultural Change*, 7(1), 61–75.
- Mbiti, J. S. (1991). *Introduction to African Religion*. Oxford: Heinemann.
- McCarthy, B. B. (1992). *Cultural Tourism: How the arts can help market tourism products – How tourism can help provide markets for the art*. Portland: Trade Paperback.
- McKercher, B. & Du Cross, H. (2002). *Cultural tourism: The partnership between tourism and cultural heritage*. Haworth Hospitality Press.
- McKercher, B. & Hilary C. (2002). *Cultural Tourism: The Partnership Between Tourism and Cultural Heritage Management*. New York: Hayworth Hospitality Press.
- Medlik, S. (1996). *Dictionary of Travel, Tourism and Hospitality Terms*. Butterworth-Heinemann (2 eds).
- Michalkó, G. (2004). A turizmuselmélet alapjai Székesfehérvár: Kodolányi János Főiskola, *Turizmus akadémia* (1).
- Minciu, R. (2004). *Economia Turismului, Editura Uranus, București*.
- Mitchell, J. & Ashley, C. (2010). *Tourism and poverty reduction: Pathways to prosperity*. London: Earthscan.
- Moswete, N., Thapa, B & Lacey, G. (2009). Village-based tourism and community participation: A case study of the Matsheng villages in southwest Botswana. In: J. Saarinen, F. Becker, H. Manwa and D. Wilson (eds.), *Sustainable tourism in Southern Africa: Local communities and natural resources in transition*, 89–209. Clevedon, UK, Channelview
- Mugalavai, V. K. (2007). The role of indigenous women in the sustainability of folk culture for cultural and creative tourism. In: M. E. Kloek and R. van der Duim (eds.), *Local communities and participation in African Tourism*. Thematic proceedings of ATLAS Africa Conference: Vol. 2, 97–105. Netherlands: ATLAS.
- Nzama, T. A. (2010). Sustainable cultural and heritage tourism development in the rural areas of KwaZulu-Natal with reference to Ntambanana Local Municipality. In: K. Zellmer, R. van der Duim and J. Saarinen (eds.), *Tourism for development: environmental sustainability, poverty reduction and empowering communities*. Thematic proceedings of ATLAS AFRICA Conferences. Vol. 6, 39–55. Netherlands: ATLAS.
- Office of National Tourism (1997). *Fact Sheet No 10 Cultural Tourism*.
- Okech, R. N. (2009). Promoting cultural tourism in Kenya: Focus on funerals in Luo and Luhya communities. *Tourism Review International* 12, 243–258.
- Prentice, R. (2001). Experiential cultural tourism: Museums & the marketing of the new romanticism of evoked authenticity. *Museum Management and Curatorship*, 19(1), 5-26.
- Richards, G (ed.) (1997). *Cultural tourism in Europe*. Wallingford CAB International. UK.
- Richards, G. (2001). *Cultural Attractions and European Tourism*. CAB International. UK
- Richards, G. (2005). *Cultural tourism in Europe*. Wallingford: CAB International. UK.
- Richards, G. (2013). *Cultural Tourism - Handbook of Leisure Studies*. Routledge: London.
- Robinson M. & Picard D. (2006) *Culture, tourism and development, UNESCO*. Retrieved from <http://unesdoc.unesco.org/images/0014/001475/147578e.pdf>
- Saarinen, J. (2009). Conclusion and critical issues in tourism and sustainability in Southern Africa. In: J. Saarinen, F. Becker, H. Manwa and D. Wilson (eds.), *Sustainable tourism in Southern Africa: Local communities and natural resources in transition*, 269–286. Channel view: Clevedon.



- Saarinen, J., Moswete, N. & Monare, M. J. (2014). Cultural Tourism: New Opportunities for Diversifying the Tourism Industry in Botswana. *Bulletin of Geography. Socio-Economic Series* 26, 7–18.
- Shackelford, P. (2001). *The social context of cultural tourism* KéK folyóirat, Budapest, 29 - 41.
- Silberberg, T. (1995). Cultural tourism and business opportunities for museum and heritage sites. *Tourism Management* 16, 361–365
- Smith, M. K. & Richard, G. (eds) (2013). *The Routledge handbook of cultural tourism*. New York & London: Routledge.
- Smith, M. K. (2003). *Issues in cultural tourism studies*. London: Routledge.
- Smith, M. K. (2004). *Issues in cultural tourism studies*. Taylor & Francis.
- Sudipta, K.S., Sarat, K.L. & Babu, G.P. (2010) Cultural Tourism in Malaysia in The Perspective of Indian Tourists: A Study. *Journal of Tourism* 16, 48-53.
- Sutherland, M. (2006). Belfast: Changing perceptions of a city through cultural tourism development. Queen's University: Belfast.
- Thorne, S. (2009). Cultural Tourism - A Place-Based Approach, Available at: <http://www.destinationworld.info/downloads/Cultural%20Tourism%20-%20A%20Place-Based%20Approach.pdf>.
- Tomaselli, K.G. (ed.) (2012). *Cultural Tourism and Identity: Rethinking Indigeneity*. Brill: Leiden
- WTO - World Tourism Organization. (2005). *City tourism and culture: The European experience*. A report of the European Travel Commission and of the World Tourism Organization, Spain.
- WTO (United Nations World Tourism Organization) 2008. *Policy for the Growth and Development of Tourism in Botswana*. UNWTO and Department of Tourism, Gaborone.
- WTO (World Tourism Organization). (2012). *UNWTO Tourism Highlights 2012 Edition*. Madrid, Spain. Retrieved from [http://dtxtg4w60xqpw.cloudfront.net/sites/all/files/docpdf/unwtohighlights12enhr\\_1.pdf](http://dtxtg4w60xqpw.cloudfront.net/sites/all/files/docpdf/unwtohighlights12enhr_1.pdf)
- Zeppel, H. & Hall, C. M. (2002). Selling art and history: Cultural heritage and tourism. *Journal of Tourism Studies*, 2(1), 29-45.
- Zeppel, H. (2002). Cultural tourism at the Cowichan native village, British Columbia. *Journal of Travel Research*, 41(1), 92–100.

### **Contact information**

VU MINH HIEU

Mendel University in Brno

Czech Republic

Hieuvu2000@gmail.com (for correspondence)

NGUYEN TAN TAI

Vietnam.

Email: tantai148@gmail.com

# IDENTIFYING MATERIAL ASPECTS AND BOUNDARIES FOR SUSTAINABILITY REPORTING: CASE STUDIES IN CZECH CORPORATIONS

*Nguyen Thi Thuc Doan*

## **Abstract**

Appropriately identify significant aspects can be seen as a significant important task in performing sustainable activities and preparing sustainable reports. Currently, GRI issues G4 guidelines to instruct organization in this main task. This paper examines the Czech companies which have identified these material aspects by applying G4, then evaluates how firms perform and disclose information regarding to this topic. From that, successful and failure in implementing G4 guidelines can be revealed. The research focuses on real cases of six Czech firms that comply with G4 in 2014 and 2015. The research firstly examines the guidelines content for identifying material aspects. Then, these companies' sustainable reports are observed to investigate how firms define and disclose material aspects. Comparison in determining sustainable measures between companies' preparation and guidelines, and between companies in different sectors are performed to provide better understanding for implementing GRI guides in corporations for other companies. After the evaluation, the paper found that even though all firms declared that they are in accordance with G4, the quality of information is not consistent. Only one firm had proper disclosure while these other fives totally neglected the guidelines, or just applied some main standard disclosures according to G4 guidelines regarding to this subject.

*Keywords: GRI-G4, materials aspects, Czech Republic.*

## **1 INTRODUCTION**

Even though sustainability development issues have been researched for the long time, enhancement on sustainability implementing and reporting is still ongoing. Studies on the impacts of sustainability development on the economic growth of corporations, business sectors, and countries have not yet finished. Due to current issues on global environmental changes and social problems occurring worldwide, this paper continues the research on sustainability development. The research focus on examining corporation sustainability reports which can reveal evidences of complying sustainability development in corporations.

This paper is structured into four sections. The first section will summarise the literatures which also become sources for further analysis in Czech corporations. Next, the research design, and sample selection are revealed in section two. Section three will concentrate on analysis in four Czech firms regarding to identifying material aspects and indicators for sustainable reporting. Finally, section four will conclude the research and discuss expected contributions and implications of this research.

## **2 LITURATURE REVIEW**

### **2.1 Emerge of sustainable developement study and implementation**

Implementation of corporate sustainability has recently emerged due to the integration into global economy. This process provides opportunities for the country's development in which economic growth is maintained as a high level, and country's resources are effectively used. More countries and organizations have required companies and members to comply with mandatory sustainability reports such as big EU companies must include sustainability factors in annual report. However, these actions create not only more opportunities but also more challenges and rules for enterprises. According to Nguyen (2007), this implementation is a long process and is presently being oriented and applied by big firms who perceive corporate social responsibility (CSR) as an attractive factor for foreign investment and export expansion. Nevertheless, it cannot be neglected that many other firms are still hesitated to implement CSR due to time and costs consuming. These pros and cons of implementing corporate sustainabilities have been revealed in many past and current researches.

Takala and Pallab (2000) defined corporate sustainability (CS) as a firm's attempt in satisfying of social, environmental, and economic purposes. Corporate social responsibility has been discussed in terms of sustainable development which, according to Kuln and Deetz, (2008), is firms' long-term growth in associated with protecting environment and improving social values. Strategic management theory states that a firm's key success is to create competitive advantages which can lead to the firm's value creation. This value creation is measure by consumers' willing to pay a premium on the firm's products and services due to firm's actions on social activities (Husted, and Allen, 2007). In addition, according to Sharma and Vredenburg (1998), innovation opportunities can be created by implementing a CSR program. And it is obviously that value creation and innovation can enhance the perception of shareholders on firm's performance and value. Moreover, based on stakeholder theory, Freeman (1984) suggested that firms orient their actions, activities and decision making not only base on the interest of shareholders but also on the interests of other stakeholders as customers, employees, suppliers and communities. Regarding to this, CSR was argued to be able to predict and decrease conflicts between firms, community and its stakeholders (Heal, G., 2005).

Profit organizations, as part of the society, play a role in resolving environmental issues and achieving better society (Frederick, 2006). As a result, companies are increasingly implementing corporate social responsibility programs, and considering their corporate sustainability performance to be able to set close relationships with environments and societies (Nicolau, 2008). These actions are expected to improve social and environment issues, and boost human's well-being. Although it is increasingly necessary for companies to engage in these activities, the other purpose of making profit of these businesses cannot be neglected. Therefore, examining the influence of society-and-environment-oriented activities on the firm financial performance is important issue. Positive impacts of sustainable development on firm performance and economic growth have been proved in many researches. Bird et al, (2007) suggested that social activities can increase firm value by positively impacting on cost saving, firm reputation, and regulatory cost avoidance. As for environmental purposes, Dowell et al., (2000) found the positive relationship between implementation of global environmental standards and firm value. Consistent with these papers, Orlitzky et al., 2003 and Nicolau, 2008 found the positive influence of firm CSR program on financial performance.

Along with favorable influences, adverse effects indicated in following papers can be seen as deterrent factors for applying sustainable programs and reporting. According to Friedman (1970), the main purpose of firm is to enhance its shareholders' wealth; hence, activities that ineffectively impact on the firm current resources will harm the firm performance. In addition to the positive or negative results on the relationships between CS and firm performance, some studies have failed to find the relationship (Margolis and Walsh, 2003). Ray et al, (2004) suggested the major reason for these different results is because of financial performance being influenced by so many variables, and inconsistencies in measuring corporate social responsibility. Given this, it is worthwhile to test the relationship between CS and financial performance, and to find appropriate measures for CS and its relationship to firm performance.

Although CS is currently being implemented by many companies, the research literature is still exploring a more appropriate measurement of CS. The need to find relevant sustainability measurement is increasingly meaningful (Tyteca, 1998) due to their ability to provide major information about economic, social and environmental issues, and to analyse the relationships among these elements (Veleva and Ellenbecker, 2001). This will help decision makers have a deeper understanding on how to attempt economic growth that is consistent to social and environment targets (Farrell and Hart, 1998). Farrell and Hart (1998) also suggested that measurement can be an individual indicator, or part of a set, or a single number of composite index, which can be used to examine whether firms have accomplished their sustainability regarding to social, environmental and economic performance (Lawrence, 1997). Given this, the stakeholder framework which consists of social and environmental issues can be introduced the types of measurement (i.e. single number of composite index). Stakeholder framework includes five dimensions relating to major stakeholders issues including employee relations, product quality, community relations, environmental issues, and diversity issues (KLD, n.d.). As for GRI, the updated guidelines (GRI-G4) provide detail disclosed instruction on economic, environmental, and social aspects.

Among guidance regarding to sustainable reporting, GRI has a long history in providing direction for sustainable reporting. In addition, more and more companies are now partly or totally applying GRI guidelines in their sustainable reports. Indeed, while GRI-G4 has just been issued in 2013, in 2014, 1190 companies have applied, and 2636 was the figure in following year (GRI, 2016). Therefore, this paper considers GRI knowledge as a good benchmark to compare and analyse the identification of material aspects and indicators for sustainable reporting.

## **2.2 GRI-G4 Guides on identifying material factors and indicators for sustainable reporting**

GRI was founded in Boston in 1997 by two United States non profit organizations, the Coalition for Environmentally Responsible Economies (CERES) and the Tellus Institute. GRI aims are to support companies, governments and other organizations to comprehend and disclose the impact of companies' operations on environmental, social issues, and other sustainability issues. As an international independent organization, GRI issued Guidelines that can be implemented by many types of organizations such as multinational organizations, public agencies, SMEs, NGOs. Currently, 10,449 organisations around the world have applied GRI which have provided more than 26,282 GRI reports. And the application trend is increasing year by year. Until now, GRI have issued four guidelines: G1, G2, G3, and G4. The later versions were reviewed and updated, so it is expected to provide better guidelines than previous versions. This report focuses on the latest guidelines of GRI, the GRI-G4.

According to GRI-G4 guidelines, the first step in delivering sustainable disclosure is identifying material aspects and boundaries. Material Aspects reveals the considerable impacts of organization's economic, environmental and social issues on stakeholders' evaluation and decision making process. Aspect Boundary describes where the significant impacts occur for each material Aspect. The Aspect Boundaries can be internal or external to the organization. GRI have been issued to support companies in determining material Aspects and Boundaries and to specify where firms' impacts may be significantly.

GRI-G4 provides two options in preparing sustainable reports: the Core option includes crucial elements of a report, and the Comprehensive option develops the Core option by adding further disclosures on firms' strategy and analysis, governance, and ethics and integrity. These differences do not impact on the firms' performance or reports' quality, it just shows how companies comply with GRI-G4. Within the disclosed requirements (appendix 1), GRI-G4 presents instruction on identified material aspects and boundaries which has the index from G4-17 to G4-23. According to GRI-G4, the identification process is divided into four steps: identification, prioritization, validation, and review.

Before moving into details of the steps, there are two principles that preparers and users should understand. The first principle is the Principle of Sustainability Context, which requires the presentation of organization performance to be placed in a sustainable context of limits and demands on environmental and social resources. And the second one is the Principle of Stakeholder Inclusiveness, which asks firms to recognize their stakeholders and respond to stakeholders' appropriate needs.

Referring to the four mentioned steps, the 'Identification Step' requires firms to identify material aspects based on Principles of Sustainable Context and Stakeholder Inclusiveness. G4 also presents a list of aspects (appendix 2) that firms can use, however, the chosen aspects should be relevant to firms' economic, environmental and social context. The relevance can be considered on top of firms' activities, products and services, or firms' relation with stakeholders. Once the aspects are identified, companies should classify into the internal and external influences. This is also the boundary indication of the aspect. Then, a list of aspects and their boundaries should be completed.

In 'Prioritization Step', preparers should apply Principles of Materiality and Stakeholder Inclusiveness to evaluate relevance of each aspect referring to the significance of firm's economic, environmental and social impacts, and to the effects on stakeholders' judgments. For every significant aspect, level of information disclosures should be stated. At the end of step two, a list of material aspects, their boundary and level of coverage should be revealed.

Next, 'Validation Step' requires the compliance with Completeness and Stakeholder Inclusiveness Principles to evaluate the validity of the chosen material aspects. The validation is approved if the report can produce equal and appropriate illustration of firm's influences regarding to economic, environmental and social aspects. Also, the report should provide sufficient and relevant information for stakeholders to be able to evaluate the firm's performance. After the approval, information needs to be collected to be disclosed. In this step, appropriate indicators should also be determined to be ready for reporting. With unavailable information, report should indicate the necessity to develop management approaches and measurements systems.

Lastly, a review should be done on previous materials aspects to inform for next period reporting. Base on these four steps, all GRI-G4 standard disclosures from 18 to 23 can be fulfilled, which also include the list of material aspects (G4-19). Eventhough these steps are not compulsory for firm to follow in order to be 'in accordance' with GRI-G4, all information in the GRI index should be disclosed according to chosen option.

### 3 RESEARCH DESIGN

When GRI-G4 was issued in 2013, there were just 35 companies implementing this guideline. However, the figures significantly increased in 2014 and 2015 in all regions. In 2014, European was the leading region in number of firms that applied G4, and in 2015, the compliant firms were double (Figure 1). With the focus on Czech Republic, this paper examines the compliance status of Czech firms in these two years. In 2014, there were two firms that declared to be in accordance with G4 (KPMG Czech Republic and Skoda), however, KPMG discontinued to followed G4 in following year and Skoda prepare the report every two years. Therefore there was no sustainable report in KPMG and Skoda in 2015. In 2015, according to GRI (2016), four new firms started to apply G4, which consist of ArcelorMittal Ostrava, CSOB, PWC Czech Republic, and Sev.en Group. Therefore, this paper will assess the compliance to G4 of all these six organizations.

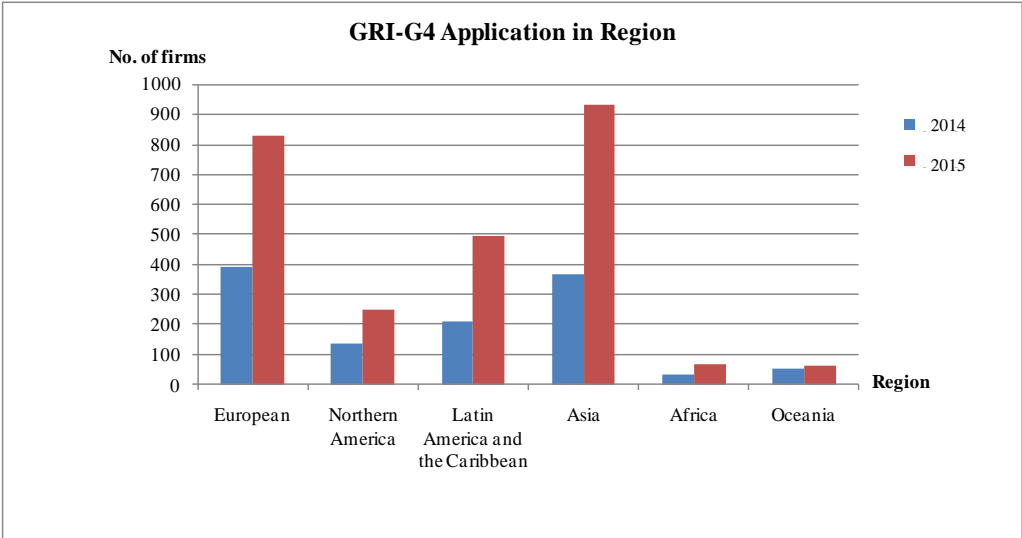


Figure 1: GRI-G4 Application in Region. Source: GRI Reports (2016)

Main methodology that applies in the research is documentary analysis. Research on GRI guidelines and firm's practical implementation regarding to identification of material aspect and indicators for sustainable reporting are carried out base on GRI and firm's reports. Then, comparison between the guidelines and the practices, and between firms' performance in preparing report in these topics are produced. Base on the comparison, appropriate analysis and conclusions are retrieved.

## 4 CASE STUDIES IN CZECH CORPORATIONS

According to G4 guidelines, whatever option the company choose, there are always seven information that the company need to disclose regarding to identified material aspects and boundaries.

Table 1: Standard Disclosures for Identified Material Aspects and Boundaries. Source: GRI-G4 (2016)

	Standard Disclosures
G4-17	All entities that are included in firm's consolidated statement need be listed. For those entities that are not covered by the report need to be reported.
G4-18	Clarify how firm has applied Reporting Principles to define report content, and illustrate the process to define report content, material aspect and boundaries.
G4-19	List all the material Aspects identified in G4-18.
G4-20	For each material Aspect, stated whether the aspect is significant for all entities determined in G4-17. For insignificant aspect, list the entities that are not considerable impacted by the aspect, or list the entities that are considerable influenced by the aspect.
G4-21	For each material Aspect, stated whether the aspect is significant for entities outside of the organization. For significant aspect, list the impacted entities, and describe the geographical location where the aspect is considerable for these entities.
G4-22	If there are any restatements from previous sustainable reports, firm should report and explain.
G4-23	If there are any major changes from previous reporting periods, state them in the Scope and Aspect Boundaries.

After completing all detailed standard disclosures, firm should have a summaries into an index at the end of sustainable report. For each disclosure, firm should indicate in which pages that the information is release and whether the information has the external assurance or not.

For Czech corporations, all six companies chose Core option and prepared G4 Index table at the end of the report. However, the levels of coverage, the details of information were not the same among these firms regarding to identified material aspects and boundaries. Indeed, among these six firms who declared that they were in accordance with GRI-G4, Arcelormittal did not disclose any information in general standard disclosures. CSOB only provided information about the list of entities included in consolidated financial statements and other unclear disclosures which did not have the pages' reference. The others disclosed in more detailed. As there was no standard disclosure in identified material aspects and boundaries in Arcelormittal Ostrava, the analysis focuses on the other five companies. Following analysis for five Czech firms are carried out according to the indicated index appearance in table 1.

### 4.1 G4-17: List all entities included in the organization's consolidated financial statement

Entities in two auditing companies in Czech Republic (PWC and KPMG) were similar to each other. Main entities included employees, working groups, clients, suppliers, media, and community (PWC (2015) and KPMG (2014)) . These illustrations were divided into three parts: entity's name, communication methods, and benefits and threads, to illustrate to whom, how and why the organization creat the relationships with. While the first two parts had no significant different in content, PWC

provided more details about the reasons to create the relationship with the entities in comparison to KPMG.

For two mining companies: Arcelormittal Ostrava and Sev.en, while no disclosures referring to identified material aspects and boundaries were made in Arcelormittal Ostrava, Sev.en made very detailed disclosures on these contents. However, contents refering benefits and threats from these stakeholders were neglected in Sev.en report. For the list of entities, Sev.en present comprehensive table about the key events with the stakeholders to illustrate for the entities' names and way to communicate.

The last two companies in the analysis include CSOB and Skoda, for G4-17, these two companies just simply listed the name of entities. There was no further information aside the entities's names in this disclosure.

#### **4.2 G4-18: Process of defining report content, material aspects, and boundaries**

According to GRI-G4 guidelines, firms can apply four steps as stated in literature review part to fulfill G4-18, 19, 20, and 21. All these five firms did not tightly followed the steps, however, among five companies, only Sev.en and Skoda provide details of the process while other companies just briefly reported on the process. For instance, CSOB stated that they defined the report content base on past experience of the CSR report, advices from Ipsos Research relating to public opinion surveys, suggestions by company's stakeholders. To define significant activities and areas, COSB just said they based on viewpoints of the stakeholders and the bank itself.

PWC and KPMG Czech Republic had similar approach in presenting the process of defining report content and material aspects. The two companies directly determined the important activities, and then explained how they manage these activities. For example, KPMG stated their considerable aspects including employees focus, environmental footprint reduction, and sustainable business development. Next, brief and general explanation for carrying out activities to meet material aspect expectation was revealed. For PWC, major aspects were involved in energy and paper consumption, and employee records, harnesses and training.

In Skoda, four-step process was illustrated in indentifying report content and material aspect. The first step indicated the global challenges by examining some external and internal researches and materials. Next, appropriate key contents were evaluated by the support off online-based media screening. Thirdly, based on previous steps, major topics were defined in the concerns of stakeholders' needs, possible contribution to group's strategic goals, and the variances of stakeholders needs and possible contribution. Lastly, due to the size, the impact, and the responsibility of the contents, and base all the GRI suggested aspects, Skoda determined key reporting contents through detailed discussions. Through these steps, there were sixteen major aspects to be identified.

As for Sev.en, firstly, appropriate information, documents and legislations were identified to suport for the preparation of the report. Then, based on the knowledge of sustainable development, Sev.en prepared a survey with 40 aspects and delivered to relevant stakeholders indicated in G4-17 and a result of 23 significant aspects was returned. This can be seen as a good approach to determine significant aspect in relating to Principles of Sustainable Context Materiality and Stakeholder Inclusiveness as stated in step 1 and 2 of G4 guidelines. Sev.en also had a deep review on 2014 report in preparing 2015 one, this is the compliance with step 4 of the guideline. Different from the guide, Sev.en did not determine the boundaries in step 1, but Sev.en waited until step three once the company could confirm for the list of material aspects. In 2015, eventhough, there were 23 materials aspects returned from the survery, Sev.en indentified 25 materials aspect in the Validation steps.

#### **4.3 G4-19: List all material aspects identified in the process for defining report content**

For G4-19, CSOB did not comply with G4 guide as there was no list of material aspects in the report. In the meantime, all the other four companies provided completed illustration of materials aspects. Under economic, environmental and social areas, in PWC, twelve material aspects were determined,

while this figure in KPMG was six. Skoda presented sixteen key actions areas to illustrated for sixteen material aspects. These actions are not totally consistent with the G4 material aspects list. However, G4 do not require firm to strictly base on G4 list to determine material aspects, hence, Skoda are in accordance with G4 in standard disclosure G4-19. Different from previous companies, Sev.en presented twenty five materials aspects in more detailed categories. The areas included economic, environmental, social sphere, coal mining, and electricity production.

#### **4.4 G4-20: Aspect boundary within the organization and G4-21: Aspect boundary outside the organization**

Among these five analysed firms, only Sev.en provided detailed classification for internal and external boundaries for each material aspect. All the rest were not comply with G4-20 and G4-21 guide in disclosing the boundaries.

#### **4.5 G4-22: Restatements of information provided in previous reports**

KPMG stated that this was the first time they prepare sustainable report in accordance with GRI-G4, thus, there was no information in G4-22 and G4-23. In Skoda, previous report was prepared in 2013, and Skoda confirmed that there had no major changes and restatement of information to the current report. As for PWC, the company affirmed that all restatements of definition and criteria were because of the expansion to G4 application. This information is also the standard disclosures of Skoda and PWC relating to G4-22 and G4-23.

Different from brief disclosures in the other companies, Sev.en provided detailed information relating to complementation of important perspectives from the comments on sustainable report in 2014. For instance, there was some adjustment on visualisation of important aspects due to employees' comments. In addition, requirement on further illustration about future dependence on government policies and possible regulation changes were fulfilled in current report.

#### **4.6 G4-23: Significant changes from previous reporting periods in the Scope and Aspect Boundaries**

Similarity to G4-22, only Sev.en provided proper standard disclosure on changes from previous reporting periods. The disclosures specified on changes in material aspects that had not been determined last year. Moreover, internal aspects which previously were identified as important, now were classified as relevant. Sev.en also indicated some changes to G4-guide, for instance, some aspects that are listed separately by GRI, were grouped by Sev.en to provide more concrete information.

## **5 CONCLUSION**

Even though all firms declared that they are in accordance with G4, the quality of information is not consistent. For example, Arcelormittal ignored the standard disclosures requirements in identified material aspects and boundaries. In the meantime, CSOB just applied two above seven standard disclosures. These were G4-17 and G4-18, however, the disclosures were still so simple. For KPMG, PWC and Skoda, these companies complied with five guides and did not present information about internal and external boundaries as indicated in G4-20 and G4-21. The other five guidelines were brief disclosed, hence, further explanation should be carrying out to have better compliance performance. Among these six firms, only Sev.en had proper disclosures regarding to identified material aspects and boundaries. The information in Sev.en had sufficient details that the users can understand what information the company provided, how and why the company delivered the information.

All these six companies are taken from completed list provided by GRI as they declared to be in accordance with G4. However, firms still have wide flexibility on how to disclose the information. As analysis above, the details and sufficiency of the standard disclosures are not consistent, which may impact on the quality of sustainable report. Therefore, more specific requirement on levels of disclosures should be added in G4 guidelines. In addition, GRI should have a review on sustainable reports of firms



that declare to be in accordance with G4 before putting these companies in the 'in accordance' lists of GRI databases.

As examination of GRI- G4 implementing on each company is still limited, therefore, this research has not compared the findings with the previous studies. Future research can be carried out in other countries, then comparison to Czech organization can be performed.

## Appendix

Appendix 1: Table 2 - Required General Standard Disclosures

General Standard Disclosures	'In accordance' – Core (This information should be disclosed in all cases)	'In accordance' – Comprehensive (This information should be disclosed in all cases)
Strategy and Analysis	G4-1	G4-1, G4-2
Organizational Profile	G4-3 to G4-16	G4-3 to G4-16
Identified Material Aspects and Boundaries	G4-17 to G4-23	G4-17 to G4-23
Stakeholder Engagement	G4-24 to G4-27	G4-24 to G4-27
Report Profile	G4-28 to G4-33	G4-28 to G4-33
Governance	G4-34	G4-34 G4-35 to G4-55(*)
Ethics and Integrity	G4-56	G4-56 G4-57 to G4-58(*)
General Standard Disclosures for Sectors	Required, if available for the organization's sector (*)	Required, if available for the organization's sector (*)

Appendix 2: Table 3 - Categories and Aspects in the Guidelines

Category	Economic	Environmental		
Aspects IV	Economic Performance Market Presence Indirect Economic Impacts Procurement Practices	Materials Energy Water Biodiversity Emissions Effluents and Waste Products and Services Compliance Transport Overall Supplier Environmental Assessment Environmental Grievance Mechanisms		
Category	Social			
Sub-Categories	Labor Practices and Decent Work	Human Rights	Society	Product Responsibility
Aspects IV	Employment Labor/Management Relations Occupational Health and Safety Training and Education Diversity and Equal Opportunity Equal Remuneration for Women and Men Supplier Assessment for Labor Practices Labor Practices Grievance Mechanisms	Investment Non-discrimination Freedom of Association and Collective Bargaining Child Labor Forced or Compulsory Labor Security Practices Indigenous Rights Assessment Supplier Human Rights Assessment Human Rights Grievance Mechanisms	Local Communities Anti-corruption Public Policy Anti-competitive Behavior Compliance Supplier Assessment for Impacts on Society Grievance Mechanisms for Impacts on Society	Customer Health and Safety Product and Service Labeling Marketing Communications Customer Privacy Compliance

## References

- Bird, R., Hall, A.D., Momente, F., and Reggiani, F. (2007). What corporate social responsibility activities are valued by the market? *Journal of Business Ethics* 76 (2), 189–206.
- Dowell, G., Hart, S.L., Yeung, B. (2000). Do corporate global environmental standards create or destroy market value? *Management Science* 46 (8), 1059–1074.
- Farrell, A., Hart, M., 1998. What does sustainability really mean? The search for useful indicators. *Environment* 40 (9), 4–9.
- Frederick, W. C. (2006). *Corporation be good! The story of corporate social responsibility*. Indianapolis, IN: Dogear Publishing.
- Freeman, R.E. (1984). *Strategic Management: A Stakeholder Approach*. Prentice Hall, Englewood Cliffs.
- Friedman, M. (1970). The Social responsibility of business is to increase its profits. *New York Times Magazine*, September 13.
- Heal, G. (2005). Corporate social responsibility: an economic and financial framework. *The Geneva Papers on Risk and Insurance: Issues and Practice* 30 (3), 387–409.
- Husted, B. W. and Allen, D. B. (2007). Strategic Corporate Social Responsibility and Value Creation among Large Firms Lessons from the Spanish Experience, *Long Range Planning*, 40, 594-610.
- KLD. (n.d.). Rating indicators. Retrieved from <http://www.kld.com/research/stats/indicators.html>.
- Kuhn, T., & Deetz, S. (2008). Critical theory and corporate social responsibility. In A. Crane, A. McWilliams, D. Matten, J. Moon, & D. S. Siegel (Eds.), *The Oxford handbook of corporate social responsibility*. Oxford, UK: Oxford University Press.
- Lawrence, G., 1997. Indicators for sustainable development. In: Dodds, F. (Ed.), *The way forward: beyond Agenda*, vol. 21. Earthscan, London, pp. 179–189.
- Margolis, J. D., & Walsh, J. P. (2003). Misery loves companies: Rethinking social initiatives by business. *Administrative Science Quarterly*, 48, 268—305.
- Nguyen, H.T, (2007). Corporate Social Responsibility of Vietnamese enterprises. Retrieved from <http://www.vietnamforumcsr.net/default.aspx?portalid=5&tabid=334&itemid=569>
- Nicolau, J.L. (2008). Corporate social responsibility: worth-creating activities. *Annals of Tourism Research* 35 (4), 990–1006.
- Orlitzky, M., Schmidt, F.L., and Rynes, S.L. (2003). Corporate social and financial performance: a meta-analysis. *Organization Studies* 24 (3), 403–441.
- Ray, G., Barney, J. B. and Muhanna, W. D. (2004). Capabilities, business processes, and competitive advantage: Choosing the dependent variable in empirical tests of the resource-based view, *Strategic Management Journal* 25(1), 23-37.
- Sharma S. and Vredenburg H. (1998). Proactive corporate environmental strategy and the development of competitively valuable capabilities, *Strategic Management Journal* 19, 729-753.
- Takala, T., Pallab, P. (2000). Individual, collective and social responsibility of the firm. *Business Ethics: A European Review*, 9 (2), 109–118.
- Tyteca, D. (1998). Sustainability indicators at the firm level, pollution and resource efficiency as a necessary condition toward sustainability. *Journal of Industrial Ecology* 2 (4), 61–77.
- Veleva, V., Ellenbecker, M., 2001. Indicators of sustainable production: framework and methodology. *Journal of Cleaner Production* 9 (6), 519–549.

**Contact information**

Nguyen Thi Thuc Doan

Tomas Bata University in Zlín, Faculty of Management and Economics

Address: Na sidlisti I 151 252 43, Pruhonice, Prague

Phone number: 770698910

Email: [doanntt@buh.edu.vn](mailto:doanntt@buh.edu.vn)

# A REVIEW AND CRITIQUE OF RESEARCHES ON KNOWLEDGE MANAGEMENT AND INNOVATION IN ACADEMIA

*Nguyen Ngoc*

## **Abstract**

Knowledge management has been deemed a new source of competitive advantage for any organization that wishes to perform better. Numerous researches have been conducted to prove positive impacts exerted on organizational performance and its innovation by knowledge management. This paper aims to advance understanding of the relationship between knowledge management and innovation in research institutes and universities by reviewing the results of previous studies that have investigated the relationship between knowledge management and innovation in academia. The results of the review from 10 studies suggest that knowledge management and innovation are interrelated in institutes and universities' performance. The paper concludes with a critique of previous studies and recommendations for future research.

**Keywords:** *knowledge management, innovation, institutes, universities, organizational performance.*

## **1 INTRODUCTION**

Academic institutions are entities deemed the main instruments of society for the constant pursuit of knowledge. Knowledge management in those organizations should help link people, processes, and technologies and provide solutions to how organizations can promote policies and practices that help people share and manage knowledge (Petrides & Nodine, 2003). Birgeneau (2005) states that higher education institutions are now facing a world that is more interconnected, one in which knowledge, creativity, and innovation are the essential elements of thriving societies. However, management has not been paid adequate attention in higher education until several decades ago. When the world enters new era of internet connection and rapid technological change, academic institutions has been forced to redefine their strategic asset and source of growth for both private and public institutions. Today there is a growing recognition that knowledge management can enable higher education to evolve more smoothly to a highly interactive and dynamic educational environment (Robson et al., 2003). Starting off with introduction, then examining extant literatures for theoretical perspectives, carefully reviewing 10 studies concerning the theme, giving critiques and recommendations for future researches and, last but not least, drawing conclusion, this paper investigates the relation between knowledge management and innovation in academia and tries to prove this bond. The paper also shows the shortcomings of those researches and proposes suggestions for future ones.

## **2 THEORETICAL PERSPECTIVES**

### **2.1 Knowledge management defined**

According to Gloet and Terziovski (2004), there is no shortage of KM definition. Depending on the approaches and author's perspectives, the definition of KM is devised accordingly.

Chong et al (2006), in industrial language, said KM is the synergistic combination of data, which eloquent the skills, expertise and innovative capacity supported by information technology. Meanwhile, Alavi and Leidner (2001) defined KM system as IT based system, which is developed to support and enhance the processes of knowledge creation, storage, retrieval, transfer and application.

Diakoulakis et al (2004), Bharadwaj and Saxena (2005), Nowack, et al (2008), in HR perspective, are of the opinion that KM is a strategy to manage organizational knowledge assets to support decision making, to enhance competitiveness, and to increase individual capacity for creativity and innovation .This strategy involves people, information, work-flows, best practices, alliances, and communities of practice.

Looking at KM from process perspective, Nonaka and Takeuchi (1995) studied how knowledge is produced, used, and diffused within organizations and how such knowledge contributes to the diffusion of innovation. KM is divided into four part viz., knowledge creation, knowledge retrieval, knowledge sharing and knowledge application. This process was reconfirmed by Wilson and Cattell (2005).

Alrawi (2008) believed knowledge management involves three perspectives emerged, information based one, a technology based one and a culture based one. Therefore, Ho (2009) supported the viewpoint by saying KM is result-oriented, process oriented, technology oriented, culture oriented and HR-oriented and supported by four key enablers viz., leadership, culture, technology, and measurement.

Plessis (2007) and Gloet and Terziovski (2004) offered more comprehensive ones. Plessis (2007) defines KM as a planned structure approach to managing creation, sharing, harvesting and leveraging of knowledge as an organizational asset to enhance an organization's ability, speed and effectiveness in delivering products or services for the benefit of clients in line with its business strategy.

While Gloet and Terziovski (2004) describe knowledge management as the formalization of and access to experience, knowledge, and expertise that create new capabilities, enable superior performance, encourage innovation, and enhance customer value.

Despite a large number of researchers have investigated knowledge management activities and process; there's still no unanimous definition of knowledge management. All in all, however, almost all researchers shared that KM helps reinforce knowledge acquisition, dissemination and utilization in an organization, promote innovation and accordingly it contributes to the improvement of organizational performance.

## **2.2 Innovation defined**

According to Damanpour et al (2009), literature views innovation as a valuable instrument enabling the firm to obtain greater capability to respond and adapt to the changes in its environment (and thus to discover new opportunities on the market and exploit them to a greater extent than do its rivals). Zahra and Covin, 1995; Camiso'n and Lo'pez, 2010; Alipour and Karimi, 2011; Rubera and Kirca (2012) support the viewpoint by reconfirming that in recent years, a growing body of research has examined the way in which innovation contributes to better organizational performance. James A. Odumeru (2013) is also of the same opinion when saying that innovation is a key determinant of organizational performance.

Robbins and Coulter (2006) defined innovation as the process of adopting creative ideas and turning them into useful products or work methods. This is unlike invention which these authors describe as the process of developing new ideas. Parashar and Singh (2005) defined innovation as the ability to combine two or more knowledge. Tran (2008), on the other hand, viewed innovation as the creative and commercial embodiment of organizational learning.

Damanpour, 1991; Camiso'n and Fore's, 2010; Molina and Mart'nez (2010) believed innovation has been understood alternately as the transformation of knowledge that the firm possesses into products and processes, and as significant changes in existing processes and products to introduce them in the market. Further, many articles that have studied the relationship between innovation and knowledge demonstrate that knowledge is a precursor of innovation (Cohen and Levinthal, 1990; Tsai, 2001; Zahra and George, 2002; Camiso'n and Fore's, 2010).

In a nutshell, innovation is a new strategy that is widely accepted by most organizations in contemporary economies. It's deemed a tool to enhance competitive advantage and improve organizational performance. Innovation is even regarded as a key determinant of organizational performance. However, the type and degree of innovation varies across industries. Therefore, every organization seeking competitive advantage and improved performance must consider the inclusion of appropriate type of innovation for achieving desired outcomes.

## **2.3 The interrelationship between KM and innovation**

According to Kumar et al., (2000), knowledge is generally believed to be one of the keys to fostering innovation since it promotes activities that create or improve the organizational processes. Rhodes et al.,

(2008) supports the viewpoint by stating that knowledge is a momentous resource for strategic organization in enhancing innovation and organizational performance improvement.

Many studies have analyzed the positive relationship between knowledge and innovation (Molina and Martı́nez, 2010; Zheng, 2010; Camelo et al., 2011). Those studies have indicated that KM could play a major role in higher organizational performance (Bierly and Daly, 2007; Choi et al., 2008; Chong et al., 2009; Schulz and Jobe, 2001; Turner and Bettis, 2002).

KM and innovation enjoy correlated and reciprocal effect. Majchrzak et al. (2004) demonstrated that the KM implementation is a strategy to improve innovation. It is regarded as the best way to enhance innovation (Majchrzak et al., 2004; Rhodes et al., 2008). In addition, Yahya and Goh (2002) described KM as a process to enhance knowledge application to achieve innovation for improving business performance. Innovation process involves the acquisition, dissemination, and use of new and existing knowledge (Damanpour, 1991; Moorman and Miner, 1998). An organization's innovativeness is closely tied to its ability to utilize its knowledge resources (Subramaniam and Youndt, 2005). Jantunen (2005) stresses that innovation is a knowledge-based process to create new ideas, markets, products and services toward achieving competitive advantage by satisfying maximum number of customers, which in turn establishes an organization as a brand.

The positive relationship between KM and innovation has been proved and gain popularity in literature. According to Chen and Huang (2009), knowledge management capacity in terms of acquisition, sharing, and application provides a positive contribution to the organization's innovation performance. Effective knowledge management facilitates knowledge communication and exchange required in the innovation process, and further enhances innovation performance through the development of new insights and capabilities (Madhavanand Grover, 1998; Nonaka and Takeuchi, 1995; Von Krogh, 1998). Therefore, knowledge management capacity plays a pivotal role in supporting and fostering innovation.

The role of knowledge management in the innovation capacity enhancement of organization is well-established and predominant in the literature (Darroch and McNaughton, 2002; Fosfuri and Tribo, 2006; Gray, 2006; Chen and Huang, 2009). Knowledge management practices can enable innovation by competence deployment (Cavusgil et al., 2003) and coordinating mechanism (Darroch and McNaughton, 2002).

Du Plessis (2007) stated that innovation in the organization depends upon the workforce knowledge and one of the factors influencing innovation capacity of the organizations is knowledge management (Lopez-Nicolas and Merono-Cerdan, 2011; Cantner and Schmudt, 2009; Schiuma and Lerro, 2008).

An organization which has knowledge management deployed will use resources more efficiently and will be more innovative and perform better (Darroch, 2005; Jantunen, 2005; Basadur and Gelade, 2006). Knowledge management also helps the organization to articulate tacit knowledge in the form of explicit knowledge and this is a strong base to bring innovation (Du Plessis, 2007; Gavrilova and Andreeva, 2012).

### **KM and innovation in academia**

Higher education institutions and research institutes, considered knowledge enterprises, for long have operated in a comparatively stable environment and faced less competitive pressure from the changes taking place in practical world. According to Petrides and Guiney (2002), the internet era and the rapid technological changes have opened up new horizons and new challenges in the educational world. The situation of fierce competitions amongst universities in a dynamic and interconnected world now made them redefine knowledge as their strategic asset and source of growth for both private and public institutions.

Jing Tian, Yoshiteru Nakamori and Andrzej P. Wierzbicki (2009) stated that universities and research institutes constitute social academic communities that play a vital role in creating and transmitting scientific knowledge, which is the fundamental source and driver for societal progress and development. KM in academia aims at integrating the knowledge produced at all levels and using it towards the institute's goals and targets. This will have the implications of improving the operational

quality, capacity development and effectiveness of the organization leading to enhanced productivity, performance and innovation.

Mathew (2010) believed KM provides some of the solutions to the problems that are relevant for sustainable higher education teaching and learning processes. He said the use of KM provides: collaborative solutions and higher learning, technological issues, learning, knowledge, competition, teacher training, resolution of student problems, assistance to business and industry, adoption of projects at more extended levels, movement of resources for enhancing development, and achievement of sustainability. Furthermore, they showed that increasing the use of KM leads to enhancements in innovation and development.

In short, review of literatures proves that KM and innovation has a significantly positive relationship that is prerequisite for any organization wishing to perform better.

### **3 RESEARCH REVIEW**

Our review of the 10 studies that have been published in many different journals across a number of disciplines showed that there is a lack of consistency in how the studies are conducted, how key variables are measured, and how data are analyzed. They, however, share with each other in findings that KM and innovation in academic settings are positively correlated.

Dev Raj Adhikari (2010), in his conceptual paper, said by deploying KM practices including strengthening teaching and learning environment, developing a system of transferring research knowledge and skills, building technology-based knowledge sharing mechanism, formulating knowledge-based networking hub may result in a quality education. NajmehShaghaei and Tayfun Turgay (2013) conducted an empirical research on the impacts of KM and innovation on school performance. They found that KM has some value to bring innovation and direct effects in improving school's performance.

Jing Tian, Yoshiteru Nakamori and Andrzej P. Wierzbicki (2009) carried out a research paper with an aim to find out why and how to use knowledge management methods in order to enhance knowledge creation in academia – at universities and research institutes. They conducted two surveys and case studies and found the link between KM and creative working environment; they also proposed their way to enhance creative environment in academia from both “soft” and “hard” aspects under the guidelines of a systems thinking framework for KM in scientific labs.

MohdGhazaliMohayidin, Nor Azirawani, Man NorfaryantiKamaruddin and Mar Idawati Margono (2007) stated that, in a university, knowledge management initiative is usually tied to its objectives and is intended to achieve specific outcomes such as improved performance through shared intelligence and higher levels of innovation.

MamtaBhusry and Jayanthi Ranjan (2012) asserted the KM impacts on learning and teaching technical educational institutions through the IT-based KM intervention. With the support of technology (technical innovation), KM exerts its influence to boost the quality of learning and teaching in an academic settings. IT-based KM system helps facilitate the promotion of institutional value and innovation in the competitive academic society. In another work published in the same years namely “Implementing Knowledge Management in Higher Educational Institutions in India: A Conceptual Framework.”, Mamta Bhusry and Jayanthi Ranjan (2012) found that KM practices including knowledge creation, knowledge encapsulation and storage, knowledge structuring, knowledge dissemination, knowledge employment and knowledge audit and measure helps create an innovation environment and enable institutions to gain a more comprehensive, reflexive and integrative view of the institutional knowledge for application in cross functional issues – ultimately leading to improved knowledge sharing and more effective decision making, planning and enhancement in performance including functional domains of an academic institution: Institutional Planning and Development, Institutional Research, Industrial Projects and Consultancy, Placement Services, Teaching and Learning Process, Recruitment Process, Performance Evaluation of Faculty, Institutional Administrative Services, Student Affairs.



Aurilla Aurelie Bechina Arntzen, Lugkana Worasinchai and Vincent M. Ribière (2009), in their case study - typed paper, stressed that by building knowledge sharing and e-learning systems, the academic setting improved not only through the communication and cooperation between students and staff, but also through creating an environment that supports efficiently the cross-organizational learning and knowledge-sharing processes.

Knowledge Management (KM) is essentially connected to the capability of organizations to acquire, share, integrate, and use the various knowledge sources to create new knowledge for achieving innovation (B. Igel and S. Numprasertchai, 2004). Avninder Gill (2009) is of the same opinion when stating in his research paper that small university only can improve its research capability by creating an environment and culture; where members can contribute to a repository of knowledge that is shared throughout the university.

In their conceptual paper, Dr. Sujata J. Dhopte and Rajan Nandola (2012) claimed that innovation helps detect weaknesses, correct inefficiencies and help academic institutions be willing to take up new challenges and responsibilities. It is innovation that brings greater access and increase in the educational level of the developing countries; facilitates diffusion of technology which in turn enhances the efficiency and quality in education and this is what knowledge management concerns.

Table 1: Summary of findings in previous studies on KM and Innovation

No	Names of Authors	Name of Article	Findings
1.	Jing Tian Yoshiteru Nakamori, Andrzej P. Wierzbicki (2009)	"Knowledge management and knowledge creation in academia: a study based on surveys in a Japanese research university"	The findings from the first survey showed that the KM obstacles reflected on various aspects: technological support, the people involved in creation activities, laboratory cultural, and so on. The seven most critical questions and three most important questions were evaluated by responders with respect to academic knowledge creation process in the second survey.
2.	B. Igel, S. Numprasertchai (2004)	Knowledge Management in University R&D in Thailand.	Knowledge Management (KM) is essentially connected to the capability of organizations to acquire, share, integrate, and use the various knowledge sources to create new knowledge for achieving innovation.
3.	Dev Raj Adhikari (2010)	Knowledge management in academic institutions.	KM helps reach the goal of quality education of a country.
4.	Najmeh Shaghaei, Tayfun Turgay (2013).	Performance improvement through Knowledge Management and Innovation in educational institutions: Teacher's perception.	KM has some value to bring innovation and direct effects in improving school's performance.
5.	Mamta Bhusry, Jayanthi Ranjan (2012).	Implementing Knowledge Management in Higher Educational Institutions in India: A Conceptual Framework.	KM in HEIs involves the discovery capture of the knowledge created, its filtering and encapsulation and mapping it to the needs of the organization to derive value from its sharing throughout the organization. A competitive edge over others depends largely on the quality of KM that organizations are able to apply to their operations.
6.	Mohd Ghazali Mohayidin, Nor Azirawani, Man Norfaryanti Kamaruddin and Mar Idawati Margono (2007)	The Application of Knowledge Management in Enhancing the Performance of Malaysian Universities.	The results indicate that info-structure support; infrastructure capacity; info-culture; and knowledge acquisition, generation, storage and dissemination; are important factors in shaping the KM initiatives. Infostructure is found to be the most significant variable. This is consistent with other studies, which confirm that people and cultural issues are the most difficult problems to resolve, but tend to produce the greatest benefits.
7.	Mamta Bhusry, Jayanthi Ranjan (2012).	Enhancing the teaching-learning process: a knowledge management approach	The authors value the impact that KM can have in enhancing the quality of teaching and learning in TEIs, and underscore the need for credible research into the benefits and challenges that the implementation of IT-based KM intervention will provide.
8.	Aurilla Aurelie Bechina Arntzen, Lugkana Worasinchi, Vincent M. Ribière, (2009)	An insight into knowledge management practices at Bangkok University	The initial overall benefits emerging from the early stage of KM at Bangkok University are encouraging. The educational community has improved not only through the communication and cooperation between students and staff, but also through creating an environment that supports efficiently the cross-organizational learning and knowledge-sharing processes.
9.	Avninder Gill, (2009)	Knowledge management initiatives at a small university	The paper investigates the main issues faced by a small university to enhance its research reputation and identify key components of a KM system that can be established to achieve these objectives.
10.	Dr. Sujata J. Dhopte, Rajan Nandola (2012)	Innovation & Knowledge Management: Leveraging the strengths of Indian Higher Education Sector	Innovation in higher education services helps to detect and correct the areas of inefficiencies and take up the challenge of competition in higher education sector which brings new set of responsibilities. Innovative education program brings greater access and increase in the educational level of the developing countries. Innovation methods lead to diffusion of technology in higher education sector which in turn has enhanced the efficiency and quality.

## 4 CRITIQUE AND RECOMMENDATIONS FOR FUTURE RESEARCH

Though the above-reviewed studies do not share the same theory on which they are based to conduct the research; research designs and measurements are different from each other, they do share with each other the same view that innovation and knowledge management are interrelated in the academic settings.

Although academic settings are the environments which are deemed a means for a society to pursue knowledge and a home where innovation is cherished and then disseminated, most of the 10 reviewed papers are conceptual ones.

There is a need for future researches in this area to conduct quantitative studies with convincing and quantifiable measurements to prove the interconnected and correlated relationship between KM and innovation in academia.

## 5 CONCLUSION

KM and innovation are two interrelated factors that help improve performance of an organization and bring about competitive advantages especially in academia. Parlbay and Taylor (2000) stressed that the primary purpose of knowledge management is to bring innovation. Meanwhile, Plessis (2007) stated that collaboration in an organization can bring the innovation and sustainable competitive advantage. This will facilitate organizational approach to the new knowledge that can be helpful to fill the knowledge gap within the organization. Through the proper knowledge distribution and sharing, academia can achieve the innovation. Innovation depends upon knowledge. So, to bring innovation, organizations must identify knowledge capability, and richness (Plessis, 2007). Cavusgil et al (2003) said knowledge can foster innovation. All in all, those two factors are interconnected and support each other. This is clearly evidence in academic settings.

### References

- Alavi, M., and Leidner, D.E. (2001). Review: Knowledge management systems: Conceptual foundations and research issues, *MIS Quarterly*, 25(1), 107-136.
- Alipour, F. and Karimi, R. (2011), "Mediation role of innovation and knowledge transfer in the relationship between learning organization and organizational performance", *International Journal of Business and Social Science*, Vol. 2 No. 19, pp. 144-147.
- Alrawi, K.W. (2008). Knowledge management and organizations perception in the United Arab Emirates. *International Journal of Commerce and Management*, 18(4), 382-394.
- Argote, L. (1999). *Organizational Learning: Creating, Retaining and Transferring Knowledge*, Norwell, MA: Kluwer.
- Aurelie Bechina Arntzen, A., Worasinchai, L., & Ribière, V. M. (2009). An insight into knowledge management practices at Bangkok University. *Journal of Knowledge Management*, 13(2), 127-144. <https://doi.org/10.1108/13673270910942745>
- Basadur, M., and Gelade, G.A. (2006). The role of knowledge management in the innovation process. *Creativity and Innovation Management*, 15(1), 45-62.
- Bharadwaj, S.S., and Saxena, K.B. (2005). Knowledge management in global software teams. *Vikalpa*, 30(4), 65-75.
- Bhusry, M., Ranjan, J., & Nagar, R. (2012). Enhancing the teaching-learning process: a knowledge management approach. *International Journal of Educational Management*, Vol. 26 No. 3, 2012, pp. 313-329.

- Bhusry, M., Ranjan, J., & Nagar, R. (2012). Implementing Knowledge Management in Higher Educational Institutions in India: A Conceptual Framework. *Liceo Journal of Higher Education Research*, 7(1). <https://doi.org/10.7828/ljher.v7i1.21>
- Bierly, P.E. and Daly, P.S. (2007), "Alternative knowledge strategies, competitive environment, and organizational performance in small manufacturing firms", *Entrepreneurship Theory and Practice*, Vol. 31 No. 4, pp. 493-516.
- Camelo, O.C., Garcí'a, C.J., Sousa, G.E. and Valle, C.R. (2011), "The influence of human resource management on knowledge sharing and innovation in Spain: the mediating role of affective commitment", *The International Journal of Human Resource Management*, Vol. 22 No. 7, pp. 1442-1463.
- Camiso'n, C. and Fore's, B. (2010), "Knowledge absorptive capacity: new insights for its conceptualization and measurement", *Journal of Business Research*, Vol. 63 No. 7, pp. 707-715.
- Camiso'n, C. and Lo'pez, A. (2010), "An examination of the relationship between manufacturing flexibility and firm performance: the mediating role of innovation", *International Journal of Operations y Production Management*, Vol. 30 No. 8, pp. 853-878.
- Cantner, U., Joel, K., and Schmutd, J. (2009). The use of knowledge management by German innovators. *Journal of Knowledge Management*, 13(4), 187-203.
- Cavusgil, T.S., Calantone, R.J., and Zhao, Y. (2003). Tacit knowledge transfer and firm innovation capability. *Journal of Business and Industrial Marketing*, 18(1), 6-12.
- Chen, Chung-Jen, and Huang, Jing-Wen (2009). Strategic human resource practices and innovation performance-The mediating role of knowledge management capacity. *Journal of Business Research*, 62, 104-114.
- Chen, M. & Chen, A. (2005). Integrating option model and knowledge management performance measures: an empirical study. *Journal of Information Science*, 31 (5), pp. 381-393.
- Choi, B., Poon, S.K. and Davis, J.G. (2008), "Effects of knowledge management strategy on organizational performance: a complementarity theory-based approach", *Omega*, Vol. 36 No. 2, pp. 235-251.
- Chong, C.W., Chong, S.C., and Yeow, H.P. (2006). KM implementation in Malaysian telecommunication industry: An empirical analysis. *Industrial Management and Data Systems*, 106(8), 1112-32.
- Chong, C.W., Choy, C.S. and Wong, K.Y. (2009), "Is the Malaysian telecommunication industry ready for knowledge management implementation?", *Journal of Knowledge Management*, Vol. 13 No. 1, pp. 69-87.
- Cohen, W.M. and Levinthal, D.A. (1990), "Absorptive capacity: a new perspective in learning and innovation", *Administrative Science Quarterly*, Vol. 17 No. 1, pp. 178-184.
- Damanpour F. Organizational innovation: a meta-analysis of effects of determinants and moderators. *Acad Manage J* 1991 34(3):555-90.
- Damanpour, F. (1991), "Organizational innovation: a meta-analysis of effects of determinants and moderators", *Academy of Management Journal*, Vol. 34 No. 3, pp. 555-590.
- Damanpour, F., & Evan, W. M. 1984. Organizational innovation and performance: The problem of organizational lag. *Administrative Science Quarterly*, 29: 392-409.
- Damanpour, F., Walker, R. and Avellaneda, C. (2009), "Combinative effects of innovation types and organizational performance: a longitudinal study of service organizations", *Journal of Management Studies*, Vol. 46 No. 4, pp. 650-675.
- Darroch, J. (2003). Developing a measure of knowledge management behaviors and practices. *Journal of Knowledge Management*, 7 (5), pp. 41-54.

- Darroch, J. (2005). Knowledge management, innovation and firm performance. *Journal of Knowledge Management*, 9(3), 101-115.
- Darroch, J., and McNaughton, R. (2002). Examining the link between knowledge management practices and types of innovation. *Journal of Intellectual capital*, 3(3), 210-222.
- Demarest, M. (1997). Understanding Knowledge Management. *Long Range Planning*, pp. 30 (3), pp. 374-384.
- Dhopte, S. & Nandola, R. (2012). Innovation & Knowledge Management: Leveraging the strengths of Indian Higher Education Sector. *International Journal of Engineering and Management Research*, Vol. 2, Issue-1, Jan 2012, pp. 37-43.
- Diakoulakis, I.E., Georgopoulos, N.B., Koulouriotis, D.E., and Emiris, D.M. (2004). Towards a holistic knowledge management model. *Journal of Knowledge Management*, 8(1), 32-46.
- Du Plessis, M. (2007). The role of knowledge management in innovation. *Journal of Knowledge Management*, 11(4), 20-29.
- Fosfuri, A., and Tribo, J. (2006). Exploring the antecedents of potential absorptive capacity and its impact on innovation performance. *Omega: The International Journal of Management Science*, 36, 173–187.
- Gavrilova, T. and Andreeva, T. (2012). Knowledge elicitation techniques in a knowledge management context. *Journal of Knowledge Management*, 16(4), 523-537.
- Gill, A. (2009). Knowledge management initiatives at a small university. *International Journal of Educational Management*, 23(7), 604–616. <https://doi.org/10.1108/09513540910990834>
- Gloet, M. and Terziovski, M. (2004), “Exploring the relationship between knowledge management practices and innovation performance”, *Journal of Manufacturing Technology Management*, Vol. 15, No. 15, pp. 402-409.
- Gray, C. (2006). Absorptive capacity, knowledge management and innovation in entrepreneurial small firms. *International Journal of Entrepreneurial Behaviour and Research*, 12(6), 345 – 360.
- Hislop, D. (2009), *Knowledge management in organizations*, 2nd edition Oxford University Press New York, NY.
- Ho, C.T. (2009). The relationship between knowledge management enablers and performance. *Industrial Management and Data Systems*, 109(1), 98–117.
- Igel, B., & Numprasertchai, S. (2004). Knowledge management in university R&D in Thailand. In *Engineering Management Conference, 2004. Proceedings. 2004 IEEE International* (Vol. 2, pp. 463–467). IEEE. Retrieved from [http://ieeexplore.ieee.org/xpls/abs\\_all.jsp?arnumber=1407177](http://ieeexplore.ieee.org/xpls/abs_all.jsp?arnumber=1407177)
- Jantunen, A. (2005). Knowledge-processing capabilities and innovative performance: An empirical study. *European Journal of Innovation Management*, 8(3), 336-349.
- Jing Tian Yoshiteru Nakamori Andrzej P. Wierzbicki, (2009), "Knowledge management and knowledge creation in academia: a study based on surveys in a Japanese research university", *Journal of Knowledge Management*, Vol. 13 Iss 2 pp. 76 – 92
- Kumar, N., Scheer, L. and Kotler, P. (2000), “From market-driven to market-driving”, *European Management Journal*, Vol. 18 No. 2, pp. 129-141.
- López-Nicolás, C., and Merono-Cerdán, A.L. (2011). Strategic knowledge management, innovation and performance, *International Journal of Information Management*, 31(6), 502-509.
- Madhavan R, Grover R. From embedded knowledge to embodied knowledge: new product development as knowledge management. *J Mark* 1998 62(4): 1–12.
- Majchrzak, A., Cooper, L.P. and Neece, O.E. (2004), “Knowledge reuse for innovation”, *Management Science*, Vol. 50 No. 2, pp. 174-188.

- Mathew, V. (2010), "Knowledge management in higher education: implementation agenda in distance learning", *2010 4<sup>th</sup> International Conference on Distance Learning and Education*, pp. 155-158.
- Miller, W. (1999). Building the ultimate resource. *Management review*, 1 (1), pp. 42-45.
- Mohayidin, M. G., Azirawani, N., Kamaruddin, M. N., & Margono, M. I. (2007). The application of knowledge management in enhancing the performance of Malaysian universities. *The Electronic Journal of Knowledge Management*, 5(3), 301–312
- Molina, M.F. and Martínez, F.M. (2010), "Social networks: effects of social capital on firm innovation", *Journal of Small Business Management*, Vol. 48 No. 2, pp. 258-279.
- Moorman C, Miner AS. Organizational improvisation and organizational memory. *Acad Manage Rev* 1998 23(4):698–723.
- Nonaka I, Takeuchi H. The knowledge-creating company. New York: Oxford University Press; 1995
- Nonaka, I. and Peltokorpi, V. (2006), "Objectivity and subjectivity in knowledge management: a review of 20 top articles", *Knowledge and Process Management*, Vol. 13 No. 2, pp. 73-82.
- Nonaka, I., and Takeuchi, H. (1995). *The Knowledge-creating company- How Japanese companies create the dynamics of innovation*, New York: Oxford University Press.
- Nowack, L., Maul, T., Kraus, W., and Hansch, W. (2008). Knowledge management supporting education and research at a university clean room. *Knowledge Management Research and Practice*, 7, 100-112.
- Odumeru, J. A. (2013). INNOVATION AND ORGANISATIONAL PERFORMANCE. *Kuwait Chapter of the Arabian Journal of Business and Management Review*, 2(12) 18,
- Ooi, K.B., Cheah, W.C., Lin, B., Teh, P.L. (2010). TQM practices and knowledge sharing: An empirical study of Malaysia's manufacturing organization. *Asia Pacific Journal of Management*, 1-20
- Parashar, M., Singh, S.M. (2005) Innovation Capability, *IIBM Management Review*, 115-123.
- Parlby, D. and Taylor, R. (2000), "The Power of Knowledge: A Business Guide to Knowledge Management", available at [www.kpmgconsulting.com/index.html](http://www.kpmgconsulting.com/index.html).
- Petrides, L. A. & Nodine, T. R. (2003). Knowledge Management for School Leaders: An ecological framework for thinking schools. *Teachers College Record*, 104, 8, 1702-1717.
- Plessis, M. (2007), "The role of knowledge management in innovation", *Journal of Knowledge Management*, Vol. 11, No.4, pp. 20-29.
- Raj Adhikari, D. (2010). Knowledge management in academic institutions. *International Journal of Educational Management*, 24(2), 94–104. <https://doi.org/10.1108/09513541011020918>
- Rhodes, J., Hung, R., Lok, P., Lien, B.Y.H. and Wu, C.M. (2008), "Factors influencing organizational knowledge transfer: implication for corporate performance", *Journal of Knowledge Management*, Vol. 12 No. 3, pp. 84-100.
- Robbins, S.P & Coulter, M (2006) *Management* (9th edition) New York, Prentice Hall
- Robson, R., Norris, D., Lefrere, P. and Mason, J. (2003), "Share and share alike: the e-knowledge transformation comes to campus", *EDUCAUSE Review*, September/October.
- Rubera, G. and Kirca, A. (2012), "Firm innovativeness and its performance outcomes: a meta-analytic review and theoretical integration", *Journal of Marketing*, Vol. 76 No. 3, pp. 130-147.
- Schiuma, G., and Lerro, A. (2008). Knowledge-based capital in building regional innovation capacity. *Journal of Knowledge Management*, 12(5), 121-136.
- Schulz, M. and Jobe, L.A. (2001), "Codification and tacitness as knowledge management strategies: an empirical exploration", *Journal of High Technology Management Research*, Vol. 12 No. 1, pp. 139-165.

- Seng, L.K., Yusof, N. A and Abidin, N. Z (2011) Types of Innovation Implemented by Housing Developer in Developing Countries. *International Journal of Academic Research*. 3(3), 614 – 618
- Shaghaei, N. & Turgay, T (2013). Performance improvement through Knowledge Management and Innovation in educational institutions: Teacher's perception. *GFTS International Journal on Business Review*, Vol.2 No.4, July 2013.
- Subramaniam M, Youndt MA. The influence of intellectual capital on the types of innovative capabilities. *Acad Manage J* 2005 48(3):450–63.
- Tian, J., Nakamori, Y., & Wierzbicki, A. P. (2009). Knowledge management and knowledge creation in academia: a study based on surveys in a Japanese research university. *Journal of Knowledge Management*, 13(2), 76–92. <https://doi.org/10.1108/13673270910942718>
- Tran, T. (2008) A conceptual model of learning culture and innovation schema. *International Business Journal*, Vol. 18 No. 3, pp. 287-299.
- Tsai, W. (2001), “Knowledge transfer in intra organizational networks: effects of network position and absorptive capacity on business unit innovation and performance”, *Academy of Management Journal*, Vol. 44 No. 5, pp. 996-1004.
- Turner, S.F. and Bettis, R.A. (2002), “Exploring depth versus breadth in knowledge management strategies”, *Computational & Mathematical Organization Theory*, Vol. 8 No. 1, pp. 49-73.
- United Nations Economic and Social Commission for Western Asia (2005), “National profile for the information society in Iraq”, available at: [www.escwa.un.org/wsis/reports/docs/Iraq\\_2005 E.pdf](http://www.escwa.un.org/wsis/reports/docs/Iraq_2005_E.pdf) (accessed 5 February 2010).
- Von Krogh G. Care in knowledge creation. *Calif Manage Rev* 1998 40(3):133–53.
- Wilson, J.P., and Cattel, A. (2005). *Knowledge Management in Human Resource Development*. Edited by Jhon. P.Wilson (2nd Ed.) Kogan Page 2005.
- Yahya, S., & Goh, W.K. (2002). Managing human resources toward achieving knowledge management. *Journal of Knowledge Management*, 6(5), 457-468.
- Zahra, S. and Covin, J.G. (1995), “Contextual influences on the corporate entrepreneurship performance relationship: a longitudinal analysis”, *Journal of Business Venturing*, Vol. 10 No. 1, pp. 43-58.
- Zahra, S. and George, G. (2002), “Absorptive capacity: a review, reconceptualization, and extension”, *Academy of Management Review*, Vol. 27 No. 2, pp. 185-203.
- Zheng, W. (2010), “A social capital perspective of innovation from individuals to nations: where is empirical literature directing us?”, *International Journal of Management*, Vol. 12 No. 2, pp. 151-183.

The author would like to thank the Internal Grant Agency of FaME for providing financial support to carry out this research. Funding was extended through: TBU No. IGA/FaME/2017/013 – The relationship between knowledge management and organisational performance with mediating role of innovation.

### **Contact information**

Nguyen Ngoc Tan, MBA.

Tomas Bata University in Zlin, Faculty of Management and Economics

Czech Republic

Email: ngocphanu@gmail.com

# INTRODUCTION IN THE EUROPEAN UNION'S SANCTION POLICY AGAINST RUSSIAN FEDERATION

*Veronika Pastorová*

## **Abstract**

As a response to the annexation of Crimean Peninsula and destabilization of a neighboring sovereign country, the European Union has imposed restrictive measures against the Russian Federation which are focusing on de-escalating the crisis in Ukraine. First diplomatic measure as a tool of political pressure were imposed by the European Council in March 2014. It was followed by economic sanctions in July 2014. After certain period of sanctions imposed on and by Russia after annexing Crimea and intervening in Eastern Ukraine, new data shows the impact on the Russian and European economies. Have they actually worked? How have they influenced politics of Russian Federation? The following pages will be dedicated to answer these questions. To achieve the goal, the author uses descriptive analysis by historical-logical method. It will be focused on the influence of sanctions, especially on Russian politics against Ukrainian independence and sovereignty, based on macroeconomic data, and in different point of view.

**Keywords:** *cooperation and trade between European Union and Russian Federation, European sanction against Russia over Ukrainian crisis.*

## **1 INTRODUCTION**

When Russia illegally annexed Crimea and started interfering in Eastern Ukraine, the West responded with several measures of different nature, so-called sanctions. The term sanction is not apt and do not cover all undertaken actions, but as it is used by authorities, as well as by public, it will be used for purpose of the article. However, the term deserves further definition (Procházka 1979, Šefčík 2001).

Economic sanctions are probably the most common foreign policy tool democracies use to bring about policy or institutional changes. (Escriba-Folch and Wright, 2010; Hansen and Borchgravink, 2006))

The European Union intention is a de-escalation of the crisis in Ukraine and to assist the country in ensuring a stable, prosperous and democratic regime. Since the European Union supports the territorial integrity and sovereignty of the country in the spring of 2014, the European Council agreed to the first diplomatic measures in response to Russia's actions on the territory of Ukraine. The sanctions were enacted in a coordinated manner by the European Union, the United States, Canada, and other NATO members and partners.

European sanctions against Russia due to the Ukrainian crisis is manifested in several areas. (Placzek, 2015) These areas are influencing (according to European Union reports):

political dimension;

diplomatic dimension;

economic dimension.

As shown on diagram, the dimensions are not figuring separately, they form together the coherent policy of European Union in aim to cause an evident change in behavior of Russian Federation in relation to Ukraine.



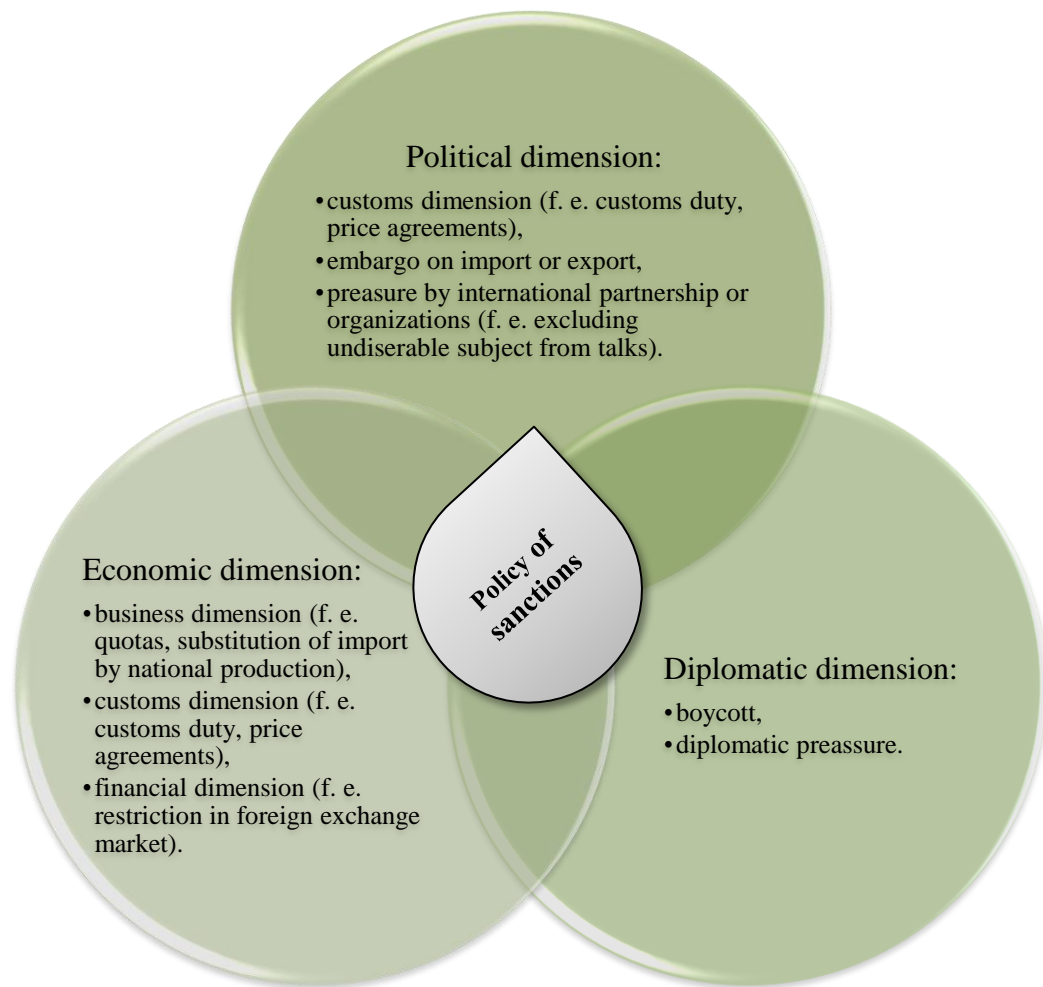


Figure 1 – Correlation between dimension of sanction policy. Source: Author.

In the text below, the three dimensions will be explored. These dimensions will be described in point of view of European Union’s external policy. The timeline shown below presents critical moments of sanctions policy against Russia. They are described in following subchapters.

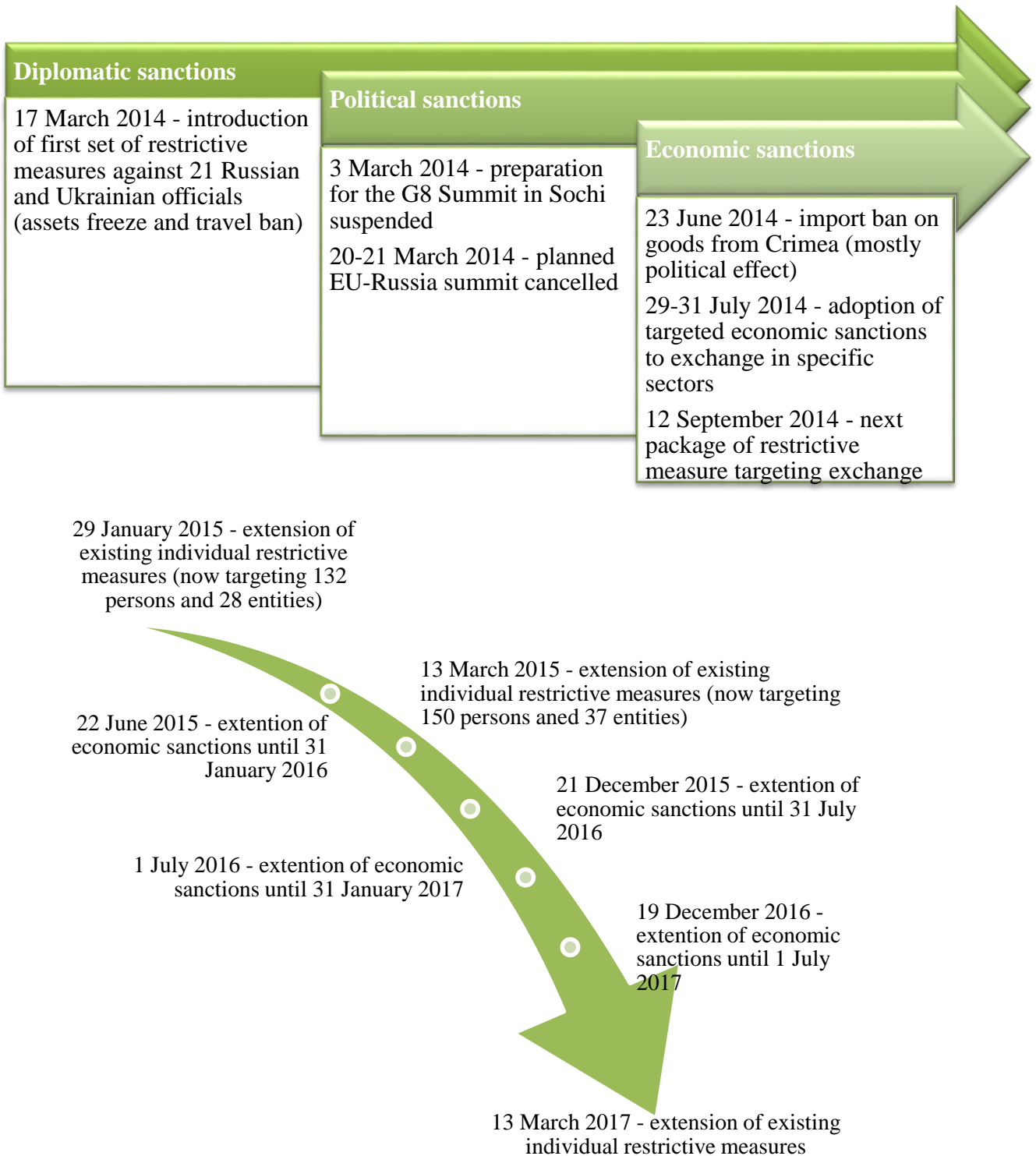


Figure 2 – Timeline of EU's sanction policy critical moments. Source: Author (according to data available on official European Council's site <http://www.consilium.europa.eu/en/policies/sanctions/ukraine-crisis/history-ukraine-crisis/>)

### **1.1 Political dimension of actions of European Union's actions**

Political dimension touches, for example, international meetings. Instead of the G8 summit in Sochi, the G7 meeting was held in Brussels, without the participation of Russia.

Bilateral talks with Russia on visa application, as well as an agreement between European Union countries and Russia, have been suspended.

Another manifestation of political pressure is the fact, that Member States of the European Union supported the suspension of negotiations on Russia's joining the Organization for Economic Co-operation and Development and member of the International Energy Agency.

### **1.2 Diplomatic dimension of actions of European Union's actions**

Diplomatic dimension is also represented by freezing assets of particularly undesirable entities deposited abroad and a visa ban for certain persons. These are the individuals and entities responsible for the fight against the territorial integrity and sovereignty of Ukraine, the person providing the support of Russian agents operating in the Crimea and in Sevastopol.

Up to this day, diplomatic sanctions affect 157 persons and 37 economic entities (according to List of persons and entities under EU restrictive measures over the territorial integrity of Ukraine issued by Council of European Union).

### **1.3 Economic dimension of actions of European Union's actions**

The economic dimension is reflected in terms of national economy, as well as in area of private enterprises.

For example, European enterprises are not allowed to buy or sell the newly released Russian financial products with maturity longer than 30 days, released by five major Russian banks, three major Russian energy companies, three major Russian defense firms or their subsidiaries. The government of Russian Federation is holding share in economic entities mentioned above.

It is also forbidden to provide loans with maturities longer than 30 days in entities referred previous paragraph.

The Council of European Union imposed an embargo on the import and export of arms and related material to Russia, covering all items in the Common Military List of the European Union. It is also applied on exports of dual use items for military use.

Export of certain equipment and technologies related to energy industry are subject of authorization and approval by the competent authorities of the Member States. The export licenses will be granted, if the products are intended for the exploration and exploitation of oil in waters deeper than 150 meters or in areas north of the Arctic Circle, and for projects that have the potential to produce oil from sources in shale formations by hydraulic fracturing.

Implementation of programs of bilateral and regional cooperation has been largely suspended. Projects dealing exclusively cross-border cooperation and civil society, however, are remained and unchanged.

## **2 ECONOMIC DIMENSION OF EUROPEAN UNION'S ACTIONS AND RUSSIA'S RETALIATORY MEASURES**

As it was mentioned, so-called sanctions affect both sides. So, what is the impact that we can see on both the Russian and European economies?

Primarily, the impact of sanctions could be noticeable in several areas. The most common and the most used are gross domestic product, inflation, unemployment and foreign commerce.

Sometimes, it is also used for example analysis of financial flows (Gurvich and Prilepsky 2015).

## 2.1 Have sanctions imposed on Russia worked?

For the Russian economy, the sanctions are generally assessed to have escalated the macroeconomic challenges it was already facing. For example, the rapid and pronounced fall in oil prices. The Russian economy depends on the price of major exported goods, such as natural gas and oil. Export of hydrocarbons constitutes more than a half of the revenues of national budget. In the middle of 2014, crude oil, due to global excess in supply, lost value. In addition, the combined effect of sanctions and of the fall in oil prices have caused pressure on the value of the Russian Rouble.

Financial sanctions, which refuse access to financing from European union, have forced the Russian government to use its foreign exchange reserves to shore up the sanctioned entities. It evoked that Central Bank of Russia suddenly ceased to defend the value of the Rouble and hike interest rates in December 2014.

However, the fall in the value of the Russian Rouble, had already raised the price of imported goods and services in Roubles. In combination with ban of import of food product from European union, it led to further inflation.

Undoubtedly, the sanctions have invoked negative effect. They have contributed to inflicting damage on the Russian economy. So, the proximate goal has been achieved. Recent data confirm Russia's entry into recession. There are many possibilities of evaluation of economic conditions, but the author focuses on gross domestic product, inflation rate, unemployment rate and trade balance. As shown in the table below, the Russian Federation evinces, by these indicators, decrease.

Table 1 Indicators of Economic Conditions of Russian Federation. Source: Author (according to data available on The Statistics Portal <https://www.statista.com/topics/2675/russia>)

GDP in current prices (in billion USD)		Unemployment rate		Inflation rate		Trade balance of goods and services (in billions of US)	
2016	1 267,75	2016	5,88 %	2016	7,24 %	2016	189,74
2015	1 326,02	2015	5,58 %	2015	15,53 %	2015	146,26
2014	2 030, 97	2014	5,20 %	2014	7,82 %	2014	?

Russia maintained a positive trade balance over last 10 years, however economy has been weakened because of reduction in global oil and gas prices. The final account for 2016 has not been published yet. Russia shipped over 285,5 billion of USD worth of products around the globe in 2016. Almost 55% of Russian exports by value are delivered to European countries, 35,7% are sold to Asian importers. Russia sells abroad another 4% worth of goods and services to Africa with 3.8% going to North America. The most important export partners are presented in figure below.

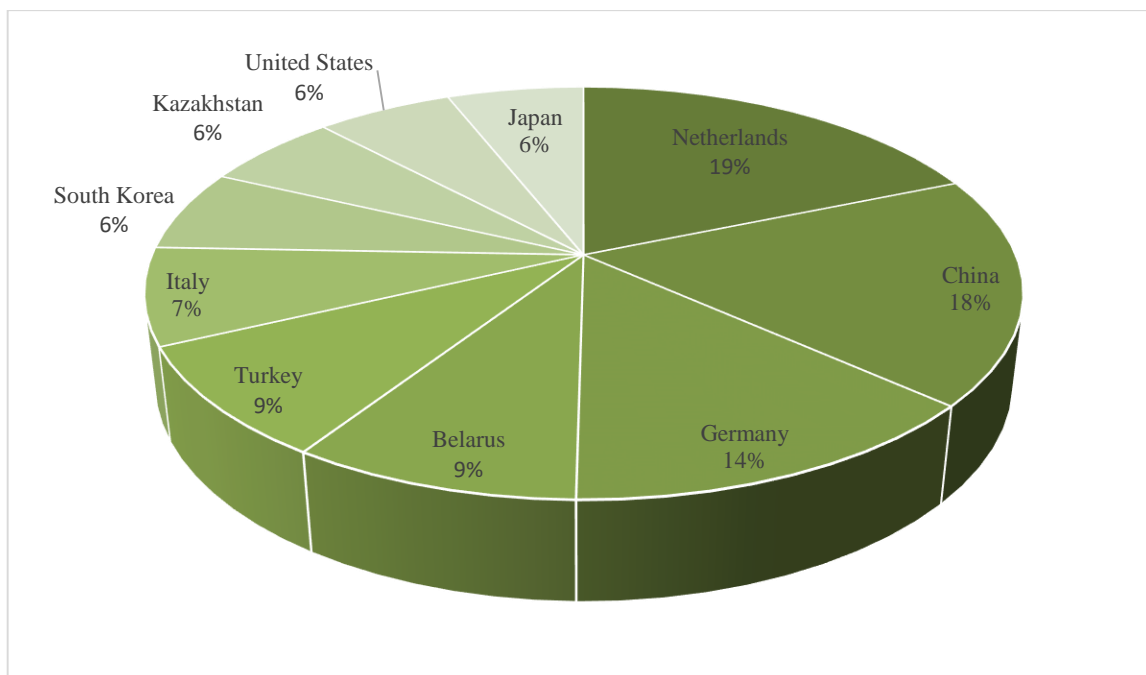


Figure 3 – Russia's Top Export Partners in 2016 (in billions of USD). Source: Author (according to data available on official Central Bank of Russia's site <http://www.cbr.ru/eng/statistics/?Prtid=svs>)

It is evident, that sanctions imposed by European Union affects Russia more roughly thanks to other factors, such as decrease in oil prices. The decline in Russian trade with extra-European countries has fallen, year on year - for example with China about 28 % and with Belarus about 41 % (Bank of Russia, 2017).

As it was mentioned bellow, the sanctions were mostly directed at banks, such as Bank of Moscow, Gazprombank Sberbank, and VTB. The imposed sanctions are expressed in a ban on borrowing with a maturity exceeding 30 days, but they generate additional effects. During the second half of 2014, the amount of foreign debt securities and public banks' syndicated loans was reduced by 11,2 billion of USD. Because of that, the Russian banks are also affected by stricter control over transactions that slows down their execution, thereby significantly increasing transaction costs (Gurvich and Prilepsy, 2016). Because of specially designed national and personal blocked list, the Russian banks are excluded from foreign exchange payments (affecting banks and companies whose owners were subjected to diplomatic sanctions). (Orlova, 2017)

Nonetheless, the Russian government insisted on forming strong national pride which should help Russians of humble origins to overcome difficulties without blaming the government of their misery. (Servettaz, 2014)

## 2.2 What have caused retaliatory measures imposed by Russian Federation?

The purpose of economic sanctions is first of all to signal disapproval to certain policy, eventually to force the targeted subject to reverse its action. Even if the targeted subject is not hit as much as was projected, the sanctions will always represent disagreement with present policy of the targeted subject.

Looking on the statistics of impact of the sanctions and Russian countermeasures on the EU, we consider them rather modest, although it should be noted that the loss of certain countries varies, according to their dependence on exports and the share of exports to the Russian Federation. The most visible effect is the substantial fall in agricultural and food exports to Russian Federation.



Figure 4 – Total Trade Flows between EU and Russia (in millions of EUR). Source: Author (according to data available on official European Commission's site [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113440.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf))

There are few EU Member States that have experienced net losses because of sanctions against Russia. These countries naturally split into two groups - those that were able to expand into new markets, but to an insufficient degree, and those who experienced losses on both counts (Sharkov 2015). To visualize the proportion of trade with Russia in global point of view, the figure of top export partners is presented.

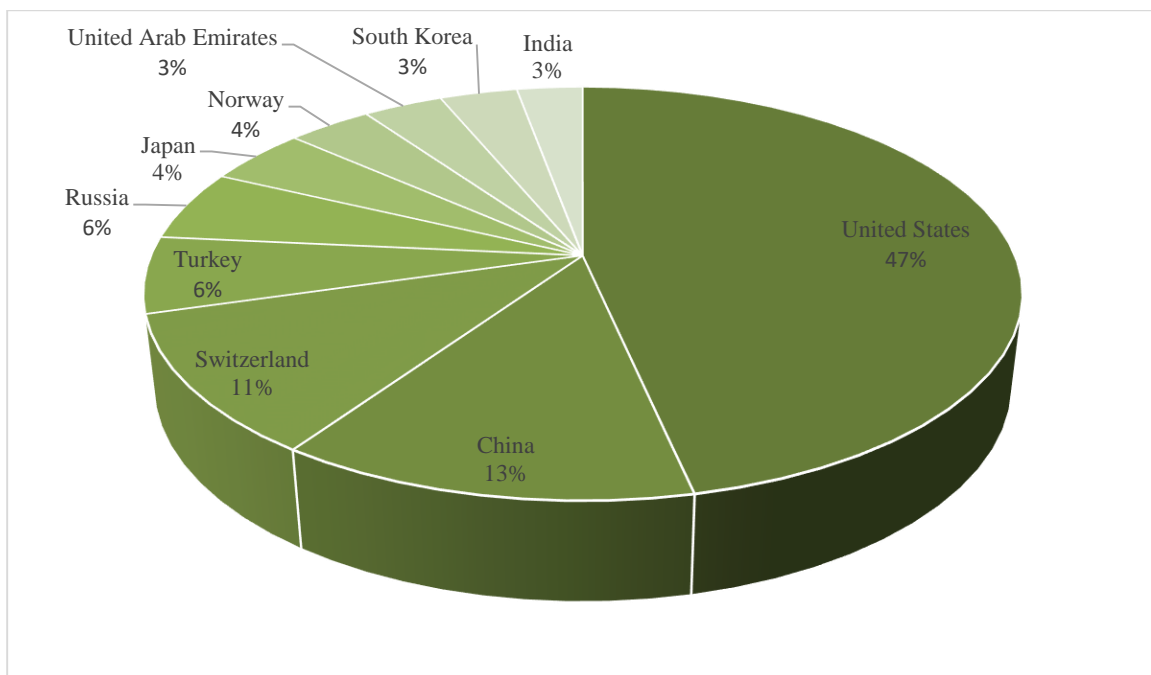


Figure 5 – EU's Top Export Partners in 2016 (in millions of EUR). Source: Author (according to data available on official European Commission's site [http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113440.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113440.pdf))

Sweden and Greece are the only countries which have experienced both types of losses, a general loss of export competitiveness which is not due to the Russian downturn (European Parliament 2015).

Countries, such as Baltic countries or Finland which are among those with the highest exposure to trade with Russia as a percentage of their GDP, are affected more than the European average (European Parliament predicts the loss of 0,3 % of GDP in the short term and 0,8% in the long run).

Estonia, Latvia, Finland, and Lithuania belong to the former category. The Lithuanian and Finnish net losses in export revenues would be expected to have a significant impact on GDP growth.

On that count, however, only Finland seems to be experiencing disappointing macroeconomic results, while Lithuania remains on a robust growth trajectory thanks to strong domestic demand (European Parliament 2015).

It is difficult to answer simple question - do the sanctions have the potential to change the future foreign policy of Russia? It is also difficult to estimate, if Russia's current behavior would get worse, without imposed sanctions. Nevertheless, any change in the sanctions regime should be well thought out. Tightening measures against Russia might nudge its economic policy. Insisting on these measures could give Russia a clear message about the development of Russian foreign policy in future which will be acceptable for its European partner.

### 3 CONCLUSION

The European Union uses sanctions to change undesirable behavior of a subject in case of endangering international peace and security and to deter others from choosing an undesirable course of action. There is not any difference in the case of sanction policy against the Russian Federation in response to the subsequent annexation of Crimea.

Sanctions approved by the European Union has contributed to poor state of Russian economy, which is suffering from the collapse of Rouble and financial crisis. Undoubtedly, the measure of sanctions imposed by European Union have helped weaken the Russian economy and to intensify the challenges that it was already facing, as it was described in previous chapter. Measure of sanction freezing access to financing have force Central Bank of Russia to stop supporting the value of the Rouble and increase interest rate. The combined effect of the sanction policy and the decline in oil and gas prices has caused downward pressure on the Rouble. Prime minister Dmitrij Medvedev has admitted the sanction have hurt the economy leading to a loss of tens of billions of USD in foreign exchange reserves. In addition, the ban on import of food has led to higher food prices and further inflation, as well as to the downward pressure of the currency.

Because of countermeasures against the European Union and because of impact of own sanction policy, almost every member state feels the decrease in export to Russia, that is affecting the economy in several ways. It is necessary to underline, that even if the targeted subject is not hit as much as was projected, the sanctions will always represent disagreement with present policy of the targeted subject. The purpose of economic sanctions is first of all to signal disapproval to certain policy, eventually to force the targeted subject to reverse its action, and the goal was in case of sanctions against Russian Federation achieved. But another question remains unanswered – how much will the European Union pay for it?

#### References

Christie, E. H. (2016). The Design and Impact of Western Economic Sanctions against Russia. *The RUSI Journal*, 161(3), 52-64. doi:10.1080/03071847.2016.1193359.

Economic impact of sanctions on the ... - European Parliament. (2015, October 31). Retrieved March 25, 2017, from [http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/569020/EPRS\\_BRI\(2015\)569020\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2015/569020/EPRS_BRI(2015)569020_EN.pdf).

Escribà-Folch, A., & Wright, J. G. (2008). *Dealing with tyranny*. Barcelona: CIDOB.

Grzywna, Z., Jałowiec, T., Kochanek, E., Książkowski, K. M., Kuck, J., Kurek, S. T., & Tomczyk, M. (2015). *Współczesna wojna handlowo-gospodarcza*. Warszawa: Difin.

Gurvich, E., & Prilepskiy, I. (2015). The impact of financial sanctions on the Russian economy. *Russian Journal of Economics*, 1(4), 359-385. doi:10.1016/j.ruje.2016.02.002.

Global Economic Prospects. (n.d.). Retrieved March 25, 2017, from <http://www.worldbank.org/en/publication/global-economic-prospects>.

Hansen, K. F., & Borchgrevink, A. (2006). Cutting Aid to Promote Peace and Democracy? Intentions and Effectiveness of Aid Sanctions. *The European Journal of Development Research*, 18(4), 622-641. doi:10.1080/09578810601070837.

Orlova, N. V. (2016). Financial Sanctions. *Problems of Economic Transition*, 58(3), 203-217. doi:10.1080/10611991.2016.1200389.

Procházka, Z. *Hospodářská válka Spojených států amerických proti Československu: [Autoreferát doktor. dis.]*. [S.l.: s.n., asi 1979]. 50 s.

Russian Federation. OECD: Better Policies for Better Lives [online]. Paris, France: Organisation for Economic Co-operation and Development, 2016 [cit. 2017-03-20]. Dostupné z: <https://data.oecd.org/russian-federation.html>.

Russia Overview. (n.d.). Retrieved March 25, 2017, from <http://www.worldbank.org/en/country/russia/overview>.

Russia – OECD. (n.d.). Retrieved March 25, 2017, from <http://www.oecd.org/russia/>.

Servettaz, E. (2014, July 1). A Sanctions Primer: What Happens to the Targeted? *World Affairs*.

Sharkov, D. (2015, June 19). Russian sanctions to 'cost Europe 100 bn euros'. *Newsweek*. Retrieved from <http://europe.newsweek.com/russian-sanctions-could-cost-europe-100-billion-328999>.

Statistics. (n.d.). Retrieved March 25, 2017, from <http://www.cbr.ru/eng/statistics/>.

Šefčík, V. *Ekonomická válka: Některé ekonomické aspekty mezinárodní bezpečnosti v období po "Studené válce"*. Vyškov: VVŠ PV, 2001. ISBN 80-7231-080-1.

Tucci, C. (2017, January 04). Topic: Russia. Retrieved March 25, 2017, from <https://www.statista.com/topics/2675/russia/>.

World Bank Group. (n.d.). Retrieved March 25, 2017, from <http://www.worldbank.org/>.

### **Contact information**

Ing. Veronika Pastorová, PhD Student

University of Defence, Faculty of Military Leadership

+420 721 262 100

[pastorova.veronika@centrum.cz](mailto:pastorova.veronika@centrum.cz)



# GREEN HUMAN RESOURCE MANAGEMENT, ENVIRONMENTAL AND FINANCIAL PERFORMANCE IN TOURISM FIRMS IN VIETNAM: CONCEPTUAL MODEL

*Pham Tan Nhat, Zuzana Tuckova*

## **Abstract**

The purpose of this study is to provide basic understandings of green human resource management, environmental performance and financial performance based on the existing literature. Additionally, it also discusses conceptual model as well as hypotheses to examine the relationships among three mentioned elements. The systemic search methodology is used to collect secondary data from books, journals, conferences and credible online sources. The findings of the reviews are to propose the conceptual model that depicts impacts of green human resource management on environment performance and financial performance, and impact of environmental performance on financial performance.

**Keywords:** *Green human resource management, environmental performance, financial performance, tourism industry, AMO theory.*

## **1 INTRODUCTION**

There are emerging environmental concerns which are shown in politics, public communication, and business activities of firms. Researchers have been interested in this aspect and that results from some countries that have offered important information to treat to climate change (Victor, 2004). Green human resource management (GHRM) is a part of Human resource management (HRM) of environmental management (EM), and GHRM has become popular within business field and its significance is increasing manifold with the passage of time and it also has had important position as a hot topic in recent studies since the awareness of EM and sustainable development have been rising day by day all around the globe remarkably (Ahmad, 2015). Currently, many organizations operating in service field have been applying EM practices driven by laws and regulations, especially in the tourism industry. In a competitive market of tourism in particular and service aspect in general, a strategy of effective HRM associated with EM is one of the critical elements of a successful company because application of GHRM in organizations can help them to reduce cost and to invest their resources for a betterment of environment (Jabbar & Abid, 2015).

In Vietnam, the tourism industry is one of the sectors which plays a key role in Vietnam's economy and the government has been offering and applying many positive policies to attract investors and travelers. According to Ministry of culture, sport and tourism of Vietnam in 2016, the number of international and domestic visitors in 12 months reached about 10,000,000 and 62,000,000 arrivals in that order. With a large number of travelers, this leads to the quick increase of human source, services, and facilities to meet tourist's demand. Hence, the environmental problems in tourism places become a big concern for the local government as well as related companies because one of priority reasons causing pollution and global warming is human activities (Martinez, 2005; Labatt & White, 2007). In fact, Vietnam government has fully recognized the importance of green growth and decided to select the green growth strategy since 2011 (Van & Tuan, 2014), and they expected that this can contribute to environmental efficiency as well as a sustainable development goal. But this strategy has been required to apply only in the exploitation of natural resource under control of local governments. Meanwhile, a few big tourism organizations perform the green strategy to attract tourists and enhance green activities for the community, many else tourism firms do not clearly identify its roles. A reason is illustrated that their priority is company's profit that they have never understood clearly about advantages of green practices or the environmental performance towards the firm's performance.

With increasing numbers of the GHRM-related studies, evaluating relationships of three elements (including GHRM, the environmental performance, and the financial performance) have done, but its results have not fully supplied research model about GHRM and/or never have examined specifically

impacts of GHRM on two else elements by quantitative methodology. Besides, some studies are insufficient availability of primary data as the small number of organizations practicing GHRM. Take the study of Jabbar & Abid (2015) is an example which he concludes that most of the firms in Pakistan are unaware of the fact that GHRM exists. Moreover, many previous studies about GHRM have performed in manufacture, exploitation and mineral firms while it has never had studies to evaluate the relationship between GHRM and the environmental and financial performance in tourism firms. As regards to GHRM in Vietnam, no prior studies were found which evaluated about green practices in HRM in any sectors in Vietnam in general and the tourism industry in particular. Therefore, this study provides basic understandings of GHRM and based on related theories and previous studies in order to propose the conceptual model.

## **2 LITERATURES REVIEW**

### **2.1 Green human resource management**

There are studies about the green practices and it is applied in many different fields, especially in the tourism industry which is related directly to the environment. According to Ahmad (2015), GHRM is viewed as an aspect and expanded from HRM. This argument is supported by Renwick et al., (2013) that GHRM is considered as HRM aspects of EM and it is relatively diverse and piecemeal. Beside, GHRM is the use of HRM policies to promote the sustainable use of resources within business organizations and enhance the cause of environmental sustainability (Mandip, 2012) and this further boosts up employee morale and satisfaction (Mampra, 2013). GHRM depends on the unique and identifiable patterns of green decisions and behavior of HR managers (Zoogah, 2011). GHRM policies and practices are used to ensure the efficient use of resources in any business through encouraging the usage the available resources such as telecommunication, less printing of papers, job sharing, video conferencing and interviews through Skype (reduce traveling expense) etc (Ashraf et al., 2015), and this is one of the main factors to enhance the firm's outcomes. In addition, GHRM is referred to all the activities involved in development, implementation and on-going maintenance of a system that aims at making employees of an organization green environment-friendly (Opatha et al., 2014; Mehta & Chugan, 2015) and encourages Corporate Social Responsibilities (CSR) (Ahmad, 2015). In conclusion, GHRM is the side of the strategy of HRM of EM that helps employees and their employers have the full awareness to protect the environment and to contribute to environmental goals, environmental sustainability in their organizations as well as firm performance.

In this paper, we use AMO theory that is the abbreviation of Ability-Motivation-Opportunity theory that is first developed by Bailey in 1993, after that some researchers such as Appelbaum, et al.,(2000) and Huselid (1995) applied this model and developed the HPWP based on AMO theory (Coz et al., 2011). The AMO theory guides choice of HRM practice in firms to be used, this means that using AMO model in HRM in general and GHRM in particular is questioned to enhance firm's performances. According to this theory, HRM policies through increasing employee's ability (they can do the job thank to owning necessary skills and knowledge), employee's motivation (they will do the job because they want to do the job and are rewarded their outcomes and behavior), and employee's opportunity (this is working environment or supports from their firm to gain their desired behavior) (Bos-Nehles et al., 2013). Based on AMO theory, application of GHRM in tourism firms can be implemented through developing three core components: developing green abilities, motivating green employee, and providing green opportunities (Opatha et al., 2015; Renwick et al., 2013; Dutta, 2012; Ahmad, 2015).

### **2.2 Financial performance**

Numerous empirical studies from 1972 to 2012 showed that financial measurement such as stock market returns, Tobin's Q (total market value of firm/Total asset value), and accounting profits ratios (ROA (return on asset), ROE (return on equity), and ROS (return on sale)) which used in the research associated with financial performance (Raze et al., 2012). In the study of Scholtens (2008) use stock returns as a financial index to evaluate the financial performance. Then, some researchers applied to profit before taxes and sales (Rajput et al., 2012) or ROE, ROA, the growth rate of main operating, expansion rate of net assets, and EPS (earning per share) to measure this concept (Pan, et al., 2014). In

this study, the accounting profits ratios (ROA, ROE, ROS, EPS) are used to examine financial performance.

### **2.3 Environmental performance**

During the year 1980's, air pollutants emitted by facilities was viewed as an indicator to measure the environmental performance (Earnhart & Lubomir, 2006), and hence many studies only focused on physical activities of manufactories to evaluate this concept. However, this approach has changed to suit management phenomenon of firms, the fact remains that environment performance definition widened to measure fully the meaning of this concept. According to Lai and Wong (2012) and Zhu et al., (2007), measures of the illustrated environmental performance is that reduction in pollution generation associated with atmospheric emissions, liquid effluents and residues; consumption of toxic, hazardous materials; water and energy use; and environmental accidents. And then, the study of AnuSingh & Shikha (2015) proposes that savings in energy and water, recycling activities, pollution prevention, the environmentally desirable impact of product or service are used to examine environmental performance. Hence, in this study, the performance of environment is measured to be more suitable with indicators associated with the saving energy and water, recycling activities, pollution prevention and frequency of environmental accidents.

## **3 METHODOLOGY**

The systemic search methodology is used to answer mentioned purposes. Collecting secondary data has been done from many different sources such as books, journals, and conferences by using the following keywords: Green practices, green human resource management, firm's performance, environmental performance, and financial performance. Additionally, statistics of the tourism industry and information of green practices of tourism firms in Vietnam are also summarized from credible online sources. The cited sources include 21 articles of the web of science or Scopus, 9 peer-reviewed articles, 3 books, 3 articles of international conferences, and website of Ministry of Culture, Sport and Tourism of Vietnam. After that, review of collected literature and results of previous studies are performed to propose the conceptual model and hypotheses to apply in Vietnam.

## **4 CONCEPTUAL MODEL AND HYPOTHESES**

### **4.1 The relationship among GHRM, financial performance, and environmental performance.**

#### *4.1.1. GHRM and environmental performance.*

According to the study of Zoogah (2011), green decisions refer to the formation of intentions and volitions of HR managers to use policies and practices to promote or prevent harm to the environment. Previous investigation results report the benefits of green practices and its impacts on the environmental performance, study of AnuSingh & Shikha (2015) clearly illustrates that if the top management has commitments to the environmental management, employees are trained about the environment, and companies implement or require green programs, three mentioned elements will have positive influences on environmental performance. Perron et al.,(2006) give results of the positive impact of green training on the environmental performance and he also mentions that green training needs to be customized to suit company's specific needs. Besides, Jabbar & Abid (2015) describes influences of green recruitment, green rewards and compensation, and environmental training on the environment performance through employee's satisfaction and their motivation in organizations. On the one hand, a survey in China of Paille et al.,(2014) evaluates impacts of the strategy of HRM on the environmental performance, its results illustrate that organizational citizenship behaviors for the environment can mediate the process through the strategy of HRM which has an impact on the environmental performance. He also shows that we should focus more on selecting, training, and reward employees for their environmental practices in the workplace in order to generate an environmental protection. In summary, GHRM can have

positive effects on the environmental performance, this means that if applying GHRM in management activities of firms, they can obtain a lot of environmental benefits for them.

Therefore the first hypothesis proposed is

H1: GHRM has a positive influence on the environmental performance.

#### *4.1.2. GHRM and financial performance.*

As regards to the relationship between GHRM and the financial performance, A firm adopts GHRM practices, this enjoys many distinguished benefits and gives a strong organization culture, build the sense of team promotion within the organization and the attractive benefit of firm is to cut cost and hence firm's performance and its productivity will increase (Ashraf et al., 2015). Besides, it has proven that there are positive relationships between the practice of corporate social responsibility and firm's financial performance (Mwangi & Jerotich, 2013; Pan et al., 2014). Wang & Sarkis (2013) find out that financial benefits associated with the environmental and social supply chain management activities; and the environmental issues interact with financial profits (Lioui & Sharma 2012). Moreover, the application of GHRM enables organizations to reduce their costs (AnuSingh & Shikha, 2015) and bring the better management of the business (Patel, 2014; Jabbar & Abid, 2015). On the whole, environment-related activities or strategy of HRM will have positive relations with finance aspects. Therefore we can conclude that when companies perform GHRM, it will bring financial benefits for them.

Therefore the second hypothesis proposed is

H2: GHRM has a positive influence on the financial performance.

#### *4.1.3. Environmental performance and financial performance*

The relationship between the environmental performance and the financial performance has not been examined clearly in tourism aspect but we cannot deny the important roles of environment protection in business results of companies. Klassen and McLaughlin (1996) collected data in manufacture firms to conclude that efficiency of EM can play positive roles in improving corporate financial performance. Similarly, evaluating the relations between the environmental performance and the financial performance with respect to the market value, Konar & Cohen (2001) shows in their study that a firm with a better environmental performance has a significant positive impact on its market value. Results from a study of Austin et al. (1999) demonstrate that the good environmental performance, as captured by low toxic emissions and hazardous waste corrective actions, and it positively affects financial rates of return. In fact, Earnhart & Lizal (2006) examine relationships of ownership, the financial performance and corporate environmental performance of companies in Czech and this study evidences that there is a positive relation between financial and environmental performance. Another current study is of Dailey (2013), the findings of a survey about consumers' behavior in the US, over two-thirds of Americans consider the environment when they offer decision to shop and the findings of this survey reinstate that good environment management practices followed by companies go a long way; it can improve sales and reduce costs. Hence if firms fully implement and have efficiency in their environmental policies, this is expected to bring a lot of financial benefits for their firms.

Therefore the third hypothesis proposed is

H3: The environmental performance has a positive influence on the financial performance.

## **4.2 Conceptual model and hypotheses**

Based on AMO theory, related studies and arguments above, we can see the role of GHRM to the environmental performance and the financial performance. Specifically, GHRM will be a factor to positively improve the efficiency of the environment as well as finance of tourism firms. In addition, there is evidence shows that performance of environment is expected to influence firm's financial benefit.

Therefore, this study suggests the conceptual model in figure 1, and after that is hypotheses summarized for depicting the relationships showed in the conceptual model.

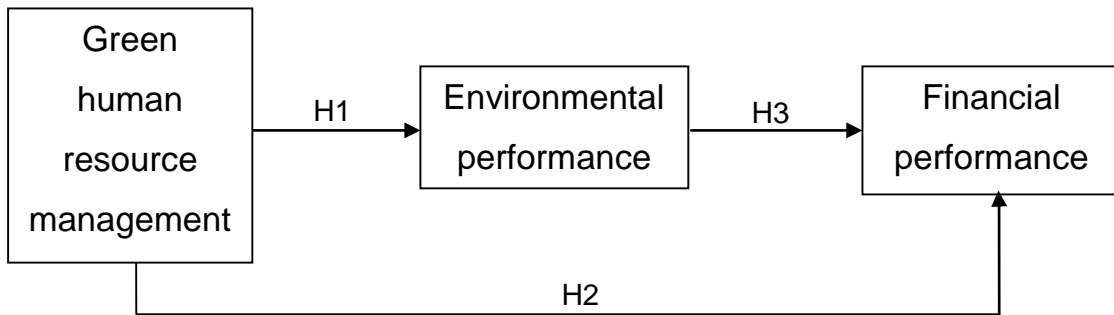


Figure 1: Conceptual model

## Hypotheses

- H1: GHRM has a positive influence on the environmental performance.
- H2: GHRM has a positive influence on the financial performance.
- H3: The environmental performance has a positive influence on the financial performance.

## 5 CONCLUSION

This study argued at the beginning of this article that green practices highly regarded by governments and organizations, and GHRM has become an interesting topic to many researchers recently. In fact, there are reported previous studies of roles and impacts of EM in companies operating in manufacture, exploitation, construction, and service field. However, almost GHRM articles usually review the related theories and the previous studies which are associated with the EM and HRM without the quantitative research about the relationship between GHRM and the environmental and financial performance in the tourism industry. In Vietnam tourism industry, although the green activities have performed in some major companies, application and understanding of green in HRM are a new topic and it is necessary for using it in their management operations. The findings that study has presented suggest that there is evidence prove influences of the strategy of HRM and green practices on environmental and financial performance, and impact of the environment performance on financial benefit. Therefore, this article proposes the conceptual model and related hypotheses.

Our research is not without its limitations which should be considered opportunities and challenges for the future investigations. First of all, the study raises important questions about how to measure GHRM, we suggest that application of AMO theory should be used in this study to evaluate the green activities in HRM and it is important to do a quantitative research in next time. Besides, the conceptual model should be widened with firm's performance which is examined through the firm's goal such as financial indexes, customer's satisfaction, employee's performance, or another factor is employee's motivation which based on the motivation theory. Finally, in Vietnam tourism industry, the EM and green activities are only applied in hotels or resorts with 4-5 star, and hence, studies about GHRM in tourism firms need to do carefully in luxury hotels or resorts.

## References

- Ahmad, S. (2015). Green human resource management: policies and practices. *Cogent Business & Management*, 2(1), 1030817.  
DOI: <http://dx.doi.org/10.1080/23311975.2015.1030817>
- AnuSingh, L., & Shikha, G. (2015). Impact of green human resource management on environmental performance in manufacturing companies: An empirical evidence. *International journal of engineering and management sciences*, 6(1), 23-30.
- Appelbaum, E. (2000). *Manufacturing advantage: Why high-performance work systems pay off*. Cornell University Press  
DOI: <http://doi.org/10.4038/sljhrm.v5i1.5624>
- Ashraf, F., Ashraf, I., & Anam, W. (2015). Green HR for Businesses. *International Journal of Academic Research in Business and Social Sciences*, 5(8), 149-156.  
DOI: 10.6007/IJARBS/v5-i8/1771
- Austin, D., Alberini, A., & Videras, J. (1999, August). Is There a Link between a Firm's Environmental and Financial Performance?. In Workshop 'Capital Markets and Environmental Performance,' Laguna Beach, CA, September.
- Bos-Nehles, A. C., Van Riemsdijk, M. J., & Kees Looise, J. (2013). Employee perceptions of line management performance: applying the AMO theory to explain the effectiveness of line managers' HRM implementation. *Human resource management*, 52(6), 861-877.
- Coz, A., Higgins, T., & Speckesser, S. (2011). *Management practices and sustainable organisational performance: An analysis of the European Company Survey 2009*. European Foundation for the Improvement of Living and Working Conditions.
- Dailey, W. (2013, April 2). Cone Communications Green Gap Trend Tracker, 2013. Retrieved from <http://www.conecomm.com/2013-green-gap-trend-tracker-1>.
- Dutta, S. (2014). Greening people: A strategic dimension. *ZENITH: International Journal of Business Economics & Management Research*, 2, 143-148.
- Huselid, M. A. (1995). The impact of human resource management practices on turnover, productivity, and corporate financial performance. *Academy of management journal*, 38(3), 635-672.
- Earnhart, D., & Lizal, L. (2006). Effects of ownership and financial performance on corporate environmental performance. *Journal of Comparative Economics*, 34(1), 111-129.  
DOI: 10.1016/j.jce.2005.11.007
- Jabbar, M. H., & Abid, M. A. (2015). Study of Green HR Practices and Its Impact on Environmental Performance: A Review. *MAGNT Research Report*, 3 (8), 142-154.  
DOI: [dx.doi.org/14.9831/1444-8939.2015/3-8/MRR.06](http://dx.doi.org/14.9831/1444-8939.2015/3-8/MRR.06)
- Klassen, R. D., & McLaughlin, C. P. (1996). The impact of environmental management on firm performance. *Management science*, 42(8), 1199-1214.
- Konar, S., & Cohen, M. A. (2001). Does the market value environmental performance?. *Review of economics and statistics*, 83(2), 281-289.  
DOI:10.1162/00346530151143815
- Labatt, S., & White, R. R. (2011). *Carbon finance: the financial implications of climate change* (Vol. 362). John Wiley & Sons.
- Lai, K. H., & Wong, C. W. (2012). Green logistics management and performance: Some empirical evidence from Chinese manufacturing exporters. *Omega*, 40(3), 267-282.  
DOI:10.1016/j.omega.2011.07.002

Lioui, A., & Sharma, Z. (2012). Environmental corporate social responsibility and financial performance: Disentangling direct and indirect effects. *Ecological Economics*, 78, 100-111.

DOI:10.1016/j.ecolecon.2012.04.004

Mampra, M. (2013). Green HRM: Does it help to build a competitive service sector? A study. In *Proceedings of tenth AIMS International Conference on Management* (pp. 1273-1281)

Mandip, G. (2012). Green HRM: People management commitment to environmental sustainability. *Research Journal of Recent Sciences*, 1(ISC-2011), 244-252.

Martinez, L. H. (2005). Post industrial revolution human activity and climate change: Why The United States must implement mandatory limits on industrial greenhouse gas emissions. *Journal of Land Use & Environmental Law*, 403-421.

Mehta, K., & Chugan, P. K. (2015). Green HRM in pursuit of environmentally sustainable business. *Universal Journal of Industrial and Business Management*, 3(3): 74-81.

DOI: 10.13189/ujibm.2015.030302

Ministry of Culture, Sport and Tourism of Vietnam, (2016, December 27). International visitors to Viet Nam in December and 12 months of 2016. Retrieved from <http://vietnamtourism.gov.vn/index.php/items/16397>.

Mwangi, C. I., & Jerotich, O. J. (2013). The relationship between corporate social responsibility practices and financial performance of firms in the manufacturing, construction and allied sector of the Nairobi Securities Exchange. *International Journal of Business, Humanities and Technology*, 3(2), 81-90.

Opatha, H. H. D. N. P., & Arulrajah, A. A. (2014). Green human resource management: simplified general reflections. *International Business Research*, 7(8), 101.

DOI:10.5539/ibr.v7n8p101

Paillé, P., Chen, Y., Boiral, O., & Jin, J. (2014). The impact of human resource management on environmental performance: An employee-level study. *Journal of Business Ethics*, 121(3), 451-466.

DOI: 10.1007/s10551-013-1732-0

Pan, X., Sha, J., Zhang, H., & Ke, W. (2014). Relationship between corporate social responsibility and financial performance in the mineral Industry: Evidence from Chinese mineral firms. *Sustainability*, 6(7), 4077-4101.

DOI:[10.3390/su6074077](https://doi.org/10.3390/su6074077)

Patel, N. P. (2014). Green HR: A Paradigm Shift In Human Resource Management Philosophy. *Journal On-line Brasileiro*, 2, 10-15.

Perron, G. M., Côté, R. P., & Duffy, J. F. (2006). Improving environmental awareness training in business. *Journal of Cleaner Production*, 14(6), 551-562.

DOI:10.1016/j.jclepro.2005.07.006

Rajput, N., Batra, G., & Pathak, R. (2012). Linking CSR and financial performance: an empirical validation. *Probl. Perspect. Manag*, 10(2), 42-49.

Raza, A., Ilyas, M. I., Rauf, R., & Qamar, R. (2012). Relationship between corporate social responsibility (CSR) and corporate financial performance (CFP): Literature review approach. *Elixir Financ. Manag*, 46, 8404-8409.

Renwick, D. W., Redman, T., & Maguire, S. (2013). Green human resource management: A review and research agenda. *International Journal of Management Reviews*, 15(1), 1-14.

DOI: 10.1111/j.1468-2370.2011.00328.x

Scholtens B, (2008). A Note on the Interaction Between Corporate Social Responsibility and Financial Performance. *Ecological Economics* 68, 46-55.

DOI:10.1016/j.ecolecon.2008.01.024

Van & Tuan, (2014). Viet Nam implements green growth: an appropriate approach in international integration. *Communist Review*, 862.

Victor, D. G. (2004). *The collapse of the Kyoto Protocol and the struggle to slow global warming*. Princeton University Press.

Wang, Z., & Sarkis, J. (2013). Investigating the relationship of sustainable supply chain management with corporate financial performance. *International Journal of Productivity and Performance Management*, 62(8), 871-888.

DOI: <http://dx.doi.org/10.1108/IJPPM-03-2013-0033>

Zhu, Q., Sarkis, J., & Lai, K. H. (2007). Green supply chain management: pressures, practices and performance within the Chinese automobile industry. *Journal of cleaner production*, 15(11), 1041-1052.

DOI:10.1016/j.jclepro.2006.05.021

Zoogah, D. B. (2011). The dynamics of Green HRM behaviors: A cognitive social information processing approach. *German Journal of Human Resource Management*, 25(2), 117-139.

DOI 10.1688/1862-0000\_ZfP\_2011\_02\_Zoogah.

#### **Contact information**

Pham Tan Nhat

Tomas Bata University in Zlín, Faculty of Management and Economics

Email: [nhatpham1729@gmail.com](mailto:nhatpham1729@gmail.com)



# EFFECT OF WEBSITE DESIGN ON POSITIVE ELECTRONIC WORD OF MOUTH INTENTION. THE ROLE MODERATOR OF GENDER

*Phan Thi Phu Quyen, Michal Pilik*

## **Abstract**

Electronic word of mouth (eWOM) communication has received considerable attention in marketing strategy because of its significant impact on behavioral consequences. In service marketing, numerous scholars and practitioners describe WOM as “a dominant force in the marketplace. Nevertheless, little effort has been given to integrate the effect of website design on eWOM intention. The objectives of this paper is to propose a framework to explain the influence of website design (aesthetics and usability) on eWOM intention via the applicability of the stimulus- organism- response model. Based on literature review and the framework used, an online questionnaire is developed and sent to more than 350 respondents in Taiwan. Then, SPSS and partial least square (PLS) will be use to analyze the collected data in further research. Lastly, the study concludes with a discussion of the expected findings and implications for both marketing theory and practice when using the proposed framework in this topic.

**Keywords:** *eWOM intention, website design, aesthetic, usability, attitude toward website, gender*

## **1 INTRODUCTION**

Electronic word of mouth refers to “consumers’ experiences and views conveyed through written words based on internet technologies” (Kim & Park 2013), or consumer exchange positive as well as negative evaluation based on direct and experiences with the other buyers (Hong & Yang, 2009). Consumers can post their opinion, comments, or reviews of product on weblogs, discussion forums, review websites, retail website (e.g. Amazon.com), newsgroup, and social networking sited (e.g. Facebook.com) (Cheung & Lee, 2012). Positive eWOM has received numerous attentions in business disciplines such as marketing, consumer behavior, economics, and information systems because of its important influence on consumer’s purchase decisions. Kim and Kim (2010) claimed that customers depend on others’ opinions and experience through WOM intentions when intending to purchase brands from website. Nevertheless, research on why consumers engage in positive eWOM providing their opinions on internet remains relatively unaddressed.

In addition, website design is one of the most essential factors in quality of website (Oneupweb, 2010). Previous literature confirmed that website design will affect customer’s perceptions and behavior, such as loyalty, satisfaction (Casaló, 2008), attitude and purchase intention (Wu et al., 2013). Whereas there has been broadly research on the effect of website on the effect of website design on consumer response behaviors, little attention has tested how website design affect online consumers’ eWOM activity on the social network site. As a result, it is timely to investigate how website design influences eWOM communication in an online shopping context.

Lastly, gender moderates many predicted effects in the preceding sections as men and women respond differently to stimuli in marketing communications (Cyr & Bonnani, 2005; Chiu et al., 2005). Previous research examined that there are differences in perception of both male and female online shopping experience (Garbarino & Strahilevitz, 2004). Furthermore, although the Internet shopping has been proposed that some demographic elements (gender, age, social class,..) affect the valence of various atmosphere cues (William & Dargel, 2004), men and women may have different attitude in the same online environment (Nadeem et al., 2015). Thus, this study contributes to the literature analyzing whether gender moderates the influence of website design on attitude toward website and eWOM intention to use a website. As a result, this study presents three main contributions:

Usability is looked at as a determinant factor of website attitude and positive eWOM

The moderating effect of gender in the relationship between website usability and website attitude.

## 2 LITERATURE REVIEW

### 2.1 Theoretical background

The impact of atmospherics on the nature and outcomes of shopping behavior has its roots in psychology. Theoretical basis of the current study is environmental psychology (Mehrabian & Russel, 1974). This model is operationalized based on a stimulus–organism–response (S–O–R) framework. Donovan and Rossiter (1994) was the first person to apply the S–O–R framework into a retail environment. According to Yoon (2012), the atmospheric cues were operationalized as the “stimuli”, shoppers’ emotional reactions as the “organism” and avoidance behaviors as the “response”.

Following the footsteps of this general study, empirical works in this area began to focus in the impact of specific atmospheric cues (stimulus), which is conceptualized by a set of attributes that affect consumer’s perceptions. The stimulus is the first step on consumer behavioral process and impact on consumers’ cognition and lead to action. Researchers have pointed out that online store atmosphere include all the elements used to design website and its layout (Chang & Chen, 2008). The organism, which served as emotional reaction in internal process, transfers between the stimuli and reaction of consumer. Essentially, the organism consists of the perceptual, physiological, feeling and activities, which lead to adjust the emotional state of the consumer. Within the S-O-R model, approach or avoidance consist of response behavior or behavioral intention, which are measured with behavioral variables like revisit the store or perform purchase behavior (Ha & Lennon, 2010). Recent studies have extended the S-O-R paradigm by exploring new variables in the response. For instance, Ladhari (2007) examined word-of-mouth intention as a response behavior plays a critical important in positive response behavior.

In the current study, the stimulus is operationalized as website design dimensions (aesthetic appeal and usability). The organism is internal response, reflected through attitude toward website during the site visit. In the last response stage, e-WOM intention will be assessed at this stage as a new variable in the S-O-R model.

### 2.2 Definitions of construct

eWOM. With the advent of the Internet, eWOM was evolved as an extended form of traditional WOM for Internet environment (Lee et al., 2012). eWOM refers to “consumers’ experiences and views conveyed through written words based on internet technologies” (Kim & Park, 2013), or consumer exchange positive as well as negative evaluation based on direct and indirect experiences with the other buyers (Hong & Yang, 2009). Consumers can post their opinion, comments, or reviews of product on weblogs, discussion forums, review websites, retail website (e.g. Amazon.com), newsgroup, and social networking sited (e.g. Facebook.com) (Cheung & Lee, 2012). In the study, e-WOM intention is defined as the consumer’s positive opinions about website or brand displayed in the website. Customers’ opinion, comments, or reviews can spread directly to receivers or indirectly through social networking.

Website design: Previous research underlined the effectiveness of web site design which is obviously important in the online store environment (Ha & Lennon, 2010). A website that provides adequate information plays a significant role in the decision-making process for consumers (Chen, Hsu & Lin, 2010). In this study, website design concentrates on two dimensions: usability and the aesthetics, which are like to be two of the most silent attributes to the users in viral environment (Kim et al. 2002). Aesthetics appeal is one of the critical dimensions in website appeal and design (Harris & Goode, 2010). Aesthetics is “a conception of what is artistically valid or beautiful” in the American Heritage Dictionary of English Language. Website aesthetics show the different aspects and attributes through combination of impressed beauty. Wang et al. (2011) stated that “an artistically beautiful website that pleases eyes may be considered superior to other less-appealing sites”. In addition, usability relates to several aspects such as users can easily manage generally system or memorize the basic function (Nielsen, 1993). In this study, aesthetic appeal is overall impressiveness and attraction of a website. Moreover, usability reflects the ease of navigating the site or making purchases through the internet.

Website attitude: A literally hundreds of definitions was for the term “attitude” (Gaeth, 1994). According to the Theory of Planned Behavior (TPB), the term attitude was defined as “a reviewer’s overall

evaluation of persons, objects, and issues” (Ajzen & Fishbein, 1980). This commonly suggested conception states that attitude is not over behavior but a disposition, which influences behavior. Attitude has a significant impact on behavior intentions, consumer choice, and consumption satisfaction (Pelayo et al., 2011). Goldsmith and Lafferty (2002) defined “attitude toward the website as a predisposition to respond in a consistently favorable or unfavorable manner to the internet”. Based on the above explanations, attitude toward website is defined as “an overall evaluation of a shopping experience at a website”.

### 2.3 Hypothesis development

According to the extended S-O-R paradigm of Eroglu (2003), website design affects cognitive responses (e.g. attitude, perception). In the same line, studies also investigated that website design cues have emerged as a strong predictor of attitude toward online store (Eroglu et al., 2003; Park et al., 2008). More specifically, Belanche et al. (2011) concluded that usability is of critical importance in helping overcome user’s fears and form a more favorable opinion of using a website. Becker and Mottay (2001) also argued that less usable websites can create more negative attitudes toward online stores. In contrast, more usable websites tend to make the opposites effect. Lee and Kozar (2011) has explored the diverse outcome of website usability in increasing consumer retention, loyalty, and positive attitude. Bearing these considerations in mind, the study proposes the first hypothesis:

Hypothesis 1: Website usability has a direct and positive influence on website attitude

In addition, aesthetics appeal can be predicted to influence customer reactions because customers are more satisfied by a virtual interaction that meets their expectation (Vilnai-Yavetz & Rafaeli, 2006). According to the S-O-R model, there is a strong relationship between the information presented on the website and the emotional states felt by consumer in that environment. Consumers' perceptions of the web store's aesthetics induce emotions, which, in turn, affect the consumers' attitudes towards the store and their purchase decisions ([Tractinsky & Lowengart, 2007](#)). Notably, Hopkins et al. (2009) demonstrated that all e-servicescape dimensions influenced customers’ attitude toward the website, yet aesthetic had the greatest impact. Based on the above explanations, it is hypothesized that:

Hypothesis 2: Website aesthetics has a direct and positive influence on website attitude

Sharing of information is a crucial aspect of the online experience (Sandes & Urdan, 2013). Moreover, recommendation is affected by customers’ informal opinion about products and brands derived from consumption experiences (Mikalef et al., 2013). This is based on the rationale that positive attitudes toward website influence current and subsequent purchase activities, leading to the spread of positive e-WOM (Tabbane & Hamouda, 2013). Furthermore, Jung and Kim (2012), in a meta-analysis to aggregate previous research finding related to eWOM stated that “71% of the articles were found to support the relationship among purchase intention, eWOM intentions, and attitude towards products and brands as dependent variables”. In addition to this, in the framework for understanding environment, which was adapted from Bitner (1992), attitude toward website is demonstrated as a component of emotional. Therefore, attitude toward website is expected to have an important impact on positive eWOM intention in the study. Based on the above explanations, it is hypothesized that:

Hypothesis 3: Greater website attitude is directly and positively related to greater level of positive eWOM with respect of a website.

Men and women think in different ways in the process of forming an attitude toward website (Sun et al., 2010). Male consumers will response immediately and with more positive attitudes and higher purchase intentions through Internet than female. The sensitive attitude toward the physical environment to female perception is higher as compared to male’s one (Chiu et al., 2005). In addition to this, the online environment has an impact on buying attitudes, but more strongly for women than for men (Dittmar et al., 2004). Women tend to enjoy shopping more than men; therefore, women likely to shop for aesthetics website. It is also supported that women hold more a positive attitudes toward shopping and a positive images of store shopping than do men (Alreck & Settle, 2002). Another point argued that women enjoy the shopping process more and spend more time shopping and searching for information, they more likely appreciate the website entertainment value and engage in more exploratory behavior on such

website. Obviously, women were more likely to use website for enjoyment and information gathering, a website with the high degree of entertainment and aesthetic appeal will increase a positive attitude toward website (Sun et al., 2010). Therefore, the following hypothesis is developed:

Hypothesis 4: Women consumers will strengthen the positive effect of aesthetic appeal on web site attitude.

According to Sanchez-Franco (2006), men and women differ in their “web acceptance and usage processes”- with men’s perception toward usefulness of the Web is stronger than women’s one. Furthermore, Sun et al. (2010) concluded that the informativeness can help form a more positive attitude for males than for females. Another research in which information design, navigation design, there are a significant difference between men and women regarding website satisfaction, lead to attitude toward website (Cyr & Bonanni, 2005). In particular, the male tendency to focus on piecemeal information suggests that the website structure would have a stronger influence on male attitudes compared to their female counterpart. Therefore, the hypothesis is tested that:

Hypothesis 5: Men consumers will strengthen the positive effect of usability on web site attitude.

### 3 PROPOSAL FRAMEWORK

The objective of this study is to integrate relevant literature and develop a research model which will identify the interrelationship among relevant constructs including website design dimensions (aesthetic appeal and usability), attitude toward website, and e-WOM intention. Based on the literature review, this study develops a research model as shown in Figure 1. It suggested that the influence of website design dimensions on attitude toward website, and the interaction effect of between attitudes toward website on e-WOM intention. In addition, gender is considered as a moderator that influence on the relationship between website design and attitude toward website.

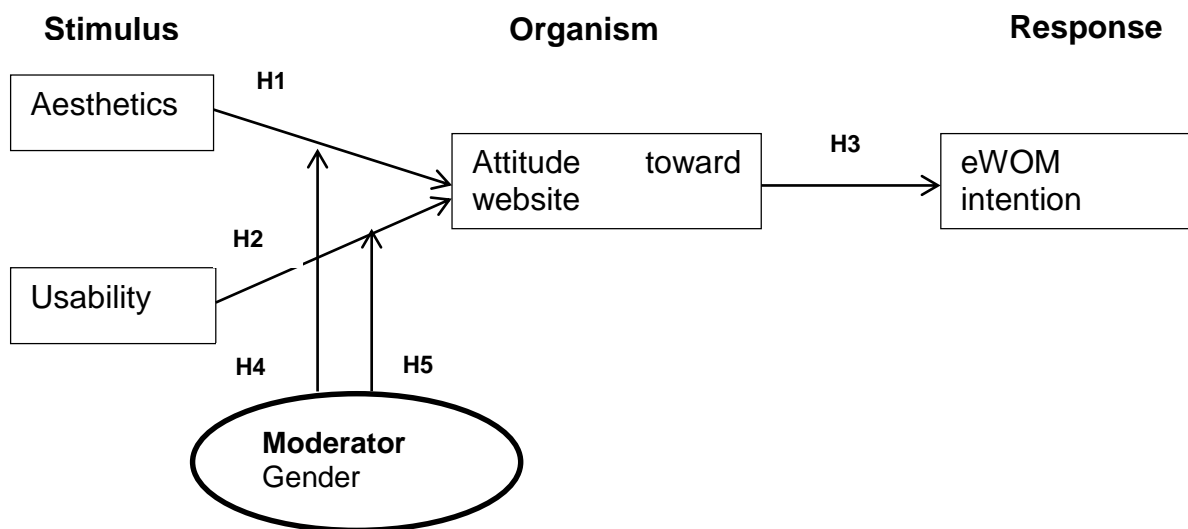


Figure 1. The proposed framework

### 4 METHODOLOGY

#### 4.1 Data

Data were collected by conducting a web survey of the Taiwan website. A specific website selling apparel products will be selected because they are the most popular merchandise categories purchased online (Seock & Bailey, 2008). Thirty expected respondents are survey in order to seeking the most popular website in Taiwan. The target respondent of this study is young consumers because they are the key drives of online purchasing, as well as become a significant part of spreading word of mouth in

social platform (Seock & Bailey, 2008). Respondents will respond to the online questionnaire by linking the survey URL. After linking to the selected website for a while, respondents completed the survey. The items in the questionnaire will be in English and be translated to Chinese and back translated to English by a Chinese doctoral student. A pilot test involving 100 respondents which will tests indicates acceptable reliability and validity of the measurements may be administered. Then, the main survey will be expected with 350 respondents. In this study, all the participants will voluntarily participate without any incentives being offered.

## **4.2 Measures**

Based on the literature review, website design will be assessed using seven-point Likert scales developed and validated by Harris and Goode (2011). Aesthetic appeal will be measured by perceived visual appeal (five items), and website usability was measured by 6 items. Secondly, attitude toward website is defined as “overall evaluations of a shopping experience at a website”. This factor will be measured with 8 items modified from Chen et al. (2002) and Kraft et al. (2005). Lastly, eWOM intention is defined that share consumer’s positive opinions about website or brand presented the website. To measure e-WOM intention, five items will be adapted from two different sources (Okazaki, 2009; Verhoef et al., 2002).

## **4.3 Statistical Method**

The model on this study will maybe be composed by a small sample and some assumptions in this study will be less restrictive, PLS can address a wider range of problems than CB-SEM. PLS uses components-based algorithms, and can estimate formative constructs. To measure the reliability and validity of the measurement model through several criteria, such as R2 value, average variance extracted (AVE), composite reliability (CR), and Cronbach’s alpha. The R2 value of the dependent constructs measures the amount of explained variance of each endogenous latent variable. In the second stage, the study will evaluate the structural model to test hypothesizes. Lastly, this study will use K-means method to cluster the respondents into 4 groups for each relational moderator in order to evaluate the moderating effects of gender moderators.

## **5 CONCLUSION**

Prior studies focus on understanding deeply of electronic word of mouth and how spread of eWOM influence on purchase decisions. However, limited attention has been investigated of how and why consumers are willing to engage in sharing positive eWOM with others in the online settings. Therefore, this study proposed a framework in order to investigate the antecedents of eWOM intentions. The study gains the application of the S-O-R model on the online shopping environment in investigating the relationship between website design and eWOM intention. From the theoretical perspectives, this study is expected to making some contributions toward understanding the formulation of eWOM intention in the line of website design. First of all, the study will explore the key role of website design features in eWOM sharing. This provides directions for website managers enhancing their understanding of improving users’ attitude toward website by improving dimensions of website design. In particular, the study will focus on two dimensions of aesthetic appeal and usability, which could be a good starting point for website designers when improving users’ attitude. The different dimensions of website design can be strategically managed, turning into a better online purchase frequency in order to building positive attitude toward website.

Secondly, the research predicts the highlights of website attitude toward spreading positive eWOM in social network site. Website design can make a positive attitude toward website, which in turn lead to superior eWOM intention. This can help demonstrate how website design impact on eWOM intention. Therefore, managers can notice on enhancing successful aesthetic appeal and usability of website, but also understanding insight on monitoring the process from website design -> attitude toward website -> e WOM intention for marketing strategy.

Lastly, the study also attempts to examine the moderating role of gender in the relationship between website design and attitude toward website. The moderating effect of gender provides new explanation to the inconsistent results on previous studies. The finding will reinforce the important role of gender in

designing website. The study will indicate whether male and female different on the influence of website design on attitude toward website or not. If a difference happens between male and female in formatting attitude, this will contribute for previous studies, which have a limited attention across the gender (Shaouf et al., 2016).

## References

- Ajzen, I., & Fishbein, M. (1980). *Understanding attitudes and predicting social behavior*, Englewood Cliffs, NJ: Prentice-Hall
- Alreck, P., & Settle, R. B. (2002). Gender effects on Internet, catalogue and store shopping. *Journal of Database Marketing & Customer Strategy Management*, 9(2), 150-162.
- Becker, S. A., & Mottay, F. E. (2001). A global perspective on web site usability. *IEEE software*, 18(1), 54-61.
- Belanche, D., Casaló, L. V., & Guinalíu, M. (2012). Website usability, consumer satisfaction and the intention to use a website: the moderating effect of perceived risk. *Journal of retailing and consumer services*, 19(1), 124-132.
- Bitner, M.J. (1992), "Servicescapes: the impact of physical surroundings on customers and employees", *Journal of Marketing*, Vol. 56 No. 2, pp. 57-71.
- Casaló, L. V., Flavián, C., & Guinalíu, M. (2008). The role of satisfaction and website usability in developing customer loyalty and positive word-of-mouth in the e-banking services. *International Journal of Bank Marketing*, 26(6), 399-417.
- Chang, H. H., & Chen, S. W. (2008). The impact of online store environment cues on purchase intention: trust and perceived risk as a mediator. *Online Information Review*, 32(6), 818-841
- Chen, Q., Clifford, S. J., & Wells, W. D. (2002). Attitude toward the site II: new information. *Journal of Advertising Research*, 42(2), 33-46
- Chen, Y. H., Hsu, I. C., & Lin, C. C. (2010). Website attributes that increase consumer purchase intention: A conjoint analysis. *Journal of business research*, 63(9), 1007-1014.
- Cheung, C. M., & Lee, M. K. (2012). What drives consumers to spread electronic word of mouth in online consumer-opinion platforms. *Decision Support Systems*, 53(1), 218-225.
- Cheung, C. M., & Lee, M. K. (2012). What drives consumers to spread electronic word of mouth in online consumer-opinion platforms. *Decision Support Systems*, 53(1), 218-225.
- Chiu, Y. B., Lin, C. P., & Tang, L. L. (2005). Gender differs: assessing a model of online purchase intentions in e-tail service. *International Journal of Service Industry Management*, 16(5), 416-435.
- Chiu, Y. B., Lin, C. P., & Tang, L. L. (2005). Gender differs: assessing a model of online purchase intentions in e-tail service. *International Journal of Service Industry Management*, 16(5), 416-435.
- Cyr, D., & Bonanni, C. (2005). Gender and website design in e-business. *International Journal of Electronic Business*, 3(6), 565-582.
- Cyr, D., & Bonanni, C. (2005). Gender and website design in e-business. *International Journal of Electronic Business*, 3(6), 565-582.
- Dittmar, H., Long, K., & Meek, R. (2004). Buying on the Internet: Gender differences in on-line and conventional buying motivations. *Sex roles*, 50(5-6), 423-444.
- Donovan, R. J., Rossiter, J. R., Marcoolyn, G., & Nesdale, A. (1994). Store atmosphere and purchasing behavior. *Journal of retailing*, 70(3), 283-294
- Eroglu, S.A., Machleit, K.A. and Davis, L.M. (2003), "Empirical testing of a model of online store atmospherics and shopper responses", *Psychology & Marketing*, Vol. 20 No. 2, pp. 139-50.
- Gaeth, G. J. (1994). Theory and method in the study of ad and brand attitudes: Toward a systemic model. *Attention, attitude, and affect in response to advertising*, 125.

- Garbarino, E., & Strahilevitz, M. (2004). Gender differences in the perceived risk of buying online and the effects of receiving a site recommendation. *Journal of Business Research*, 57(7), 768-775.
- Goldsmith, R. E., & Lafferty, B. A. (2002). Consumer response to Web sites and their influence on advertising effectiveness. *Internet Research*, 12(4), 318-328.
- Ha, Y., & Lennon, S. J. (2010). Online visual merchandising (VMD) cues and consumer pleasure and arousal: purchasing versus browsing situation. *Psychology & Marketing*, 27(2), 141-165.
- Harris, L. C., & Goode, M. M. (2010). Online servicescapes, trust, and purchase intentions. *Journal of Services Marketing*, 24(3), 230-243.
- Hong, S. Y., & Yang, S. U. (2009). Effects of reputation, relational satisfaction, and customer–company identification on positive word-of-mouth intentions. *Journal of Public Relations Research*, 21(4), 381-403.
- Hong, S. Y., & Yang, S. U. (2009). Effects of reputation, relational satisfaction, and customer–company identification on positive word-of-mouth intentions. *Journal of Public Relations Research*, 21(4), 381-403.
- Hopkins, C. D., Grove, S. J., Raymond, M. A., & LaForge, M. C. (2009). Designing the e-servicescape: Implications for online retailers. *Journal of Internet Commerce*, 8(1-2), 23-43.
- Jung & Kim (2012), Determinants of Electronic Word-of-mouth: Meta-analysis of quantitative research, proceeding of the Atlantic marketing association
- Kim, S., & Park, H. (2013). Effects of various characteristics of social commerce (s-commerce) on consumers' trust and trust performance. *International Journal of Information Management*, 33(2), 318-332.
- Kim, S., & Park, H. (2013). Effects of various characteristics of social commerce (s-commerce) on consumers' trust and trust performance. *International Journal of Information Management*, 33(2), 318-332.
- Kim, Y. J., & Kim, H. Y. (2010). The effect of justice and trust on eWOM in social media marketing: focused on power blog and meta blog. *The Journal of Internet Electronic Commerce Research*, 10(3), 131–155.
- Kraft, P., Rise, J., Sutton, S., & Røysamb, E. (2005). Perceived difficulty in the theory of planned behaviour: Perceived behavioural control or affective attitude?. *British Journal of Social Psychology*, 44(3), 479-496
- Ladhari, R. (2007). The effect of consumption emotions on satisfaction and word-of-mouth communications. *Psychology & Marketing*, 24(12), 1085-1108.
- Lee, D., Kim, H. S., & Kim, J. K. (2012). The role of self-construal in consumers' electronic word of mouth (eWOM) in social networking sites: A social cognitive approach. *Computers in human behavior*, 28(3), 1054-1062
- Lee, Y., & Kozar, K. A. (2012). Understanding of website usability: Specifying and measuring constructs and their relationships. *Decision Support Systems*, 52(2), 450-463.
- Mehrabian, A. & Russel, J. A. 1974. *An Approach to Environmental Psychology*. MIT Press, Cambridge, MA
- Mikalef, P., Giannakos, M., & Pateli, A. (2013). Shopping and Word-of-mouth intentions on social media. *Journal of theoretical and applied electronic commerce research*, 8(1), 17-34.
- Nadeem, W., Andreini, D., Salo, J., & Laukkanen, T. (2015). Engaging consumers online through websites and social media: A gender study of Italian Generation Y clothing consumers. *International Journal of Information Management*, 35(4), 432-442.
- Nielsen, J. (1994). *Usability engineering*. Elsevier.

- Okazaki, S. (2009). Social influence model and electronic word of mouth: PC versus mobile internet. *International Journal of Advertising*, 28(3), 439-472.
- Park, J., Stoel, L., & Lennon, S. J. (2008). Cognitive, affective and conative responses to visual simulation: The effects of rotation in online product presentation. *Journal of Consumer Behaviour*, 7(1), 72-87.
- Pelayo, M., Cebrián, D., Areosa, A., Agra, Y., Izquierdo, J. V., & Buendía, F. (2011). Effects of online palliative care training on knowledge, attitude and satisfaction of primary care physicians. *BMC family practice*, 12(1), 37.
- Sanchez-Franco, M. J. (2006). Exploring the influence of gender on the web usage via partial least squares. *Behaviour & Information Technology*, 25(1), 19-36.
- Sandes, F. S., & Urda, A. T. (2013). Electronic word-of-mouth impacts on consumer behavior: Exploratory and experimental studies. *Journal of International Consumer Marketing*, 25(3), 181-197.
- Seock, Y. K., & Bailey, L. R. (2008). The influence of college students' shopping orientations and gender differences on online information searches and purchase behaviours. *International Journal of Consumer Studies*, 32(2), 113-121.
- Shaouf, A., Lü, K., & Li, X. (2016). The effect of web advertising visual design on online purchase intention: An examination across gender. *Computers in Human Behavior*, 60, 622-634.
- Sun, Y., Lim, K. H., Jiang, C., Peng, J. Z., & Chen, X. (2010). Do males and females think in the same way? An empirical investigation on the gender differences in Web advertising evaluation. *Computers in Human Behavior*, 26(6), 1614-1624.
- Tabbane, R. S., & Hamouda, M. (2013). Impact of eWom on the Tunisian consumer's attitude towards the product. In *Advances in Business-Related Scientific Research Conference 2013*, Venice Italy.
- Tractinsky, N., & Lowengart, O. (2007). Web-store aesthetics in e-retailing: A conceptual framework and some theoretical implications. *Academy of Marketing Science Review*, 11(1), 1-18.
- Verhoef, P. C., Franses, P. H., & Donkers, B. (2002). Changing perceptions and changing behavior in customer relationships. *Marketing Letters*, 13(2), 121-134.
- Vilnai-Yavetz, I., & Rafaeli, A. (2006). Aesthetics and professionalism of virtual servicescapes. *Journal of Service Research*, 8(3), 245-259.
- Wang, Y. J., Minor, M. S., & Wei, J. (2011). Aesthetics and the online shopping environment: Understanding consumer responses. *Journal of Retailing*, 87(1), 46-58.
- Williams, R., & Dargel, M. (2004). From servicescape to "cyberscape". *Marketing Intelligence & Planning*, 22(3), 310-320.
- Wu, W. Y., Lee, C. L., Fu, C. S., & Wang, H. C. (2013). How can online store layout design and atmosphere influence consumer shopping intention on a website?. *International Journal of Retail & Distribution Management*, 42(1), 4-24.
- Yoon, E. (2012). Effects of Website Environmental Cues on Consumers' Response and Outcome Behaviors.



**Contact information**

Phan Thi Phu Quyen

Ph.D. Student

Tomas Bata University in Zlín, Faculty of Management and Economics

T.G Masaryka 5555, 760 01, Zlin - Czech Republic

Corresponding author

[phuquyen.due@gmail.com](mailto:phuquyen.due@gmail.com)

doc. Ing. Michal Pilík, Ph.D

Tomas Bata University in Zlín, Faculty of Management and Economics

T.G Masaryka 5555, 760 01, Zlin - Czech Republic

[pilik@fame.utb.cz](mailto:pilik@fame.utb.cz)

# MARKETING COMMUNICATIONS ON B2B MARKETS

*Lucie Povolná*

## **Abstract**

Business to business (B2B) communications have long been based on personal contact. With the development of internet technologies, however, part of B2B communications has moved online, and this trend will continue to increase. This article investigates how the marketing communications on modern B2B markets have been changing and provides information to European industrial companies on how to modernize their current communication techniques. In order to report on the current state of B2B communications, a literature review has been conducted. A qualitative study among representatives of the European machine tools market followed, so as to determine the state of communications in a specific part of the market. It was discovered that the European B2B marketers in the field of machine tools have an overview of the new marketing communication techniques, but the use is narrow. This shows the large reserves in marketing techniques and the opportunities to make the communications strategies of these companies more efficient. Future research should validate these findings by means of quantitative methods to propose actions for restructuring their communications strategies and techniques, as in the following decades the millennial generation will take over management positions and will call for modern forms of communication.

**Keywords:** *B2B, communications, content, customer, online marketing.*

## **1 INTRODUCTION**

### **1.1 Communications on B2B markets**

Current corporate communications have shifted to the concept of integrated marketing communications. The basics of marketing communications are still relevant, but it is necessary (Batra and Keller 2016) to apply them in new ways. Marketing communications optimization leads to increased communication efficiency, which brings benefits (Luxton, Reid and Mavondo 2015) in the form of increased brand values and financial returns. In other words, integrated marketing communications has become a competitive advantage (Ellis 2011) and maximizes the impact of communications.

Lindsay (2016) points out that any communication stimulus represents the brand. This means to communicate relevant content instantly through all communication channels at once and to be able to pass information on and offline. Information itself has become the dominant component of marketing (Rowley 2008), and it has become much more personal.

Setting the optimal marketing communication programme requires the knowledge of the market environment and the current trends. Marketing communications is a crucial component of modern marketing, which has become more complicated (Batra and Keller 2016) with the recent advent of the Internet and other digital tools. The Internet facilitates interactivity, and allows global coverage and accessibility 24/7. The internet combines (Evans, King 1999) the benefits of all media, since it works with text, audio and visual means. This makes the Internet efficient in comparison with other forms of marketing communications.

A B2B advertising message must be more than mere information; “it needs to be liked” (Baack et al. 2016). Creative advertisements encourage a stronger relationship than non-creative advertisements, moreover, they catch managers’ attention and are more interesting, which has an impact on shaping the relationship to the advertisement. A popular advertisement (Baack et al. 2016) leads to a better brand awareness, a better relationship with the brand, and to stronger business intentions. A customer devotes his time (Barta and Keller 2016) only to certain brands in a certain time. It is inevitable to make differences among various customers and carefully select a way to communicate with them.

Industrial market companies use several communication channels at the same time. Nanji (2014a) contends that the most effective channels for the acquisition of leads and potential customers are trade fairs, internet searches and emails. As the purchase goes through various stages, the channels through

which buyers are gaining information are changing. While searching for the first information (Nanji 2016), the B2B buyers use social media, and as they proceed to the purchase, they use internal information.

## **1.2 Modern Customer**

Modern B2B buyers require the personal approach. Account-Based Marketing, or Key Account Marketing has been developing recently. In order to identify the customer properly Vajre (2015) stresses the need for interaction with the team of sellers, the attendance of trade fairs and contacting the former (and potential) customers.

In general, existing customers possess much larger value than customers which are new to the company and the extension of cooperation with them is essential for maximizing the value of the company. An existing customer care allows understanding the customer better, finding a valuable insight (Johnson 2016) and discussing with him objectives and vision, so that both sides can understand each other and so the customer may accept (Saldi 2015) the sellers ideas and solutions.

Current customer obtains information before he ever comes into contact with the seller. Davies (2015) states that obtaining information used to make approximately 10% of the purchase process earlier, now it is 50-70%. In the future, this number will continue to grow. The internet provides a huge amount of information in the forums, user groups, social networks, or in queries in Google to the potential clients. The personal contact comes in the later stages of the shopping process, which also saves costs to the seller.

The reason why the company loses its clients, or why leads do not turn into customers is the bad customer understanding of the value offered. It is caused (Batra and Keller 2016, Finn 2016) by poorly performed positioning. For a proper understanding the customer it is important that marketing and sales (business) departments cooperate. There is a need (Finn 2016) to periodically transmit information and better understand what the customer's expected value is. The competitive intelligence is of great importance, however, tends to be underestimated. It provides the overview of the industry, but also (Cupman, 2015) helps one's own differentiation. Furthermore, it is highly beneficial to learn from mistakes and ask those customers who ended up with no purchase, what did make them to do such decision.

## **2 LITERATURE RESEARCH**

On basis of the studied materials the most important trend in B2B marketing communications were summarized in the following points: events, content, webs, social media and mobiles. The most important issues for the marketers' success are: the key advantage of the product, what influences the customers' decision and why the businesses are losing their clients.

The author assumes mostly literature from the U.S. The most successful companies of the world have their origins there and their business technique is highly developed. Another reason is that the most number of information on B2B issues was offered by U.S. resources. At the time of research there was not much academic literature available, which is a subject of academic work of Lilien (2016) who pinpoints that there is a notable disbalance between resources on B2C and B2B literature.

### **2.1 Selected Trends in B2B Communications**

#### **Events**

The most part of B2B marketers participate on the events, especially conferences, trade fairs, exhibitions, webinars etc. (Vohra, Seethapathy 2014). Participation in trade fairs is essential for the company's communications. At trade fairs it is very advisable (STI 016) to have agreed the meetings in advance, as all the businessmen are very busy and they have almost no time left. The sellers must therefore be able to impress very quickly. It is also important to participate at professional forums (national and local), where buyers are present. It is a great challenge to become speaker at such events.

The most popular in the United States are conferences (Vohra, Seethapathy 2014) and a lot of marketers participate or organize them. Similarly do the fairs, exhibitions, but also the webinars. These events aim mainly to find people interested in the product, build brand and engage the customer.

## Content

B2B buyers are focused on gathering information to reduce risks (Swani 2016) through the comments and opinions of others – they seek the relevant information. The use of right information (Handley 2015), and the popularity of the content (Rapp 2013), has become a competitive advantage for the firm in the market. Therefore, the marketers are trying to implement strategies (Swani 2016) that will encourage customer's interaction in order to affect sales, generate leads, build relationships, increase brand awareness, and loyalty, or speed up the buying decision. In the context of social networks, the popularity of the content (Rapp 2013, Swani 2016) affects sales, brand, brand performance, loyalty and social media ROI. Handley (2015) points out that three-quarters of the companies have a strategy for content creation, but only a third of all create content based on any documentation.

A survey of Seismic (2016) refers that the content is based on intuition rather than on the basis of the survey, and the reasons given for the lack of content targeting are the absence of technology, resources and data. Study of the State of Digital Marketing Report (2016) denotes that U.S. B2B marketers agree that white papers, webinars and case studies are the most effective of the content tools. According to the study of CMO Council (2015) the most important obstacles to bring content to potential customers are poorly targeted content, budget constraints or the content is not important for the target group, etc.

## Websites

Corporate websites provide a lot of information. According to Nanji (2014b) the corporate customers lack most on sites the complete contact information, a list of clients and research reports. The customers (2015 B2B Web Usability Report 2015) also miss details on products and technical support, price lists and product evaluation. Buyers most often leave the web sites because of the missing message, no contact information and animated advertisements.

Marketers often create web sites for its brand, where they place the contents and post it with the expectation that the follower or fans will like this information and share it (De Vries, Gensler, Leeflang 2012) on social media where content is created by the customers without the sellers.

## Social Media

Social networks is a channel for comprehensive brand communication, where its difference can be expressed. They create (Waks 2016) the effect of a community and the brand impression, which must be consistent with the corporate values. The social media need a strong content strategy. Social media are an important tool (Siamagka et al. 2015) for attracting new customers and cultivating relationships with existing customers. The use of social media has (Michaelidou 2011) the power to create competitive advantage and greater performance (Lau 2011) of the entire communications.

LinkedIn takes the lead among the social networks, it is followed by Twitter and Facebook in the U.S. (DEMANDwave 2016, Regalix 2015). Most of the leads from social media come from LinkedIn and the most successful leads from LinkedIn come from the discuss groups. The analysis of the debate of the target audience (Rethinking the B2B Buyer's Journey 2016) allows the unveiling of their issues, which enables the firms to create content. These activities should be complemented (Khan 2015) by personal communication.

Siamagka et al. show (2015) that the adoption of social media is significantly affected by the innovating character of the company and the perceived usefulness. The more innovative, the more willing the companies are to accept them. (Michaelidou 2011).

Social media do not require a high initial investment. Platform for social media are owned and managed by another company and the content is made up by organizations, external stakeholders and potential and existing customers (Siamagka et al. 2015).

B2B companies do not accept social network (Michaelidou 2011) because they see it unimportant in their industry, they feel uncertainty about how to reach their business goals through the social networks.

Other barriers (Siamagka et al. 2015) are represented by the concerns about reputation, legal affairs, lack of senior management support party and unwillingness to lose control over the brand. According to Stelzner (2015) B2B marketers still cannot join Facebook fans through likes and comments which would effectively hit their audience.

#### Mobiles

Mobile devices are ubiquitous and they enable to execute the problem quickly. SMS messages can be integrated into the sales strategy (Weeks 2016, Waks 2016) together with e-mails and telephone calls. The message should go straight to the point. Texting during the sales process (Weeks 2016) increases the chance of up to 40% to turn potential customers into actual customers, but it is not appropriate (Waks 2016) to text before the first contact is made.

## **2.2 Research Problem**

The aim of the research is to find out basic information about the tools of marketing communications used by engineering firms on the European B2B markets. We have reasons to believe that: personal contact is essential in B2B, content posted online is an important source of information for buying machinery and the use of social networking has become a necessity.

## **3 METHODS AND DATA**

On the basis of a literature research both from academic sources and from the professional research organizations sources, the content and structure for personal interviews were designed. The aim was to find out what tools of marketing communications are used by machinery vendors operating on the European market. This part of researched was realized in March and April 2016.

Qualitative research included informal in-depth interviews (April - May 2016) and the semi structured interviews (June 2016) with the dealers of the Czech machine tools producer across Europe. The broad variety of experts provided very wide picture of findings. The informal in-depth interviews were conducted individually with 7 specialists, who were traders acting on the U.S. B2B markets, representatives of the CzechTrade Chicago, a representative of the Embassy of the Czech Republic Washington DC, representatives of Czech machine tool manufacturer exporting to all over the world. The brainstorming method was used during the interview.

The semi structured interviews were conducted with the dealers of the Czech machine tools producer, who operate across Europe (25 persons). The interviews were realized on the occasion of the annual congress of these retailers. The congress provided an opportunity to obtain a large series of information and attitudes from various branch experts. The short time period for the research realization was in compliance with *ceteris paribus* as the longer research time would increase the risk of data inconsistency.

The interviews were focused on determining the state of what forms of communications were the most important for these sellers, the representatives of the B2B market, and what their relationship to the use of internet tools was. The interviews started with questions about where did the representatives of the B2B machine tool market search for information about the producers, what type of content did the customers prefer, how important the personal contact was, what type of online information did the sellers use and how important it was; finally the sellers were asked about the reasons for losing the business cases and about competition advantage of the producer.

## **4 RESULTS**

### **4.1 In-depth interviews**

As mentioned in the previous part, B2B market in U. S. was taken as an inspiration for its major advance and a wide information base. U.S. B2B markets are characterized by their great professionalism and problem-solving without emotion. It is one of the most challenging and fastest markets; the suppliers just like the buyers have tightly-defined and respected positions. Experts said that it is not possible to succeed in these markets without high-quality and technically-perfect products. According to experts an

American customer is generally pragmatic and can be reached only by a balanced mix of technical level of product, quality, price, support and communication. The communications environment is transparent, the dealings are open, prompt and direct. If a company wants to succeed in the United States, it must think about the business cases from the position of the other party, realize that a customer decides upon the profit and needs an extraordinary offer. At present, the biggest challenges of B2B marketers in the United States are building brand, expansion and the fight against financial constraints.

## **4.2 Semi-structured interviews**

The most important resources of information about the machine tools products for the customers are the colleagues in the organization, vendors themselves (both in person and on the web), reviews by users and trade fairs. The most important form of the content obtaining is a personal meeting with the manufacturer and his brochures. The personal contact is essential, the information provided online is searched for on a regular basis, often rather as complementary.

The usage of online channels by buyers benefits vendors with better informed customer, it also attracts new customers and it provides faster realization of upgrading the products. The online information is not being used on a regular basis, the content does not publish enough information, websites are too complicated, the customers are afraid of creditworthiness and management do not support the use of online information are the major obstacle to use them.

The most popular social networking sites are Facebook, LinkedIn, Google + and almost half of the interviewers do not use them at all. The most effective business techniques are references, internet search, but also participation in trade fairs and e-mailing. The vendors do not see the social media effective enough.

Generally they mostly obtain shared experiences, impressions of the products and its reviews from online channels and they conduct their own data analysis online. While dealing with customers they conduct a personal meeting, then write e-mails and make telephone calls.

European machine tool vendors do use the modern tools of marketing communications, but within a limited range. Traditional forms of communications remain relevant. Online content is very important for the companies, but they do not always rely on it.

## **5 DISCUSSION**

The company should understand what a key advantage of its product or a brand over the competition is and what the determining factors of customer's deciding are. The correctly made positioning is the basis for marketing communications. Sharing of customer experience across departments, knowledge of the competition and searching for the causes of the failure are significant for making out the efficient strategy.

Traditional forms of communications have not lost its importance, but some have moved into the form of freely available information. It can be reached by the potential customers according to their needs and save the costs of numerous personal encounters in the early stages of the purchase process to both parties. There is an obvious need for maximum use of online channels, the creation of relevant content and the best possible understanding the customer.

Various industries have been digitized at different levels. According to McKinsey Global Institute (2015) the sectors with the highest productivity (ICT, media, services, and financial services) are considerably digitized, although in recent years other industries have advanced forward significantly. On B2B markets, the more advanced the production technology is, the more digitized communications are, and vice versa (like more traditional branches e.g. construction).

## 6 CONCLUSION

The aim of this paper was to describe current trends in marketing communications on B2B markets and suggest recommendations for companies that want to enter these markets. Numerous resources have been studied and experts and vendors from B2B market have been interviewed. The marketers on B2B markets use the modern ways of communications including the social media but they seem to be rather traditional and still rely on personal contact. The ways of communications during the purchasing process has changed significantly in accordance to various phases. Nowadays the customer can come to the personal meeting very well informed and prepared better than ever before. Creating an effective communications mix means a competitive advantage on B2B markets. The basis for the creation of effective communications is the best possible knowledge of the customer, which is inherent to the most successful companies. The use of the proposed recommendations reduces the risk of business failure and thus reduces the financial losses.

Research in the area of marketing trends will belong to important issues in the near future, since marketing is currently a real driver of the business. This paper has identified current trends, and in the future it will be complimented by a quantitative study on the actual state of these activities among the vendors in the area of mechanical engineering on the European markets.

### References

- Baack, D. W., Wilson, R. T., Van Dessel, M. M & Patti, C.H. (2016),. Advertising to businesses: Does creativity matter? *Industrial Marketing Management* [online]. 55(55), 169-177 [cit. 2017-01-05]. DOI: 10.1016/j.indmarman.2015.10.001. ISSN 00198501. Available at: <http://www.sciencedirect.com/science/article/pii/S001985011500293X?>
- Batra R. & Keller, K. L. (2016). *Integrating Marketing Communications: New Findings, New Lessons and New Ideas*. *Journal of Marketing*, in press.
- Cupman, J. (2015) Five Top Tips for Successfully Profiling Your Competitors. In: *MarketingProfs* [online]. Dover, DE: MarketingProfs, [cit. 2017-01-30]. Available at: <http://www.marketingprofs.com/articles/2015/28353/five-top-tips-for-successfully-profiling-your-competitors>
- Davies, A. (2015) Five Ways to Prove Marketing's Value by Saving Sales Costs. In: *MarketingProfs* [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/articles/2015/27997/five-ways-to-prove-marketings-value-by-saving-sales-costs>
- De Vries, L., Gensler S. & Leeftang P. S. H.. (2012) Popularity of Brand Posts on Brand Fan Pages: An Investigation of the Effects of Social Media Marketing. *Journal of Interactive Marketing* [online]., 26(2), 83-91 [cit. 2017-01-05]. DOI: 10.1016/j.intmar.2012.01.003. ISSN 10949968. Available at: <http://www.sciencedirect.com/science/article/pii/S1094996812000060>
- Ellis, N., *Business to Business Marketing: Relationships, Networks and Strategies*. Oxford University Press, 2010. ISBN: 9780199551682.
- Evans, J. R. & King V. E.. (1999) Business-to-Business Marketing and the World Wide Web. Planning, Managing, and Assessing Web Sites. *Industrial Marketing Management* [online]., 28(4), 343-358 [cit. 2016-09-21]. DOI: 10.1016/S0019-8501(98)00013-3. ISSN 00198501.
- Finn, G.. (2016) The Three Most Important B2B Marketing Questions for 2016. In: *MarketingProfs* [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/articles/2016/29093/the-three-most-important-b2b-marketing-questions-for-2016>
- Handley, A.. (2016) B2B Content Marketing Benchmarks, Budgets, and Trends. In: *MarketingProfs* [online]. Dover, DE: MarketingProfs, [cit. 2016-09-22]. Available at: <http://www.marketingprofs.com/charts/2015/28555/2016-b2b-content-marketing-benchmarks-budgets-and-trends>

- Jarski, V. (2013) B2B Buyers: Traits by Generation. In: MarketingProfs [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/chirp/2013/11087/b2b-buyers-traits-by-generation-infographic>
- Johnson, R. Successful B2B Marketers Know Customer Experience Is a Three-Legged Stool. In: MarketingProfs [online]. Dover, DE: MarketingProfs, 2016 [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/opinions/2016/29600/successful-b2b-marketers-know-customer-experience-is-a-three-legged-stool>
- Khan, J. (2015) Four Powerful Tips for a Highly Effective B2B Social Media Strategy. In: MarketingProfs [online]. Dover, DE: MarketingProfs, [cit. 2016-09-22]. Available at: <http://www.marketingprofs.com/articles/2015/28217/four-powerful-tips-for-a-highly-effective-b2b-social-media-strategy>
- Lau, C.-M. (2011) Team and organizational resources, strategic orientations, and firm performance in a transitional economy. *Journal of Business Research* [online]., 64(12), 1344-1351 [cit. 2017-01-05]. DOI: 10.1016/j.jbusres.2011.01.001. ISSN 01482963. Available at: <http://www.sciencedirect.com/science/article/pii/S0148296311000026>
- Lilien, G. L. (2016), The B2B Knowledge Gap. *International Journal of Research in Marketing* [online]. 33(3), 543-556 [cit. 2017-03-29]. DOI: 10.1016/j.ijresmar.2016.01.003. ISSN 01678116.
- Lindsay, K. (2016). Three New Roles That Every Marketer Must Play. In: MarketingProfs [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/opinions/2016/29633/three-new-roles-that-every-marketer-must-play>
- Luxton, S., Reid M & Mavondo F. (2015), Integrated Marketing Communication Capability and Brand Performance. *Journal of Advertising* [online]. 44(1), 37-46 [cit. 2016-09-21]. DOI: 10.1080/00913367.2014.934938. ISSN 00913367.
- MC Kinsey (2015) GLOBAL INSTITUTE. DIGITAL AMERICA: A TALE OF THE HAVES AND HAVE-MORES. In: McKinsey Global Institute [online]. Global: McKinsey Global Institute, [cit. 2016-09-21]. Available at: <http://www.mckinsey.com/~media/mckinsey/industries/high%20tech/our%20insights/digital%20america%20a%20tale%20of%20the%20haves%20and%20have%20mores/digital%20america%20full%20report%20december%202015.ashx>
- Michaelidou, N., Siamagka, N. T & Christodoulides, G. (2011), Usage, barriers and measurement of social media marketing: An exploratory investigation of small and medium B2B brands. *Industrial Marketing Management* [online]. 40(7), 1153-1159 [cit. 2017-01-05]. DOI: 10.1016/j.indmarman.2011.09.009. ISSN 00198501. Available at: <http://www.sciencedirect.com/science/article/pii/S0019850111001374>
- Nanji, A. (2015) B2B Buying: Millennials vs. Gen X and Baby Boomers. In: MarketingProfs [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: B2B Buying: Millennials vs. Gen X and Baby Boomers
- Nanji, A. (2014a) The Most Effective B2B Lead Generation Tactics. In: MarketingProfs [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/charts/2014/26398/the-most-effective-b2b-lead-generation-tactics>
- Nanji, A. (2014b) What B2B Buyers Value Most on Vendor Websites. In: MarketingProfs [online]. Dover, DE: MarketingProfs, [cit. 2016-09-22]. Available at: <http://www.marketingprofs.com/charts/2015/27454/what-b2b-buyers-value-most-on-vendor-websites>
- Rapp, A., Beitelspacher L., Grewal, D. & Hughes, D. (2013), Understanding social media effects across seller, retailer, and consumer interactions. *Journal of the Academy of Marketing Science* [online]. 41(5), 547-566 [cit. 2017-01-05]. DOI: 10.1007/s11747-013-0326-9. ISSN 00920703. Available at: <http://eds.b.ebscohost.com/eds/pdfviewer/pdfviewer?sid=bc9485e2-928e-4b52-b384-51fb4d8aa15b%40sessionmgr120&vid=9&hid=113>



Rowley, J. (2008), Understanding digital content marketing. *Journal of Marketing Management* [online]. 24(5-6), 517-540 [cit. 2016-09-22]. ISSN 0267257X. Available at: <http://search.ebscohost.com/login.aspx?direct=true&db=bth&an=33462529&scope=site>

Saldi, M.. (2015) Top 5 Keys to Customer Retention. In: *MarketingProfs* [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/articles/2015/27280/top-5-keys-to-customer-retention>

Siamagka, N.-T., Christodoulides G, Michaelidou N.& Valvi A. (2015),. Determinants of social media adoption by B2B organizations. *Industrial Marketing Management* [online]. 51(51), 89-99 [cit. 2017-01-05]. DOI: 10.1016/j.indmarman.2015.05.005. ISSN 00198501. Available at: <http://www.sciencedirect.com/science/article/pii/S0019850115001741?>

Stelzner, M. A. (2015) Social Media Marketing Industry Report. In: [Http://www.socialmediaexaminer.com](http://www.socialmediaexaminer.com) [online]. <http://www.socialmediaexaminer.com>: Social Marketing Examiner, 2016 [cit. 2017-01-05]. Available at: [http://www.socialmediaexaminer.com/report/?awt\\_m=1bwQRJr.ILT&awt\\_email=lucie.povolna%40ujep.cz](http://www.socialmediaexaminer.com/report/?awt_m=1bwQRJr.ILT&awt_email=lucie.povolna%40ujep.cz)

Swani, K., Milne G. R., Brown, B. P., Assaf, A. G. & Donthu N. (2016). What messages to post? Evaluating the popularity of social media communications in business versus consumer markets. *Industrial Marketing Management* [online]. [cit. 2017-01-05]. DOI: 10.1016/j.indmarman.2016.07.006. ISSN 00198501.

Vajre, S. (2015) Five Simple Ways to Get Your First Account-Based Marketing Campaign Up and Running. In: *MarketingProfs* [online]. Dover, DE: MarketingProfs, [cit. 2016-09-21]. Available at: <http://www.marketingprofs.com/articles/2015/28426/five-simple-ways-to-get-your-first-account-based-marketing-campaign-up-and-running>

Vohra, N. & Seethapathy S.. State of B2B Event Marketing. In: *Regalix* [online]. Palo Alto, CA: Regalix, 2014 [cit. 2016-09-22]. Available at: <http://www.regalix.com/wp-content/uploads/2014/11/State-of-B2B-Event-Marketing1.pdf>

Weeks, C. (2016) How to Text Your Sales Prospects to Increase Conversions. In: *MarketingProfs* [online]. Dover, DE: MarketingProfs, [cit. 2016-09-22]. Available at: <http://www.marketingprofs.com/articles/2016/29419/how-to-text-your-sales-prospects-to-increase-conversions>

Czechtrade (2014) [online]. Praha: Česká agentura na podporu obchodu/CzechTrade, [cit. 2016-09-22]. Available at: <http://www.czechtrade.cz/>

B2B Web Usability Report: (2015) What B2B Buyers Want from Vendor Websites. In: *KoMarketing* [online]. Boston: Huff Industrial Marketing, KoMarketing, & BuyerZone, 2015 [cit. 2017-01-06]. Available at: <http://www.komarketingassociates.com/files/b2b-web-usability-report-2015.pdf>

Lead Flow That Helps You Grow. (2015) In: *CMO COUNCIL* [online]. San Jose, CA: CMO COUNCIL, [cit. 2016-09-22]. Available at: <https://www.cmocouncil.org/authority-leadership/reports/all>

Rethinking the B2B Buyer's Journey: How marketers are adapting to a changing world. (2016) In: *LinkedIn: Marketing Solution* [online]. LinkedIn: LinkedIn, [cit. 2017-01-06]. Available at: <https://business.linkedin.com/marketing-solutions/c/16/2/rethinking-the-b2b-buyers#.....>

### **Contact information**

Ing. Lucie Povolná

Tomas Bata University in Zlín, Faculty of Management and Economics

Mostní 5139 760 01 Zlín

+420475284709

[lucie.povolna@ujep.cz](mailto:lucie.povolna@ujep.cz)

# CONSUMER COMPLAINT BEHAVIOUR, WARRANTY AND WARRANTY CLAIM: BRIEF OVERVIEW

*Sayanti Shaw*

## **Abstract**

The consumer complaint behaviour is an area of research, which deals with the identification and analysis of all the aspects involved in the consumer reaction to a product or a service failure and the consequent perceived dissatisfaction. The present study examines and reports the consumer complaint behaviour concerning warranty and warranty claim aspects. The main objective is to identify and comprehend consumer behaviour regarding complaint in relation to warranty and warranty claim. Based on literature review, the research findings suggest, warranty as well as warranty claim play significant role on consumer complaint behaviour. This study reviewing various aspects in the area of consumer complaint behaviour including warranty and warranty claim would be useful to marketing theory and practices for practitioners including scholars in marketing literature.

**Keywords:** *consumer complaint behaviour, dissatisfaction, warranty, warranty claim*

## **1 INTRODUCTION**

In today's ever-changing, complex, highly competitive, digitally enhanced and increasingly transparent world, business organizations are increasingly embracing customer centricity. Businesses that take a customer-centric approach do more than say they put their customers first; they make it a priority to provide an exceptional customer experience and ensure their satisfaction at the point of sale and after the sale to drive repeat business, customer loyalty, increase profits and gain a competitive edge. Consumer satisfaction is the consumers' perceived relation of expectation and the performance of the products and services. If the consumer's experiences with a product/service are higher than expected then that customer is satisfied, or else dissatisfaction emerges (Schiffman & Kanuk, 2000). Keeping customers satisfied is vitally important for firms to generate revenue (Barlow & Møller, 1996). However, no organisation is so perfect in the delivery of superior customer performance that significant levels of dissatisfaction (the source of complaints) do not exist (Wysocki, Kepner, & Glasser, 2001). In order to achieve a high level of consumer satisfaction, it is important for an organisation to meet consumer expectations. When the expectations of consumers are not met in terms of product/service satisfaction, will result to consumers' disappointment. Consequently, post-purchase behaviour intention of consumers must be a major concern to businesses, such that consequence actions will not have negative effects on the organization. Therefore, deep understanding of consumers' needs and expectations is crucially important for business organisations. However, unless customers wish to react and provide their feedback against the failed products/services, it is sometimes difficult to realise what customers expect and where the problem lies. In this context, complaints and warranty claims act as useful and meaningful source of information to improve customer satisfaction.

## **2 PURPOSE AND METHOD**

The purpose of this current research paper is to review and analyse the consumer complaint behaviour emphasising on warranty and warranty claim. The paper highlights and identifies different aspects of consumer complaint behaviour, warranty and warranty claim. The study is based on previous theoretical and empirical research papers.

## **3 CONSUMER COMPLAINT BEHAVIOUR**

Complaining is "an expression of dissatisfaction, whether subjectively experienced or not, for the purpose of venting emotions or achieving intrapsychic goals, interpersonal goals, or both" (Kowalski, 1996). A consumer complaint refers to an action taken by a person who wants to communicate something negative regarding a product/service (Jacoby & Jaccard, 1981). Though complaint behaviour

is generally understood to be caused by consumer dissatisfaction (Williams, Drake, & Moran, 1993) and that dissatisfied consumers are more likely to complain than satisfied consumers (Heung & Lam, 2003; Maute & Forrester, 1993) but dissatisfaction is not the only reason why consumers complain (Jacoby & Jaccard, 1981). Some studies have also shown that even some satisfied customers may still complain in order to provide useful feedback to product/service providers on product/service quality (Liu, Kang, Bai, & Zhang, 2006). Moreover, the consumer complaint behaviour can be conceptualised as a set of multiple (both behavioural and non-behavioural) responses, some or all of which are triggered by perceived dissatisfaction with a purchase period (Singh, 1988). Consumer complaint behaviour is a multidimensional and extremely complex phenomenon (Singh & Howell, 1985). Complaints may arise because of defective products/services, low or poor quality of products/services, unreliable products/services, disparity in product/service commitment by product or service provider, discrepancy between customer expectation and perceived product/service performance. The responses of consumer complaint behaviour could be generally classified into several possible categories, for example, voice responses, personal/private responses, third party responses, and non-action or inertia (Mousavi & Esfidani, 2013). Voice responses occur when customers decide to express their dissatisfaction to the responsible party (e.g. seeking redress from the seller) (Butelli, 2007). Personal/private responses indicate that complaint is done privately through negative word-of-mouth (verbal and online) communications to family and friends or the decision not to repurchase the product/ service again or collective purchase boycott or switching and exit (McQuilken & Robertson, 2011; Moliner Velázquez, Fuentes Blasco, Gil Saura, & Berenguer Contró, 2010). Third party responses happen when an individual or organization who is external to the consumer initiates redress and is not directly involved in the dissatisfying transaction (e.g. reporting to an agency of consumer protection, taking legal action, or share their unsatisfactory experience to media and newspapers) (Reiboldt, 2003). Non-action or inertia happens when even though there is product/service failure but the customer decides to remain silent, tolerate dissatisfaction or, don't protest (Hawkins, Bust, & Kani, 2007).

The consumers' decision of taking any action (i.e. complaining) or not (i.e. not complaining) depends on many factors such as importance of the purchase to consumer, cost-benefit and time involved in complaining, attitude-toward-complaining and propensity-to-complain, attribution of blame, level of information and complaining experience, ease and simplicity of the reaction in dissatisfaction conditions, the overall level of customer satisfaction from store brand and behavioural characteristics of customers (Bodey & Grace, 2007; S. W. Hansen, 1997; Hawkins et al., 2007; Heung & Lam, 2003; Kim, Wang, & Mattila, 2010; Moliner Velázquez et al., 2010). Customers evaluate the balance between costs and benefits of complaining from economic as well as psychological perspective (Andreasen, 1988; Huppertz, 2003). A customer can complain even with a low level of dissatisfaction if the perceived benefit is remarkable. On the contrary, even if considerable dissatisfaction exists but the perceived benefit is low that would not lead a customer to complain (Landon, 1977). Customers decide to complain when they assess the probability of obtaining favourable outcome of complaining to be positive (Hirschman, 1970). Consumer complaint behaviour is generally goal-directed (McQuilken & Robertson, 2011). By complaining, customers can search for different possible outcomes, which can be combined together. On average, customers hope for a tangible solution of a specific problem, through refund, exchange, repair; a psychological compensation obtaining apologies; a social benefit, "preventing the cause for their dissatisfaction from occurring to other consumers" (Landon, 1977). In other circumstances, a complaint has only one objective: venting anger and frustration for reducing stress. In this case, no reaction from the seller or the service provider is really expected and the complaining behaviour has a cathartic effect (Nyer, 2000). There are different types of complainers, such as, passives (least likely to complain); voicers (likely to complain directly to the product or service provider); irates (most likely to engage in negative word of mouth, stop patronage, and complain to the provider but not to a third party); activist (engage heavily in all types of complaining, including complaining to a third party) (Hoyer & MacInnis, 2007).

The main factors which may influence the consumer complaint behaviour can be classified into four types, i.e., personal, product/service, situational and macro factors (Mousavi & Esfidani, 2013). While, personal (individual) factors include attitudes toward complaint (Ekiz & Au, 2011; Svavi, Svensson, Slåtten, & Edvardsson, 2010; Yuksel, Kilinc, & Yuksel, 2006), customer advocacy (Chelminski & Coulter, 2011), religious beliefs (Swimberghe, Sharma, & Flurry, 2009), demographic variables (Chan,

Hsiao, & Lee, 2016; Heung & Lam, 2003; Jacoby & Jaccard, 1981; Li, 2010; Metehan & Zengin, 2011; Oly Ndubisi & Yin Ling, 2006), personality (Daly, Anne Lee, Soutar, & Rasmi, 2010; Huppertz, 2003; Jin, 2010), psychological costs (Broekhuizen, Jager, & others, 2004), personal norms (Oh, 2006) and attribution of blame (Garry et al., 2010). Product/service factors comprise the type of services, the magnitude of product/service failure (Casado, Nicolau, & Mas, 2011; Chang, Ho, & Tseng, 2007), the level of dissatisfaction (Oh, 2006), product/service importance (Huppertz, 2003; Tronvoll, 2007) and price of product/service (T. Hansen, Wilke, & Zaichkowsky, 2010). Moreover, situational factors consist of the prior experience of complaints (Jin, 2010), time lost (Dolinsky, 1994), switching convenience (Kasabov & Warlow, 2010), complaint addressee (Moliner Velázquez et al., 2010), competitor density (Tsarenko & Rooslani Tojib, 2011), inconvenience and the likelihood of successful redress (Drew, Mani, Datta, Howard, & Griffin, 2003; Jin, 2010). Finally, macro element such as culture can also affect consumer complaint behaviour (Baker, Meyer, & Chebat, 2013; Ngai, Heung, Wong, & Chan, 2007; Patterson, Cowley, & Prasongsukarn, 2006; Swanson, Frankel, Sagan, & Johansen, 2011).

Some organisations mistakenly infer that if they do not receive any complaint, the customers are happy and satisfied, but firms fail to understand that it is quite probable that the customers took their business elsewhere, because of habit of non-complaining or perhaps because they perceived it as pointless action and this, as a result, would have serious impact on firms' sales and profitability. Complaints from consumers must be treated as important opportunities from a business perspective because they allow organisations to take corrective actions and enhance their performance. Thus, organisations that clearly grasp the meaning and the usefulness of consumer complaint behaviour have the possibility to create efficient complaint resolution strategies (Nyer, 2000) which might be relevant in improving their performance, customer service, generating higher consumer retention, higher revenues and diminishing negative word-of-mouth (Bolting, 1989; Fornell & Wernerfelt, 1987). Accordingly, complaints do not have to be seen in a negative manner; in fact, complaining must take the connotation of being extremely useful for organisations for identifying problems and correct them, retaining the consumer more satisfied for showing concern in trying to sort out the matter, instead of disposing of the problem through banal excuses.

## **4 WARRANTY**

Nowadays, new products/services are appearing in the marketplace at an ever-increasing pace. Their introduction is either market driven – a result of increasing customer needs and expectations – or technology driven – resulting from advances in technology or both. Furthermore, each new generation is more complex than the earlier generation it replaces and the complexity of products/services tends to increase with each new generation. As part of the input to their purchase decisions, customers expect assurance that a product/service will perform at a satisfactory level during its useful life. From the firm's perspective, they not only need to provide this assurance to customer, but more importantly, need to ensure customer satisfaction as well. In modern business world, satisfying the customer is one of the basic objectives of the organization and without this, survival in a fiercely competitive global market environment would be impossible. Moreover, the legislations are getting more stringent to protect consumer interests. Organisations have responded to these challenges by bundling products/services with post-sale support such as warranties. Warranty can be defined as a written assurance that the manufacturer or seller of a product/service will guarantee the quality and reliability of the product/service in terms of correcting any legitimate problems with the product/service at no additional cost, for some expressed or implied period of time or use (Pecht, 2006). A warranty is a contractual agreement associated with the sale of a product/ service that requires the manufacturer or seller to take the responsibility to either rectify or compensate for any failures within the warranty coverage period. Based on this concept, a warranty contract should contain at least three characteristics: the coverage period (fixed or random), the method of compensations, and the conditions under which such compensations would be offered (Pham, 2006). A warranty may be implicit or it may be explicitly stated.

A product/service is said to fail when it is unable to perform its intended function satisfactorily when properly used. The contract specifies both the performance that is to be expected and the redress available to the buyer if a failure occurs. In broad terms, the purpose of a warranty is to establish liability between the two parties (manufacturer/seller and buyer) in the event that a product/service fails.

Although regulations seem to be the reason for organisations to offer warranty, literature reveals that warranty is dictated more by customer and market competition. The primary role of a warranty is to ensure a post-purchase remedy for consumers. From the buyer's perspective, it offers protection against premature failures (i.e. when a product/service, properly used, fails to perform as intended or as specified by the manufacturer/seller). It gives assurance, confidence as well as peace of mind to the consumer that a product/service is fit for the purpose for which it is sold and would work well (Rahman & Chattopadhyay, 2004). Consumers are dissatisfied when purchased goods/services failed to meet their expectations. Most of the time consumers complain about their dissatisfaction to the responsible party (manufacturer or seller) when they see there is a real favourable outcome of the consumer complaint. A warranty is any obligation that an organisation assumes towards consumers and by means of which it undertakes to repair or replace goods/services for consumers free of charge, reimburse the purchase price, or provide any other remedy, when products/services fail to function properly or do not have the properties specified in the warranty certificate or advertisement. If consumers have received warranties from sellers or manufacturers for purchased products/services, but the products/services do not function properly or do not have the properties stated in warranty certificates or advertisements, consumers are more tend to lean towards complaints of what they considered the product/ service malfunctions with optimistic probability of obtaining favourable outcome, in form of, refund, repair, replacement, compensation or any other remedy by enforcing their rights provided by warranty agreements. Warranties can benefit consumers by giving customer protection if problems arise after sale and entitling consumers to get refund, replacement, repair, compensation or any other remedy, as specified in warranty agreements, in the event of problems. It seems reasonable to say that without a warranty; customers are less likely to complain or come back. Buyers consider different attributes whenever they purchase a product/service. Naturally, product/service attributes and features have influence on consumer buying decision. At the same time, other supplementary service and information like warranty can instigate consumers buying decision. In the purchase decision of a product/service, buyers typically compare characteristics of comparable models of competing brands. When competing brands are nearly identical, it is very difficult, in many instances, to choose a particular product/service solely on the basis of the product/service -related characteristics such as price, special features, perceived product quality and reliability, financing offered by the manufacturer, and so on. In such situations, post-sale factors—warranty, parts availability and cost, service, maintenance, and so forth—take on added importance in product/service choice. Among these factors, warranty is a factor that is known (or at least potentially known) to the buyer at the time of purchase (Cai, Cude, & Swagler, 2004; Murthy, 2006). Often customers are uncertain about, and have no easy way to research new product/service performance. In this context, warranties play an important role. From the firm's angle, a warranty is an important dimension of competitive strategy, and warranty is a source of market power not because of the actual rectifications that are done but because of the perception by the customer that the company is willing to perform needed rectifications. Many companies, whether they are established and reputed or new and non-reputed are offering different types of warranty to the target market. The normal/basic warranty, is an integral part of the product/service sale and is factored into the sale price, whereas extended warranty (sometimes referred as extended service contract or extended service plans) is offered to lengthen the coverage provided by the basic/normal warranty and the buyer can choose that by paying an extra amount. The use of warranties is widespread and they serve many purposes. These include legal protection for manufacturer or seller and buyer, signals of product/service quality, assurance that the product/service will perform at a satisfactory level, providing a means of compensating buyers when a purchased product/service does not perform as promised and resolving disputes between buyer and manufacturer or seller.

Warranties may act as signals of product/service quality (Boulding & Kirmani, 1993; Spence, 1977). The information role that warranties play and the additional information they provide about quality of the products has been studied by (Grossman, 1981). A longer warranty may be offered by a product with lower quality (Balachander, 2001). In a market where a new product competes with an existing product, signalling behaviour leads to an outcome where the less reliable product may carry the longer warranty. However, a high-quality product might provide a longer warranty to signal its quality to uninformed buyers (Spence, 1977). Consumers consider warranty as signals of product quality because they know that offering warranties are expensive for firms. Signalling matters more to consumers for products in

which consumers face larger asymmetric information. The magnitude of asymmetric information will depend on the information available to the consumer prior to purchase. The more prior information, the consumer accumulates on the product, the less asymmetric information the consumer faces and the less attractive warranties are as signals of product quality (Choi & Ishii, 2010). Warranty brings reliability for the consumer. Warranties are provided in order to increase the consumers' level of reliability about companies' products/services and in turn increase their sales and profits. The warranty terms offered result in different expectations (real or perceived) from buyers. When these expectations are not met there is dissatisfaction and this leads to a negative word-of-mouth impact that affects sales. Better warranty terms are meant to convey a more reliable and better quality product. When buyers are unable to evaluate reliability and quality there is scope for the manufacturer or seller to exploit this. This leads to the moral hazard problem (Murthy, 2006). Warranty and product quality can be thought of as consistent with the use of warranty as a basis for judging quality of a product/service when consumer moral hazard is present (Lutz, 1989). Manufacturers or sellers have also used warranties to promote and differentiate their product from those of competitors, with better terms implying a more reliable product. Several firms use warranties for product differentiation and to increase sales (Menezes & Quelch, 1990). If consumers are risk averse, it is better for the firm to offer a warranty (Heal, 1977). Again, if consumers are heterogeneous, different price-warranty bundles can be used to price discriminate, both in monopoly (Adams & Yellen, 1976; Matthews & Moore, 1987) or in competition (Rothschild & Stiglitz, 1976). Moreover, if quality is endogenous, firms can use warranties to credibly bond themselves to high quality production (Courville & Hausman, 1979; Grossman, 1981; Oi, 1973). "Attitudes" refers to buyers' positive or negative orientations toward warranties and the implementation of warranties. It seems likely that warranty attitudes range from positive to neutral. It seems reasonable to expect a relationship between attitudes toward warranties and select consumer behaviours (McGann, 1972; McQuade, 1972). Positive attitudes toward warranties suggest a greater predisposition to search for warranty information. Negative warranty attitudes by consumers, in contrast, imply that these consumers feel that warranties are of no value (McQuade, 1972; Pennock & Jaeger, 1964; Perry & Perry, 1976; Trombetta & Wilson, 1975). Marketing and social psychological theory also suggest that discrete groups of consumers have different orientations toward warranties (Darden & Howell, 1978; Kendall & Russ, 1975). Consumers in different social classes attach different values to shopping tasks (Hollingshead & Redlich, 1958) and to the risk involved in purchasing products (Loudenback & Goebel, 1974). Market segments with high incomes and better education may prefer higher prices with longer (and better) warranties in compare to market segments with lower incomes and less education who may prefer lower prices at the cost of less warranty coverage. However, lack of relationship between warranty attitudes and the socioeconomic characteristics of the consumers has also been reported (Darden & Rao, 1979).

Warranty is a commercial issue and reliability is a technical issue. The link between warranty and reliability is complicated since each affects the other through multiple causal effect relationships (Murthy, 2006). From the business perspective, there can be multiple goals such as market share, total profits etc. Better warranties impact total sales in a positive manner (due to their promotional effect), but also result in higher warranty costs. The increase in warranty cost implies a higher sale price and this, in turn, has a negative impact on total sales, in turn affecting total profits. Warranty costs can be reduced with improved product reliability. Manufacturer or seller reputation would have a direct impact on consumer judgments of product quality. For this reason, manufacturer or seller decides to offer a warranty that is better than its competitors. Indeed, a better warranty led to higher perceptions of quality when the manufacturer or seller offering the warranty was reputed to manufacture or sell high-quality products/services (Boulding & Kirmani, 1993). A better warranty coverage did not influence perceptions of quality when the manufacturer or seller had a poor reputation. The extent of warranty protection appears to bear no general relation to the overall performance of a product/service. That is, the manufacturers or sellers of more reliable brands of a particular product/service may offer more, equal, or even less warranty protection than sellers of less reliable brands. Longer warranties increase consumers' utility and increase the likelihood of product being chosen. Longer warranties appear to be valued most for products/services on which the consumer has the least a priori information and those offered by brands with which the consumer has no prior purchase experience (Choi & Ishii, 2010). The positive impact of warranty information on perceived product quality has also been reported (Perry & Perry, 1976; Shimp & Bearden, 1982). It appears, therefore, that even in the presence of other intrinsic

cues, consumers rely on warranty information to make inferences about product quality and form attitudes. Both warranty information and brand name are used as risk reducers by consumers (Bearden & Shimp, 1982; Roselius, 1971; Shimp & Bearden, 1982). Warranties may reduce consumers' perceptions of risk associated with new product purchases. However, according to (Olson & Jacoby, 1972; Roselius, 1971) when consumers have available positive information about a brand's performance history, their reliance on warranty information in forming an evaluation of a new product under the same brand name would be limited. On the other hand, when no information is available to consumers about a brand's performance history, consumers will tend to rely on warranty information to form evaluations of that brand. Experts have the ability to process information more comprehensively and make more refined judgments (Maheswaran & Sternthal, 1990). For experts, a better warranty leads to perceptions of higher quality, regardless of firm reputation. Novices, on the other hand, tend to perceive a better warranty as a signal of higher quality only when the firm is reputable but not when its reputation is low (Srivastava & Mitra, 1998). A warranty of any type, since it involves an additional service associated with a product, will lead to potential costs beyond those associated with the design, manufacture, and sale of the product. These costs, in fact, are unpredictable future costs and can vary from 2% to as much as 15% of net sales (McGuire, 1980). The warranty costs depend on the reliability performance of the product/services and the product/service usage. This, in turn, depends on several factors some under the control of the firm (such as the decisions made during the design and development of the product) and others under the control of the consumer (such as the usage intensity, operating environment and maintenance). These costs have a significant impact on the competitive behaviour as well as total profit of the business organisations, who need to devise strategies to reduce this type of costs. The cost associated with the servicing of the warranty per item sold is a random variable of considerable importance to firms (Jack & Murthy, 2001). (Blischke & Murthy, 1983) discuss the expected warranty costs for a wide variety of warranty policies. Duration of lifetime warranty is a source of confusion because of difficulties in understanding life measures of coverage (Denicola, 1975). In spite of complications in defining life, lifetime warranty has received a huge popularity in the product market as it guarantees a long reliable function of products/services.

Warranty is an important part of the marketing and sales programmes. A warranty has the ability to boost marketing and sales as it encourages consumers to buy a product/service by reducing the risk of the purchase decision, and it generates more sales to existing customers by enhancing loyalty, along with attracting new customers (Hart, 1988). Warranties serve as marketing device to extract consumer surplus if a product/service is offered with a variety of warranty contracts. However, warranty contracts cannot be used as a device to maintain producer surplus because as product/service warranties may require a larger network of dealers which might be expensive to setup, in that case, it serves as a barrier to entry of producers (Emons, 1989). When products are sold with warranties, a linkage is created between buyer and seller. Because the seller's future profitability is dependent upon the behaviour of future consumers, warranties also imply a linkage between different cohorts of consumers (Bigelow, Cooper, & Ross, 1993). In order to stay active in the market, firms have to be committed to their warranty obligations and treat consumers as their associates in order to gain future profits, retain existing customers and entice future customers.

## **5 WARRANTY CLAIM**

During consumption or possession of the products/services, perceived dissatisfaction by consumers may turn into complaints against the failed products/services. The customers' complaints may or may not be paired with a demand for redress. However, if the consumers seek redress and the purchased products/services are within the warranty period, that may lead them to claim the warranty for purchases, i.e. get repair, replacement or refund for the failed products/services. Consumer behaviour concerning warranty claim captures consumer's attitudes, preferences, intentions, and decisions regarding his/her claim for repair, replacement or refund from a product or service provider, in the case of non-performance or underperformance of a product/service. Warranty claim can be stated as customer's claim for replacement, repair or compensation for the failed product/service. A firm's complaint handling activities can involve restitution and compensation in the form of reimbursement, product/service replacement, credit, apology, repair, refund, and correction. Proper (improper) handling

of consumers' warranty claims, arising as result of product/service failures, may have far-reaching positive (negative) consequences for the firm's relationship with its customers. Effective handling of consumers' warranty claims can be beneficial to the firm by several means such as preventing loss of consumers; revealing problems related to the product/service; providing opportunities for product/service improvement as well as marketing programmes improvement; providing information to improve consumers' satisfaction; giving ideas about new product/service concepts; protecting the trade or service mark; preventing negative word of mouth (WOM) communication about the product or service provider to other customers. Effective handling of consumers' warranty claims can also culminate customer satisfaction, trust, commitment, positive word of mouth (WOM) communication, and future purchase. Consumers' warranty claims when handled well may help organisations retain existing customers and could result in new customers being referred to their business. On the other hand, ineffective handling of consumers' warranty claims increases frustration and dissatisfaction, reinforces negative consumer reactions and harms reputation of product or service provider. Moreover, failure to handle consumers' warranty claims properly provokes consumers' negative word of mouth (WOM) or/and exit intentions along with encouraging others to do the same and these can have catastrophic effects on organisations' business. Furthermore, the cost of losing a customer is huge and it surpasses the cost of making corrections or any resolutions in handling warranty claims. Hence, responding effectively and efficiently to consumer warranty claims is critically important for product or service providers in order to reduce customer dissatisfaction, provide differentiation in the marketplace and maintain customer loyalty.

## **6 DISCUSSION**

This paper is an exploratory literature survey on consumer complaint behaviour concerning warranty and warranty claim aspects. From the literature survey, it has been observed that research has been performed on various aspects of consumer complaint behaviour and warranty, however, the interconnectivity between the both has been overlooked. This interconnectivity might help to develop hypotheses and problem-oriented solutions in the domain of consumer complaint behaviour primarily focused on warranty claims and its issues. Following this literature study will help to develop the additional broad research on the issues of consumer complaint behaviour, warranty and warranty claim. Besides, based on this literature survey, hypotheses will be formulated to fulfill the objective of the current ongoing research: "Consumer Behaviour and Warranty Claim".

## **7 CONCLUSION**

In conclusion, the review study has provided information and insights on consumer complaint behaviour, warranty and warranty claim. From the research review, it can be observed, consumer complaint behaviour identifies many elements that can cause complaint reactions and effect both organisations and consumers. The research findings suggest, warranty as well as warranty claim play important role on consumer complaint behaviour. Consumers' complaints against the failed products/services, warranties bundled with products/services and claims of these warranties in case of non-performance or underperformance of products/services have been found to be beneficial not only to consumers but also to business organisations. This study will contribute to the body of knowledge in the area of consumer complaint behaviour, warranty and warranty claim, having theoretical as well as practical significance.

### **Acknowledgement**

I would like to thank the Faculty of Management and Economics at Tomas Bata University in Zlin. This work was supported by the Internal Grant Agency of Tomas Bata University in Zlin under project number IGA/FaME/2016/006.



## References

- Adams, W. J., & Yellen, J. L. (1976). Commodity bundling and the burden of monopoly. *The Quarterly Journal of Economics*, 475–498.
- Andreasen, A. R. (1988). Consumer complaints and redress: What we know and what we don't know. *The Frontier of Research in the Consumer Interest*, 675, 722.
- Baker, T. L., Meyer, T., & Chebat, J.-C. (2013). Cultural impacts on felt and expressed emotions and third party complaint relationships. *Journal of Business Research*, 66(7), 816–822.
- Balachander, S. (2001). Warranty signalling and reputation. *Management Science*, 47(9), 1282–1289.
- Barlow, J., & Møller, C. (1996). *A complaint is a gift: using customer feedback as a strategic tool*. Berrett-Koehler Publishers.
- Bearden, W. O., & Shimp, T. A. (1982). The use of extrinsic cues to facilitate product adoption. *Journal of Marketing Research*, 229–239.
- Bigelow, J., Cooper, R., & Ross, T. W. (1993). Warranties without commitment to market participation. *International Economic Review*, 85–100.
- Blischke, W. R., & Murthy, D. N. P. (1983). *Warranty cost analysis, 1994*. Marcel Dekker, New York.
- Bodey, K., & Grace, D. (2007). Contrasting “complainers” with “non-complainers” on attitude toward complaining, propensity to complain, and key personality characteristics: A nomological look. *Psychology & Marketing*, 24(7), 579–594.
- Bolfing, C. P. (1989). How do customers express dissatisfaction and what can service marketers do about it? *Journal of Services Marketing*, 3(2), 5–23.
- Boulding, W., & Kirmani, A. (1993). A consumer-side experimental examination of signaling theory: do consumers perceive warranties as signals of quality? *Journal of Consumer Research*, 20(1), 111–123.
- Broekhuizen, T. L. J., Jager, W., & others. (2004). *A conceptual model of channel choice: Measuring online and offline shopping value perceptions*. University of Groningen.
- Butelli, S. (2007). *Consumer complaint behavior (CCB): a literature review*. Newcastle: Northumbria University.
- Cai, Y., Cude, B., & Swagler, R. (2004). Country-of-origin effects on consumers' willingness to buy foreign products: An experiment in consumer decision making. *Consumer Interests Annual*, 50, 98–105.
- Casado, A. B., Nicolau, J. L., & Mas, F. J. (2011). The harmful consequences of failed recoveries in the banking industry. *International Journal of Bank Marketing*, 29(1), 32–49.
- Chan, G. S. H., Hsiao, A. C.-H., & Lee, A. L. Y. (2016). Exploration of Customer Compliant Behavior toward Asian Full-Service Restaurants. *International Journal of Marketing Studies*, 8(2), 46.
- Chang, H.-S., Ho, J.-L., & Tseng, C.-M. (2007). Justice Strategy Options for Increased Customer Value in a Services Recovery Setting. *The International Journal of Business and Information*, 2(2), 241–264.
- Chelminski, P., & Coulter, R. A. (2011). An examination of consumer advocacy and complaining behavior in the context of service failure. *Journal of Services Marketing*, 25(5), 361–370.
- Choi, B., & Ishii, J. (2010). Consumer perception of warranty as signal of quality: An empirical study of power train warranties.
- Courville, L., & Hausman, W. H. (1979). Warranty scope and reliability under imperfect information and alternative market structures. *Journal of Business*, 361–378.
- Daly, T. M., Anne Lee, J., Soutar, G. N., & Rasmi, S. (2010). Conflict-handling style measurement: a best-worst scaling application. *International Journal of Conflict Management*, 21(3), 281–308.
- Darden, W. R., & Howell, R. (1978). CASORT: An Approach to Updating Data Sets. *Journal of Marketing Research*, 14, 115.

- Darden, W. R., & Rao, C. P. (1979). A linear covariate model of warranty attitudes and behaviors. *Journal of Marketing Research*, 466–477.
- Denicola, R. C. (1975). The Magnuson-Moss Warranty Act: Making Consumer Product Warranty a Federal Case. *Fordham L. Rev.*, 44, 273.
- Dolinsky, A. L. (1994). A consumer complaint framework with resulting strategies: An application to higher education. *Journal of Services Marketing*, 8(3), 27–39.
- Drew, J. H., Mani, D. R., Datta, P., Howard, J., & Griffin, S. (2003). A Study In Business-to-Business Complaining Behavior: Yellow Pages Advertisers. *Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behavior*, 16, 1.
- Ekiz, E. H., & Au, N. (2011). Comparing Chinese and American attitudes towards complaining. *International Journal of Contemporary Hospitality Management*, 23(3), 327–343.
- Emons, W. (1989). The theory of warranty contracts. *Journal of Economic Surveys*, 3(1), 43–57.
- Fornell, C., & Wernerfelt, B. (1987). Defensive marketing strategy by customer complaint management: a theoretical analysis. *Journal of Marketing Research*, 337–346.
- Garry, T., Melewar, T. C., Tiu Wright, L., Gruber, T., Henneberg, S. C., Ashnai, B., ... Reppel, A. (2010). Complaint resolution management expectations in an asymmetric business-to-business context. *Journal of Business & Industrial Marketing*, 25(5), 360–371.
- Grossman, S. J. (1981). The informational role of warranties and private disclosure about product quality. *The Journal of Law and Economics*, 24(3), 461–483.
- Hansen, S. W. (1997). Power as a predictor of industrial complaining styles in a buyer/seller relationship: the buyer's perspective. *Journal of Business & Industrial Marketing*, 12(2), 134–148.
- Hansen, T., Wilke, R., & Zaichkowsky, J. (2010). Managing consumer complaints: differences and similarities among heterogeneous retailers. *International Journal of Retail & Distribution Management*, 38(1), 6–23.
- Hart, C. W. L. (1988). The Power of Uncondirional Service Guaranrees. *Harvard Business Review*, 66(4).
- Hawkins, D., Bust, R., & Kani, K. (2007). *Consumer Behavior*, translated by Rousta & Atayi. Sargol Express.
- Heal, G. (1977). Guarantees and risk-sharing. *The Review of Economic Studies*, 549–560.
- Heung, V. C. S., & Lam, T. (2003). Customer complaint behaviour towards hotel restaurant services. *International Journal of Contemporary Hospitality Management*, 15(5), 283–289.
- Hirschman, A. O. (1970). *Exit, voice, and loyalty: Responses to decline in firms, organizations, and states* (Vol. 25). Harvard university press.
- Hollingshead, A. B., & Redlich, F. C. (1958). Social class and mental illness: Community study.
- Hoyer, W. D., & MacInnis, D. J. (2007). *Consumer Behavior*, George T. Hoffman, United States of America.
- Huppertz, J. W. (2003). An effort model of first-stage complaining behavior. *Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behavior*, 16, 132.
- Jack, N., & Murthy, D. N. P. (2001). A servicing strategy for items sold under warranty. *Journal of the Operational Research Society*, 52(11), 1284–1288.
- Jacoby, J., & Jaccard, J. J. (1981). The sources, meaning, and validity of consumer complaint behavior: A psychological analysis. *Journal of Retailing*.
- Jin, L. (2010). Determinants of customers' complaint intention: empirical study in the context of China's retail industry. *Nankai Business Review International*, 1(1), 87–99.

- Kasabov, E., & Warlow, A. J. (2010). Towards a new model of “customer compliance” service provision. *European Journal of Marketing*, 44(6), 700–729.
- Kendall, C. L., & Russ, F. A. (1975). Warranty and complaint policies: An opportunity for marketing management. *The Journal of Marketing*, 36–43.
- Kim, M. G., Wang, C., & Mattila, A. S. (2010). The relationship between consumer complaining behavior and service recovery: An integrative review. *International Journal of Contemporary Hospitality Management*, 22(7), 975–991.
- Kowalski, R. M. (1996). Complaints and complaining: Functions, antecedents, and consequences. *Psychological Bulletin*, 119(2), 179.
- Landon, E. L. (1977). A model of consumer complaint behavior. *Consumer Satisfaction, Dissatisfaction and Complaining Behavior*, 31–35.
- Li, M. (2010). Exploration of Chinese consumer complaint behavior in the hospitality industry.
- Liu, J.-L., Kang, J., Bai, Y., & Zhang, X. (2006). The study of customer complaints management based on system dynamics: Modeling and simulation. In *Machine Learning and Cybernetics, 2006 International Conference on* (pp. 2040–2046).
- Loudenback, L. J., & Goebel, J. W. (1974). Marketing in the Age of Strict Liability. *The Journal of Marketing*, 62–66.
- Lutz, N. A. (1989). Warranties as signals under consumer moral hazard. *The Rand Journal of Economics*, 239–255.
- Maheswaran, D., & Sternthal, B. (1990). The effects of knowledge, motivation, and type of message on ad processing and product judgments. *Journal of Consumer Research*, 17(1), 66–73.
- Matthews, S., & Moore, J. (1987). Monopoly provision of quality and warranties: An exploration in the theory of multidimensional screening. *Econometrica: Journal of the Econometric Society*, 441–467.
- Maute, M. F., & Forrester, W. R. (1993). The structure and determinants of consumer complaint intentions and behavior. *Journal of Economic Psychology*, 14(2), 219–247.
- McGann, A. F. (1972). Nonmetric multidimensional scaling of consumer perceptions of automobile tire warranties. *ProQuest Information & Learning*.
- McGuire, E. P. (1980). Industrial product warranties: Policies and practices.
- McQuade, W. (1972). WHY NOBODYS HAPPY ABOUT APPLIANCES. *Fortune*, 85(5), 180.
- McQuilken, L., & Robertson, N. (2011). The influence of guarantees, active requests to voice and failure severity on customer complaint behavior. *International Journal of Hospitality Management*, 30(4), 953–962.
- Menezes, M. A. J., & Quelch, J. A. (1990). Leverage your warranty program. *MIT Sloan Management Review*, 31(4), 69.
- Metehan, T., & Zengin, A. Y. (2011). Demographic characteristics and complaint behavior: An empirical study concerning Turkish customers. *International Journal of Business and Social Science*, 2(9).
- Moliner Velázquez, B., Fuentes Blasco, M., Gil Saura, I., & Berenguer Contró, G. (2010). Causes for complaining behaviour intentions: the moderator effect of previous customer experience of the restaurant. *Journal of Services Marketing*, 24(7), 532–545.
- Mousavi, M., & Esfidani, M. R. (2013). A Comprehensive Model of Customers’ Complaint Behavior1. *International Journal of Academic Research in Business and Social Sciences*, 3(5), 548.
- Murthy, D. N. P. (2006). Product warranty and reliability. *Annals of Operations Research*, 143(1), 133–146.

- Ngai, E. W. T., Heung, V. C. S., Wong, Y. H., & Chan, F. K. Y. (2007). Consumer complaint behaviour of Asians and non-Asians about hotel services: an empirical analysis. *European Journal of Marketing*, 41(11/12), 1375–1391.
- Nyer, P. U. (2000). An investigation into whether complaining can cause increased consumer satisfaction. *Journal of Consumer Marketing*, 17(1), 9–19.
- Oh, D.-G. (2006). Complaining intentions and their relationships to complaining behavior of academic library users in South Korea. *Library Management*, 27(3), 168–189.
- Oi, W. Y. (1973). The economics of product safety. *The Bell Journal of Economics and Management Science*, 3–28.
- Olson, J. C., & Jacoby, J. (1972). Cue utilization in the quality perception process. In *SV-proceedings of the third annual conference of the association for consumer research*.
- Oly Ndubisi, N., & Yin Ling, T. (2006). Complaint behaviour of Malaysian consumers. *Management Research News*, 29(1/2), 65–76.
- Patterson, P. G., Cowley, E., & Prasongsukarn, K. (2006). Service failure recovery: the moderating impact of individual-level cultural value orientation on perceptions of justice. *International Journal of Research in Marketing*, 23(3), 263–277.
- Pecht, M. G. (2006). Establishing a relationship between warranty and reliability. *IEEE Transactions on Electronics Packaging Manufacturing*, 29(3), 184–190.
- Pennock, J. L., & Jaeger, C. M. (1964). Household service life of durable goods. *Journal of Home Economics*, 56(1), 22–26.
- Perry, M., & Perry, A. (1976). Service contract compared to warranty as a means to reduce consumers risk. *Journal of Retailing*, 52(2), 33.
- Pham, H. (2006). *Springer handbook of engineering statistics*. Springer Science & Business Media.
- Rahman, A., & Chattopadhyay, G. N. (2004). Lifetime warranty policies: complexities in modelling and potential for industry application. In *Asia Pacific Industrial Engineering and Management Systems Conference (APIEMS)*.
- Reiboldt, W. (2003). Factors that Influence a Consumer Complainer's Rating of Service Received from a Third Party Complaint-Handling Agency-The Los Angeles Department of Consumer Affairs. *Journal of Consumer Satisfaction, Dissatisfaction and Complaining Behavior*, 16, 166.
- Roselius, T. (1971). Consumer rankings of risk reduction methods. *The Journal of Marketing*, 56–61.
- Rothschild, M., & Stiglitz, J. (1976). Equilibrium in competitive insurance markets: An essay on the economics of imperfect information. *The Quarterly Journal of Economics*, 629–649.
- Schiffman, L. G., & Kanuk, L. L. (2000). *Consumer behavior*, 7th. NY: Prentice Hall.
- Shimp, T. A., & Bearden, W. O. (1982). Warranty and other extrinsic cue effects on consumers' risk perceptions. *Journal of Consumer Research*, 9(1), 38–46.
- Singh, J. (1988). Consumer complaint intentions and behavior: definitional and taxonomical issues. *The Journal of Marketing*, 93–107.
- Singh, J., & Howell, R. D. (1985). Consumer complaining behavior: a review and prospectus. *Consumer Satisfaction, Dissatisfaction and Complaining Behavior*, 1, 41–49.
- Spence, M. (1977). Consumer misperceptions, product failure and producer liability. *The Review of Economic Studies*, 561–572.
- Srivastava, J., & Mitra, A. (1998). Warranty as a signal of quality: The moderating effect of consumer knowledge on quality evaluations. *Marketing Letters*, 9(4), 327–336.

- Svari, S., Svensson, G., Slåtten, T., & Edvardsson, B. (2010). A DIP-construct of perceived justice in negative service encounters and complaint handling in the Norwegian tourism industry. *Managing Service Quality: An International Journal*, 20(1), 26–45.
- Swanson, S. R., Frankel, R., Sagan, M., & Johansen, D. L. (2011). Private and public voice: exploring cultural influence. *Managing Service Quality: An International Journal*, 21(3), 216–239.
- Swimberghe, K., Sharma, D., & Flurry, L. (2009). An exploratory investigation of the consumer religious commitment and its influence on store loyalty and consumer complaint intentions. *Journal of Consumer Marketing*, 26(5), 340–347.
- Trombetta, W. L., & Wilson, T. L. (1975). Foreseeability of misuse and abnormal use of products by the consumer. *The Journal of Marketing*, 48–55.
- Tronvoll, B. (2007). Customer complaint behaviour from the perspective of the service-dominant logic of marketing. *Managing Service Quality: An International Journal*, 17(6), 601–620.
- Tsarenko, Y., & Rooslani Tojib, D. (2011). A transactional model of forgiveness in the service failure context: a customer-driven approach. *Journal of Services Marketing*, 25(5), 381–392.
- Williams, T. D., Drake, M. F., & Moran, J. D. (1993). Complaint behaviour, price paid and the store patronized. *International Journal of Retail & Distribution Management*, 21(5).
- Wysocki, A. F., Kepner, K. W., & Glasser, M. W. (2001). *Customer complaints and types of customers*. Citeseer.
- Yuksel, A., Kilinc, U., & Yuksel, F. (2006). Cross-national analysis of hotel customers' attitudes toward complaining and their complaining behaviours. *Tourism Management*, 27(1), 11–24.

### **Contact information**

Ms. Sayanti Shaw, M.Sc.

Department of Management and Marketing

Tomas Bata University in Zlín, Faculty of Management and Economics

Mostní 5139, 760 01 Zlín, Czech Republic

+420 776348221

sayantishaw@gmail.com, [shaw@fame.utb.cz](mailto:shaw@fame.utb.cz)

# BULL WHIP EFFECT IN THE FMCG INDUSTRY

*Diána Strommer*

## **Abstract**

The role of logistics is getting more and more in focus in the operation of enterprises. Nowadays cost reduction is also getting more important as a part of the fierce competition. Logistics can really make a difference in this field. To have it as a supportive function we need to pay attention on the performance connected to it. Logistics performance has several fields and indicators and it can be measured several ways. We can hardly concentrate on the financial points and find some fields to improve, but in long term thinking it is worth to include a wider range of metrics, to pay attention on other perspectives also which can influence the processing and performance of the supply chain.

Supply chain operation has several difficulties. One of the biggest issues is the bullwhip effect. As a result of the lack of communication, fear of shortage, price changes and several other obstacles the demand in different parts of the chain can highly differ from the end user's need. The bullwhip effect can increase the cost of the supply chain operation and with this the product cost will also increase. It can come out in warehousing, production, transportation etc. cost. It depends on the decisions made in the given part of the chain. At the end of the day it means that the company needs to work with higher price and it will be less competitive and lose market share.

In my research I check out an example of the bullwhip effect. I introduce the theoretical background and I also show how it occurred in a real life situation. In my research I check the operation from the distributor perspective and present a possible occurrence of the bullwhip effect in the sales order figures.

**Keywords:** *logistics, logistics performance, performance measurement, bullwhip effect*

## **1 INTRODUCTION**

The role of logistics is really important and becoming more and more in the focus of the operation of enterprises. Logistics is responsible for the synchronisation of production processes, the cooperation of components and also for the external contacts. Large amount of costs comes from that field and the efficiency also highly depends on it. In the globalised world cooperation is indispensable, mainly inside the supply chains. It causes that the importance of supply chain management highly increased.

As this field is quite important enterprises can win but also can lose a lot. A wrongly operating system generates losses, can double the operation costs and not able to fulfil the requirements, satisfy the customers. Conversely a proper operation has beneficial effect on the whole company. It can save money, time and effort. Supply chain management became one of the core elements of the growth targets. The processes inside are really complex and complicated, the collaboration became the essential part of the everyday work.

“If I can define it, I can measure it. If I can measure it, I can analyse it. If I can analyse it, I can control it. If I can control it, I can improve it.” (Sarada, Manjusmita, 2012, p.110)

This quote fully describes the importance of performance measurement. The enterprises have goals. They want to reach as effective operation as possible. To reach this the processes need to be measured. The results need to be analysed and that way the problem need to be controlled and solved with the execution of required changes. At the end of the day we need to improve the operation by building in the required changes.

In my research I worked with one of the pain points of the performance, the bullwhip effect. This phenomenon has huge impact on the logistics operation. As a result overstock, out of stock, higher lead time or other malfunctions can come out. This has huge cost related effect as well. As in my practical research I mainly introduce how bullwhip effect came out in practise I also introduced the theoretical background of it.

I also found it important to clarify the industry, because it has important impact on the processes. The FMCG industry's specifications are shortly summarised in a sub chapter.

My practical results

## 2 THEORETICAL BACKGROUND

In the following pages I introduce performance measurement. I present the importance of it and also the role in the companies' life. After I also show the causes and consequences of bullwhip effect as connected to logistics performance it has huge impact. I also make a short summary of the main features of FMCG industry as my research was made in a company in that sector.

### 2.1 Performance measurement.

Why is it important to measure the performance? It can be answered easily. It affects the behaviour of the supply chain performance. It provide information if the supply chain has degraded or successfully improved. (Lapide, 2000) Measurement in the globalised market became more important because it can drive to lower costs, growing profit and enhanced shareholder value. (Keebler, Durtsche, 2014)

If we want to make a decision about the efficiency of the supply chain we need to make measurements. These measures are not easy but they are necessary to support the strategy of the company. We can use a lot of different systems for this. These systems have different goal but there are some common things which are the followings: cost-efficiency, profitability, corporate social responsibility, deliver on-time, growth in sales, job security and working conditions, customer satisfaction, flexibility, minimalised loss and damage and product availability are achieved.

The performance and can be translated to three dimensions a following way: (Andersen, Fagerhaug, 2000)

1. Efficiency: the first dimension is about how the company or system can adapt the operation to the environmental needs and strategical needs.
2. Effectiveness: the second dimension is about how the system can be developed to reach higher success.
3. Changeability: the third dimension is about the awareness of changes and the claim of the adaption.

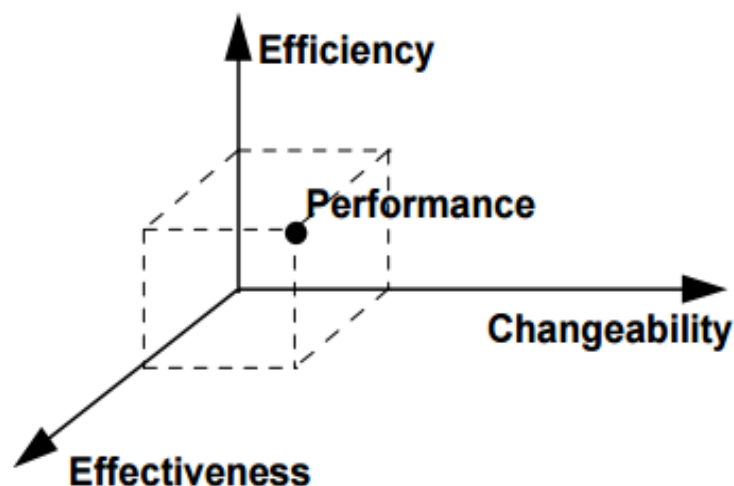


Figure 1 – The three dimension of the performance Source: Andersen, Fagerhaug, 2000

We need to find a proper tool, a good measure. What is a good measure contains? It is quantitative, so it can be expressed by numbers and it can be compared. It is easy to understand, which is stands for what the result express and also for the way it was delivered. It encourages the shareholders for the

appropriate behaviour, in the way the reward is a productive behaviour. The good measure is visible; the process is transparent and clear. It is defined and mutually understood by all of the key participant. It contains all the outputs and inputs. The measures focus on the key performance indicators that are of real value. They are multidimensional and show the trade-offs of utilisation, productivity and performance. (Keebler et al, 1999)

The measurement can have three functions: (Sarada, Manjusmita, 2012)

1. Informing: inform the managers to help the decision making processes out.
2. Steering: set the targets, evolve guidelines.
3. Controlling: they can be used as the part of the supervision.

To measure a performance of a company we not only need to have some tools or practice but we need to have a complex system required by the complicated working environment. In this system we collect, analyse and elaborate information with the goal of further development.

To reach development in the company life the goals needs to be clear. The measurement should be driven by the company's objectives. This makes it possible to support actions and opportunities during the improvement of the company. The system need to focus on short and long term results, needs to use different perspectives (such as competitor or internal), need to be used in different organisational levels. The company needs to use limited number or measures in a structured way. That is why the performance measurement tools and models are really helpful. (Sarada, Manjusmita, 2012)

The measurements are created for improve, to reach the goals. Therefore the measurement needs to be harmonised with the goals of the company. To reach the goal it is necessary to gain the effectiveness in operational level. (Lapide, 2000)

The following figure shows the way of the introduction of the performance measurement.

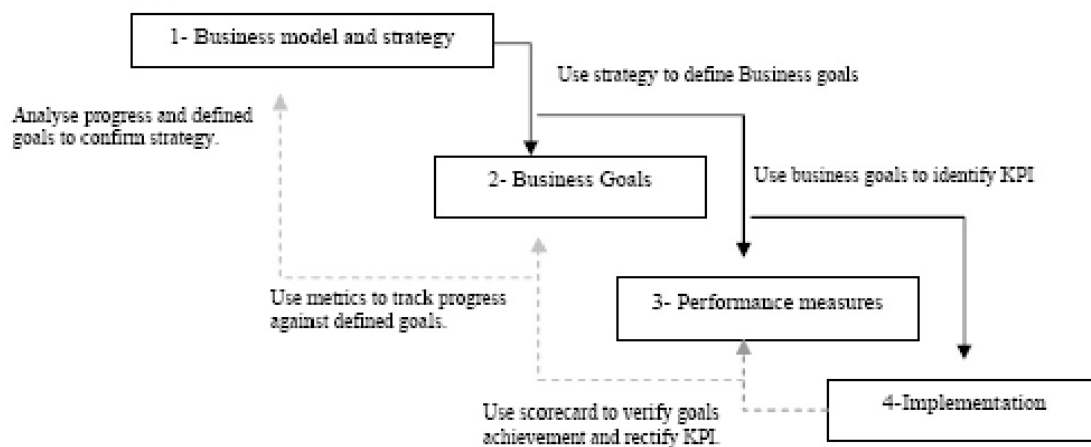


Figure -2 – The way of introducing performance measurement, Source: Lapide, 2000

First of all the company needs to be completely aware of the business strategy it follows. This indicates a set of goals helping out this strategy. To reach these goals a level of performance, operation is required can be measured by performance measurement tools and metrics. The business goals are the key elements in the creation of key performance indicators. The last step is the implementation.

Otherwise the first step is the implementation. Afterwards the verification of goals and recruitments of the performance indicators are coming. The metrics can be used for following-up the defined goals. At the end of the day the goals reached confirm and support the business strategy.

## 2.2 Bullwhip effect

The phenomenon was first realized by Procter and Gamble based checking the demand of Pampers diapers. There were significant gap between the demand and the supply of the product. It first came out



at the retail partner how stopped sticking to the end user's needs and raised the order. This effect as it went through the chain multiplied and the demand at the end of the change had no connection with the customer's need. (Hau, Padmanabhan, Whang, 1997) By definition the bullwhip effect is the amplification of order volatility along the supply chain. (Wang, Disney, 2016)



Figure 3 – The bullwhip effect. Source: Seifert, Isaksson, 2015

There are multiple reasons behind bullwhip effect. The main indicators are the followings: Forecasting is happening based on estimation in all part of the chain. These estimations are highly depends on the information flow going through the chain and the relationship and level of trust in the chain. This calculated amount is only means the basis and the safety stock is still increasing it. As a result the demand will be different in different elements of the chain. The batching of orders has also impact on the difference. Usually the ordering is not happing right after the need was generated but after a given amount of demand or time period. This also result peeks if the chains order management is not working on a common way. Prices change can also result the gap. (Hau, Padmanabhan, Whang, 1997)

Another important field is the fear of backlog. In our customer centric operation backlog is not acceptable. To prevent it the stock level is getting higher. As in the chain not always the end user is the customer it is true for each member so at the end the manufacturer receive unrealistic demand. As the needs are growing in the chain the lead time is also growing which result unpredictability which also feed the previously mentioned fear. The difference or gap will grow with the growing number of members in the chain. As it was mention before information and trust is really important, but at the end all of the companies are going for their own profit and goals. This makes transparent operation and common management hard. Usually the local goal is more in focus than the global one. The differences partial coming out in the organisation of operation. The inventory management and company processes can also differ company by company. If it is not chosen properly the conclusion can also be backlog or overstock. (Ranjan, Susmita, 2010)

The results are very serious and most of the cases also have financial consequences. One of the possible outcomes are the high level of stock which comes out in the chain in a multiplied way. The order can grow or decrease suddenly which means the capacity utilization is also problematic. As the processes cannot really been planned properly warehousing, production and other logistics related cost will grow significantly. The customer satisfaction can also decrease as the level of supply can be problematic. (Szegedi, 2010)

To measure the bullwhip effect we can compare the variance, ratio or difference between order and demand. If the order information is not available sales data, production numbers or shipments can be also compared. (Wang, Disney, 2016)

### 2.3 FMCG industry

First of all I would like to make it clear what FMCG industry means. FMCG stands for Fast Moving Consumer Goods, also known as Consumer Packed Goods. This industry contains a lot of famous brands like Dove or Coca Cola. These products are used in our everyday life, they are bought during our ordinary shopping. This industry contains several groups of food and non-food products such as paper products, personal care, consumer electronics, tobacco, alcoholic drinks, pharmaceuticals etc. (About FMCG, 2015)

These are non-durable products. The customers spend minimum time and effort on the procurement of these products. Even so marketing activity is really concentrates on them. The involvement of the customer is quite low but the possibilities are big, wide range of substitutes are available. (Majumdar, 2004)

The products can be categorised in three category: (Majumdar, 2004)

1. Staples: Consumed on a regular basis. For example toothpaste
2. Impulse goods: Purchased without any planning by external stimulus. For example chocolate bars.
3. Emergency goods: Purchased for a particular need. For example umbrella on a rainy day.

Various retail channels create the retail market of fast moving consumer goods industry. The FMCG companies provide to the retail sector essential consumption goods which are sold to households. The products are sold in several type of stores: non-specialised stores, tobacco, beverage, food stores, as cosmetic, pharmaceutical, toilet articles. With the modern technics they are also available by web shops, mail order houses. The products are sold not only on retail bases but also on wholesale. (Çelen et al, 2005)

These goods are fast moving because they are the ones leaving the supermarket shelves the quickest time. These specific items are relatively cheap and high volume is consumed. The demand is usually universal. These items are replaced frequently and not used in an extended period of time. The products are needed to be replaced at least on monthly bases. The sales of the products are highly supported and determined by promotion. The price fluctuation over a year is observable according to promotional and normal periods. The core point in the way of success of these products is the availability. They need to be placed in the shelves of most of the hypermarkets, supermarkets and also in grocery stores. The price is also an important factor. Because of the fierce competition the companies have to support the products with suitable and competitive prices. (fmcg.ws, n.d.)

The market of fast moving consumer goods is characterised by high sales volumes. Because of this reason the production of these products are manufactured in mass production, millions of tonnes are produced year by year. For the economical operation high sales volumes are indispensable. Because of the sales volume and the competition the products are also characterised by low margins. The marketers set the price as low as possible and the turnover is coming from the high volume of the sales. (Majumdar, 2004)

### **3 PRACTICAL RESULTS**

In my practical research I examined the effects when the company cannot deliver a product during a longer period. I was searching for the answer for the following question: What will be the reaction of the customers?

First of all in this case the customers are not the final users of the product who consume them at the end. The supply chain is examined from the distributor point of view, so the customers are retailers.

In the current situation the company was not able to deliver products to the customers. It was a six weeks long period out of stock. It was a foreseen problem, the supplier informed the company that there will be a delay in material supply. This information was sent out one and a half week before the shortage. So the customers could get information on time. All of the customers get the same information with the same timing.

I examined the reactions was given by the customer for the situation. I made groups of customers. During making these groups I took into consideration the specifications of the retail companies like size, order attitude, position, etc. The groups are the followings:

- Hiper 1: A hypermarket where the order is generated by the system.
- Hiper 2: A hypermarket with human involvement in ordering.
- Super: The category contains all the supermarkets.

- Discount: This category contains the discount stores.
- Traditional: The traditional trade contains all the little grocery stores can be found all over the country.

I checked the ordered amounts compared to the average weekly orders in two weeks period before the shortage. The average is based in a one year period orders. The result is visible on the figure 4. below.

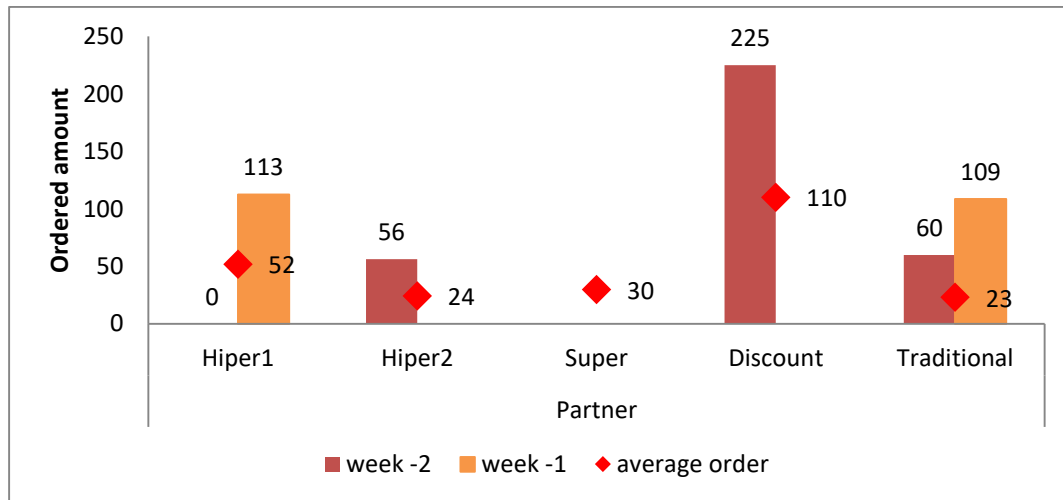


Figure -44 – Weekly orders compared to average amount

It is visible that the partners ordered over the average before the out of stock situation as it was expected. They built stock before the problematic period. There was difference in the stock building process. Hiper 1 only did this 1 week after the information flow. The missing order is also coming from the ordering process. This partner works with 4 week ordering process. There is always one week pause in every fourth week. For this partner the high order is not so frequent, so one week before the out of stock situation the high needs are coming from the successful information share, the stock building activity. Compared to the average ordered amount which is 52 cases this order is an outlier with 113 cases.

Hiper 2 ordered right after the communication. For this partner the average amount is 24 cases and the order is 56 cases. Here we can see the stock building. With this partner the communication went through faster. In this case the ordering process is based on the inventory level. This partner found the stock level proper for riding out the shortage, so there is no need for additional order right before the problematic period.

Super did not pay any attention on this need of stock building. Here the ordering process is based on the stock level. During the ordering process the information about the shortage were missed out. The partner was not prepared properly.

The Discount placed higher order two weeks before the shortage. The average order quantity is 110 cases the order amount was 225. This partner shows the highest fluctuation in ordered amounts. This high order can be the result of the shared message, but it is not sure. Order peaks are quite frequent in the procurement process of discounters.

The traditional trade is the only partner group with orders on each weeks. This is because of the composition of the group. For these partners fluctuation in orders is not really typical. The orders are usually around the average, which is 20-30 cases. This quantity is showing growth mainly because of promotions. In this problematic situation the orders were 3 times above the average. Here the stock building held up to two weeks.

The partners reacted differently. This shows that the partners understood the information in a very diverse way. There are various way of building the information in the ordering process.

The behaviour of the partners during the shortage is visible in the figure 5. below. The figure shows in cases the amount which was ordered by the partners during the out of stock period. It shows separately

the orders by partner and by week. The third dimension shows the ordered amount of the product in cases.

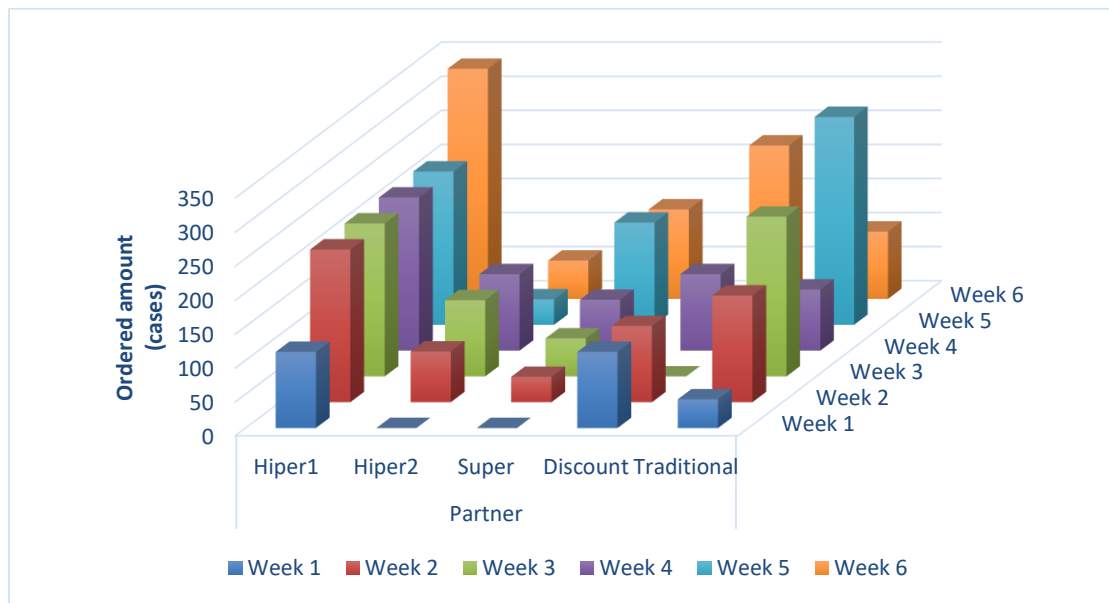


Figure -5 – Orders during the shortage

It is visible that the partners reacted differently. Hiper 1 ordered the double of regular amount the first week. As it was mentioned before the average order is 50 cases, here the actual order in the first week of the shortage is 100 cases. On the second week the order doubled. In the end after four weeks the order was equal to the sum of the first and second weeks order, it rose above 300 cases. It is because of the ordering system. The decisions are not made by a human, but a program. In the first week, the information of shortage was added, so the demand was low. Later on the original demand was placed, and after four weeks the system automatically made a bigger demand because of the long term absence of delivering. Here the four week ordering process changes a bit. We cannot see the one week 0 order gaps. This is because of the lack of delivering goods.

Hiper 2 reacted in a different way. In the beginning the partners have not ordered anything. Right after during a three weeks period the orders were three times higher than the average. The highest order was placed in the fourth week of the shortage (110 cases) It is visible that the information reached the partner totally only on the fourth week, because here the partner placed far lower orders than before.

In case of Super category continuous growth of orders is visible in the six weeks period. They ordered according to their stock level. The information was ignored about the out of stock in the decision making process. In this continuous growth every week we can see 1,5 time higher orders than in the week before. The orders reach a 150 cases peak which is five times higher than the average order quantity.

Discount stores order in a really hectic way. They are not paying attention to the information giving by the company. They use their ordering models and habits during the determination of the ordered amount. The ordered quantities are equal to the average amounts. They are around 110 cases.

Traditional trade as visible in the chart is not really consistent in the ordering process. This is caused by the structure of the segment. This group contains a lot of little stores. They have headquarters and the headquarters also have common distribution units and so on. In this system the flow of information is really difficult and slow. This justifies the reaction visible upwards. During the shortage they also reach 300 cases with the orders as hypermarket 1. The main difference is that traditional trade usually orders half as much as Hiper 1. These peaks here are really high.

When the stock cover got normal again it is also important to examine the effects of the long term shortage. Is there any fear in the customers? Do they expect any further shortage? It is visible if we check out their orders shown by figure 6.

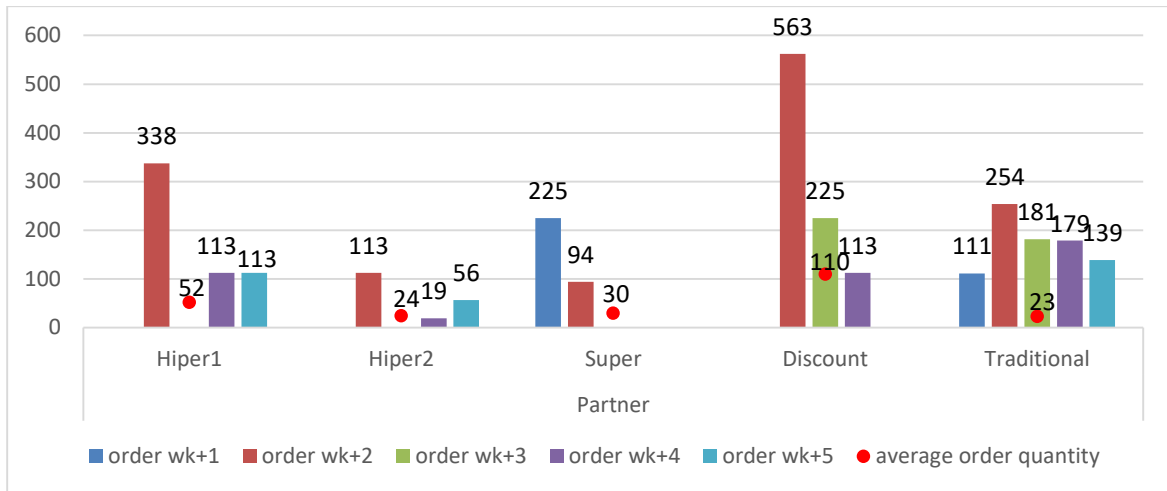


Figure - 6 – The period after the shortage

The figure shows the average amount. It is marked with red dots. This amount is the same as it was visible before in figure 6.

As it is visible in the figure the first weeks task was refilling the missing stock. The partners were informed about the end of the shortage. The fastest reaction came from traditional trade and supermarkets. They started to refill their stock. The supermarket partner ordered ten times the average amount, so the stock refill started with more than 200 cases. In the second week these processes proceed. The order was still three times higher than the average. Supermarket category here stopped the refill, they went back to inventory based ordering. For the traditional trade the first week order was really high. They could not fill back their inventory in the examined five weeks period. For this subdivided group it takes longer time to fill the stock back. As it is visible in figure their order started to decrease after the second week.

In hypermarket 1 category an outstanding order came in the second week after the stock availability. This quantity is six times higher than the average. This peak covered the demand for two weeks and after the partner decreased the demand and went back to the average ordered quantity.

In the second hypermarket category there is also a peak for the refill and the orders. This is five times higher than the average. After this partner also go back to the level of the average stock.

Discount partner run out of stock according to the numbers. The needed supply is far higher than the usual orders. Here we also can see five times higher order than the ordinary. Discount partner also needed two weeks to fill the stock.

During the shortage the reactions of the partners were really different. This comes mainly from the features of the industry and the ordering process. As I mentioned hypermarket one category use procurement program for placing the order. Here the human participation is really low. In regular bases this automated system works very effectively, it can fulfil the requirements. Although in a situation like this the system is not satisfactory. The partner should give higher human input in this given period to the system to avoid the lost sales. The placed orders which were higher and higher cannot solve the problem at all. In the given situation the human participation was not enough in this stock building period. In long term without any further problem the operation of the ordering system could be satisfactory. In the current situation an important moral of the fable is to find out the limitation of the system.

## 4 CONCLUSION AND NEXT STEPS

Through the example we could see how easily bullwhip effect can come out in a chain. This research was done from the distributor point of view. It is presented as the customer of the manufacturing site which has a problem with suppling and also a contact link between retail partner and the production. As the retail partner has no chance to fill their stock they raised their orders, even if there were

communicated that they cannot fulfil their needs. At the end it meant that the manufacturer get continuous feedback on the need ignoring the warning and information which was sent out. So during the issue the end users' needs and the orders in the chain were not in the same level.

It is also visible that the retail partners are handled the problem in a very different way. This can be explained by the communication differences. Even if the same information was shared the connections and communication is still can differ partner by partner. What is more the IT background (ordering program) can also generate unreal stock level. We could also see that different methods are used in the retailers to determine their stock level and needs. This also resulted that they reacted diverse way.

Based on the practical research we can see that the bullwhip effect has huge impact on the performance. Out of stock cost a big loss for the company. It also affected the reputation as in long term the partners can decide to choose substitute products what is very dangerous in this industry.

As a continuation of this research I will also work with seasonality. As most of the products in FMCG and even in other industries have some kind of seasonality we need a method of handling it and an approach to use the capacity in a proper way in this case as well. Seasonality can have huge effect on performance and the imperfect capacity usage can result huge additional costs.

## **Acknowledgement**

I would like to give special thanks to The Ministry of Human Capacities. This essay could not be created without their help. Supported by the únkp-16-4 New National Excellence Program of the Ministry of Human Capacities.

## **References**

Andersen, B. & Fagerhaug, T. (2000): Performance Measurement of Logistics Processes. online available:  
[http://www.researchgate.net/publication/229044388\\_Performance\\_measurement\\_of\\_logistics\\_processes](http://www.researchgate.net/publication/229044388_Performance_measurement_of_logistics_processes), downloaded: 2015.03.24.

Basu, J. R. & Wright, N. (2008):Chapter 19 – Supply chain performance, Total Supply Chain Management, 2008, Pages: 335-357

Böhma, A. C., Leonea, H. P & Henningb, G. P (2007): Industrial supply chains: Performance measures, metrics and benchmarks, Computer Aided Chemical Engineering, Volume 24, 2007, Pages 757–762

Çelen, A. Erdoğan, T. & Taymaz, E. (2005). "Fast Moving Consumer Goods Competitive Conditions and Policies" (PDF). Economic Research Center, Middle East Technical University. Retrieved 2007-07-09., p.2-4

Ducq, Y. & Berrah, L (2009): Supply Chain Performance Measurement: management models, performance indicators and interoperability, IFAC Proceedings Volumes, Volume 42, Issue 4, 2009, Pages 2053–2058

Humphries, A.S. & McComie, L. (2010): Performance measurement in the management of food supply chain relationships, Woodhead Publishing Series in Food Science, Technology and Nutrition, 2010, Pages 19–36

Isaksson, O. H. D. & Seifert, R. W (2015) "Quantifying the Bullwhip Effect Using Two-Echelon Data: A Cross-Industry Empirical Investigation," forthcoming in the International Journal of Production Economics.

Keebler, J.S. & Durtsche, D.A. (2014): Logistics Performance Measurement and the 3PL Value <http://logisticsquarterly.com/issues/7-2/article1.html>, downloaded: 2015.06.02.

Keebler, J. S., Manrodt, K. B, Durchette, D. A., & Ledyard, D. M. (1999): Keeping score: measuring the business value of logistics in the supply chain, CSC, The University of Tennessee

L. Lapede (2000): What about measuring supply chain performance? Supply Chain Excellence Through Technology, online available: <http://ftp.gunadarma.ac.id/idkf/idkf-wireless/aplikasi/e-commerce/lapede.pdf>, downloaded: 2015.11.01.

Lee, H. L., Padmanabhan, V., & Whang, S. (1997), The bullwhip effect in supply chains. Sloan Management Review, 38(3), 93–102.

R. Majumdar (2004). Product Management in India. PHI Learning. Pages. 26–27. ISBN 978-81-203-1252-4

Ranjan, B. & Susmita, B (2010): A review of the causes of bullwhip effect in a supply chain. Springer-Verlag London Limited 2010

Sarada P. P. & Manjusmita Dr. D. (2012): Study of Performance Measurement in Logistics management, Indian Journal of Research 2012 march 110.page

Z. Szegedi (2012): Ellátási lánc menedzsment, Kossuth publisher, Budapest

Sarana, M. & Mason, R.J. (2006): The alignment of collaboration and the importance of integrated performance measurement, 2nd I\*PROMS Virtual International Conference, Pages 45-51

Wang X. & Disney S.M. (2016): The bullwhip effect: Progress, trends and directions, European Journal of Operational research, 1 May 2016, Pp 691–701

About FMCG (2015): What is the FMCG industry? online available: <http://www.about-fmcg.com/What-is-FMCG>, downloaded: 2015.09.15.

Fast moving consumer goods. online available: <http://www.fmcg.ws/>, downloaded: 2015.09.15.

U.S. Department of State (2005): How we access performance. online available: <http://www.state.gov/s/d/rm/rls/perfrpt/2005hlts/html/57960.htm>, downloaded: 2015.09.10.

### **Contact information**

Diána Strommer, PhD student

Széchenyi István University, Multidisciplinary Doctoral School of Engineering Sciences

1078, Budapest, Marek József u. 13

+36306322282

dianastrommer@gmail.com

# MODELS OF SOCIAL HOUSING IN STRATEGIC PLANNING

*Petr Štěpánek*

## **Abstract**

Despite the key importance of housing as a stabilizing social factor, the field of its spatial modelling isn't in Czech Republic a subject of any extensive research. In connection to the Social Housing Act in due process, it is necessary, considering the economic and social sustainability of the subsidized development, to specify more accurately the characteristics and qualitative standard of such buildings. The topic of the paper is, on the basis of harmonized spatial, social and economic requirements of different levels of social housing (emergency, social and affordable) and development character (new buildings as well as re-use of existing housing stock), to create models, the characteristic of which can serve as referential frame for qualified planning and procurement of such projects.

**Keywords:** social housing, strategic planning, economic and social sustainability.

## **1 INTRODUCTION: THE SOCIAL HOUSING AND THE HOUSING FINANCIAL SUPPORT LAW**

### **1.1 New legislative framework for social housing support**

A comprehensive and often broad-spectrum housing support is based on a social sustainability policy in many countries (i.e. Austria, Germany, Netherlands, France). In the Czech Republic, although in some parameters (i.e. support for the reduction of the energy intensity of family houses and apartment buildings) we are approaching Austria, we have currently no legislative framework to formulate the parameters of social housing and parameters for recipients of social housing. The responsibility for providing social housing that corresponds to the social sustainability policy hasn't been defined yet. Support for social housing is uncoordinated.

The draft of the "Social Housing and the Housing Financial Support Law" was approved by the Government on March 8th 2017. It was submitted by the Minister of Labour and Social Affairs, by the Minister of Human Rights, Equal Opportunities and Legislation and by the Minister of Regional Development. The attitudes of the ministries to the law varied diametrically and were outweighed by the concept of the Ministry of Labour and Social Affairs. Now the law is waiting to be discussed (and will probably be approved) in the Chamber of Deputies of the Parliament of the Czech Republic.

Objectives and risks of implementing the new law

One of the goals of the Act is to define the responsibility of municipalities to provide affordable housing. This obligation is accompanied by subsidies for construction and investment. The immediate consequence of the envisaged approval of the Act will be the decision-making on the form of these investments in hundreds of towns and municipalities of the Czech Republic.

The spatial and technical parameters of the provided social housing result from the sociodemographic, social and other parameters of the beneficiaries. The way of securing social housing will result mainly from the price map of the location. The starting point is the price of a new real estate - usually an apartment building - with adequate spatial and technological parameters.

A fundamental reason for applying the methodology is also the problematic legal status of members of municipal councils. Their decision-making involves material or even criminal responsibility. Legal uncertainty and the risk of possible criminal prosecution in recent times often make decisions by municipal representations about investment limited. The  $N_{met}$  methodical tool is a valuable argument for them. However, the result is always the provision of housing corresponding to the physical parameters.



## **1.2 Issues of (social) housing in strategic urban plans**

More importantly, however, is the inclusion of sustainable housing issues in strategic urban plans. Smart city concepts, public space humanization trends and the need to ensure the economic sustainability of settlements through the integration of their commercial and residential functions assume a sufficient level of social cohesion. An example of Vienna, Copenhagen, Barcelona, German and Dutch cities shows that this path is right.

Strategic plans were often only formally processed in the past. Their existence, among other things, made it possible to draw European funds. Consequently, their content has focused mainly on infrastructure investments. Today, economic sustainability, competitiveness and social cohesion are central to strategic planning. This objective can also be achieved by sophisticated support for social housing and, naturally, the public space tied to it.

Transparent decision-making methodology is also important for democratic participatory processes. The quality of participation in the Czech Republic is negatively determined by the deficit of the knowledge of the subject of the discussion and of the relevant methodologies describing the public interest.

## **2 ROADS TO PROVIDE SOCIAL HOUSING AND DECISION MAKING PROCESSES**

### **2.1 The influence of the price real estate map on the form of implementation of the laws on social housing and public interest**

The market price of apartments in the Czech Republic, however, depends mainly on the locality. In some localities (e.g. Most, Chomutov, Sokolov districts), the cost of the unit is usually around 250,000 CZK. In the capital city, the price of an apartment of the same quality is about 20 times higher. This implies the need for analytical methodology for the decision-making processes of public investors in social housing.

While the price for a new construction or reconstruction (especially if it's conditional on selection and management by a public investor and implemented on the land of the municipality) is determined by the project parameters (construction, terrain, geological conditions and location, used materials) based on and in respect for spatial models, the value of the purchased property will vary in dependence on the particular location, not only in the context of the Czech Republic, but also in the given place of residence, which is absolutely essential.

Municipal representations will decide between construction, reconstruction and purchase of real estate. This decision will also be influenced by the public interest and the cross-sectional paradigm of social and environmental sustainability and the need to take into account the quality and value of public space. This approach should be taken into account in the preference of investment interventions in the public space and the preference of cross-sectional social housing models.

## 2.2 Selection of optimal solutions for social housing

The hypothesis formulations are as follows:

- a) In some cases (e.g. structurally affected regions), it is best to provide social housing only by buying cheap, easily accessible apartments. In such cases, the price of the apartment is often not even the cost of the reconstruction, nor does it include the cost of the land. Economically optimal, therefore, is the need for social housing to deal with the purchase of an existing housing stock, or to supplement it with a reconstruction.

The potential for investment in the public interest can then be focused, for example, on revitalizing and improving the public space.

- b) On the contrary, in large cities where the price of apartments is extremely high, it is optimal to saturate the need for social apartments by reconstructing a housing stock owned by the city or by building on land owned by the city.
- c) In all parts of the regions, there are all options, among which it is necessary to decide and to take into account not only economic but also public interest.
- d) The lower boundary of the new construction is (unlike the purchase of the existing real estate) non-negotiable and often higher than the model (minimum) price comparable to the spatial models.

However, the decision-making scheme must take into account the public interest in choosing this option (spatial plan, quality of public space, architectural quality, social economic aspects).

- e) In terms of social cohesion and sustainability as well as the reputation of the locality, the quality of the public (not exclusively physical) space is greater than the disproportion in the quality of the individual dwellings.

This problem solves a consistent policy of the social mix much more efficiently than increasing building investment lines.

The team led by dr. Lux, which addresses the social and economic aspects of social housing in our research project, concluded: If we perceived, that the Czech Republic as the only statistical unit, social housing would be paid in small municipalities (up to 5,000 inhabitants) because the purchase of a flat on the secondary market is not financially more advantageous than the construction of comparable flats. In medium-sized municipalities (20-50 thousand inhabitants), social housing would not be paid for, because the purchase of a flat on the secondary market is financially more advantageous than the construction of comparable new flats.

Large cities (over 100,000 inhabitants) would be paid to pay for social housing; Acquisition of an apartment on the secondary market is financially less favourable than the construction of comparable new dwellings under these conditions.

However, this general rule will not always apply, especially the prices of purchased properties in the structurally affected regions.

### **3 PUBLIC INTEREST - ITS DEFINITION, QUANTIFICATION AND EVALUATION IN THE FIELD OF SOCIAL HOUSING**

#### **3.1 Methodological framework**

Defining public interest is not easy. Public interest parameters are determined politically, regionally, historically, etc. The core pillar for codifying the public interest is the company's value system. The community, which is able to formulate its value system, easily realizes its participative, planning and control roles.

The innovative aspect of the methodology is the emphasis on achieving the maximum possible public interest in deciding on investment in social housing. Public interest is then defined by cross-sectional paradigms of quality of life, sustainability and benchmarking (or even general competitiveness). The methodology is based on the evaluation of a set of hierarchical or quantified economic, environmental, social, technological and architectural indicators.

If the decision model is to function, it must be comprehensible, transparent and easy to use. In smaller settlements there is a workable model based on the set of criteria, big cities can not do without partial cost-benefit analyzes for individual parts of the investment.

A fundamental reason for applying the methodology is also the problematic position of members of municipal councils whose decision is tied to material or even criminal responsibility, and the  $N_{met}$  methodical instrument is a valuable argumentative tool for them and which, in recent times, has often limited the municipalities' decisions on investment.

At the same time, this methodology has the potential to contribute to improving the preparation and updating of strategic plans of settlements and regions which - in addition to making EU funding available - are increasingly perceived as key planning documents and their quality (also because they do not reflect Specific legislative framework) derives from the ability of a holistic approach to their processing, but also from the associated participative process.

The starting point for comparing the value and impact of an investment to saturation of the need for social housing in the municipality is a spatial model taking into account the necessary quality and size of the property. Here is usually possible to ensure:

- new construction,
- Purchase of already completed real estate (and its possible reconstruction)
- or reconstruction of real estate owned by the municipality.

However, the result is always the provision of housing corresponding to the physical parameters

While the price for new construction or reconstruction (especially if it is conditional on selection and management by a public investor and implemented on the land of a municipality) is determined by parameters of the project (the demands of the building, the terrain, the geological conditions and the locality, the used materials) based on and with respect to spatial models, the value of the real estate acquired by the purchase will vary depending on the particular location not only in the context of the Czech Republic, but also in the given locations, and it is absolutely essential.

#### **3.2 Links to other strategic and methodological documents**

Methodological support for the formulation of indicators are the following sources:

- Strategic documents of the Government of the Czech Republic,
- strategic documents of settlements and regions, smart city projects,
- methodology of the National Network of Healthy Cities,
- methodology of the Concept of smart cities,
- foreign methodologies such as the Morgenstadt CityLab index,
- sectoral and field studies addressing partial issues of spatial planning and urban planning, available research and final work,

- codification of supporting economic, especially subsidizing instruments, which can be used in the implementation of social housing concepts from the public sector (subsidy titles of the Ministry of Regional Development, Ministry of the Environment, Ministry of Labor and Social Affairs), banking products (loans and supported loans from EIB, ERSTE, ČMZRB)
- experience with other administrative tools (i.e. privatization of housing stock) in relation to different ownership forms of housing,
- IRI real estate indices,
- European indicators ECI,
- methodical risk analysis / CBA basis.

Hierarchical structuring and quantification of the impact of all relevant determinants and indicators that influence decision-making on the form, scale and financing of housing (social) housing is verifiable on model pilot examples.

### 3.3 Evaluation framework

Indices of public interest  $I_{pn}$  can be defined to any extent (from an arithmetic point of view), the significance of sub-items is then reflected in the index size.

Public interest can be formulated (and then quantitated) using indicators from the area:

- economic sustainability,
- social sustainability and cohesion,
- environmental sustainability,
- quality of life
- the quality of public space,
- innovation,
- the role of local self-
- community,
- local specifics and priorities, etc.
- or by benchmarking of reference locations, regions, locations or projects.

Indicator is the obtained and supported information (not always quantitative) providing a plausible measure of a certain phenomenon, which may include partial components generating, as a result, simplified and possibly aggregated values.

The indicators can then be divided into:

- aggregated (evaluates multiple processes and phenomena and includes more, often not quite homogeneous, components) in one indicator);
- specific (local, community, focusing primarily on quality of life);
- indicator sets (set of customized indicators),
- participative (communication, serving for public presentation),
- program / evaluation (designed with respect to specific objectives).

The applicability of indicators is then limited by their significance, representativeness, uniqueness and measurability, cost of data acquisition, information and monitoring, relevance/error rate.

In the case of decision-making processes related to social housing, we focus on indicators at the level of settlements and regions.

The presented methodology is unique in view of the integration of commonly used indicators (e.g. sustainable development) with those that take into account the specifics of architectural practice and spatial planning and, above all, innovatively formulate public interest amongst others in connection with the improvement of the public space in the broader sense.

The use of this part of the methodology in the decision-making and planning process is evaluative, with the use of the evaluation method:

- internal (i.e., implemented), alternatively mixed,
- formative (i.e. before the start of the project),

- using the primary data of the investor as well as secondary data concerning the territory of other spatial, environmental, social and economic contexts

The methodological evaluation respects the main evaluation criteria, so-called rule 5U (in Czech): usefulness, effectiveness, economics, usefulness, sustainability.

These criteria are then assigned to determinants influencing economic analysis and decision-making processes on the form of social housing provision.

The list of determinants that influence economic analysis and decision making on the form of social housing provision should include in the methodology itself:

- Indicator / Component Name
- Meaning (scale, (not) conditioning)
- Quantification / identification of performance, type of measure
- Link to other policies / strategies

An extended description of the evaluation determinants then describes:

- Specification of the subject of evaluation
- Context description
- Description of the evaluation procedure
- Criterion's justifiability, link to other documents
- Validity of information
- Reliability of information
- Method of evaluation of information
- Ensuring impartiality and justification
- Meta-evaluation

## **4 EVALUATION INDICATORS OF PUBLIC INTEREST**

The table summarizes the indicators that are relevant to be considered when assessing the project intent. They can be hierarchized and quantified using a scale (1-2-3) or a simple binary evaluation (met / unfulfilled).

General This evaluation can justify and legitimize the decision to generous public investment than eg. The simple purchase of cheap apartments.

### **4.1 Examples of economic / cost indicators**

- Public support / de minimis (lower investment will allow the drawing of a grant or facilitate the selection procedure).
- Possibility to apply the appropriate form of public support.
- Compliance with cost-benefit analysis.
- Positive Benchmarking (Similar Buildings, Site Price), deviation from other (alternatively, aplacy of other / index, etc.) method.
- Effect of Naegeli method.
- Increase in the value of surrounding plots.
- Tender procedures beyond the scope of the Public Procurement Act
- Sponsorship of non-public / OoB co-financing.
- Real Estate Market Vector
- Application of the yield method (in relation to the lease)
- Involvement of SME sector
- Further equipment of the apartment

### **4.2 Examples of economic / cost indicators**

- Architecture quality (compliance with the conditions of architectural competition - the argument of the extension of the cultural heritage). Awards.

- Rescue of a valuable historical building (it concerns mainly reconstruction, rarely buying).
- Improving and cultivating of public space (compliance with the public area manual).
- Influence on the value of public space (master plan). Integration into a contiguous, compact territory.
- Connection to public transport. Walking distance, traffic junction, multiple types of public transport
- Integration into a protected area.
- Implementation of BAT (best available technologies) or SBT (smart building technologies).
- Collaboration with the university / VVI sector in the design.
- Standard for handicapped.

#### **4.3 Examples of social indicators**

- Social cohesion (social mix condition)
- Impact on social sustainability.
- Provision of housing for professions providing public interest (can be quantified by the difference in wages in the partial CBA).
- Keeping jobs in the region.
- Ensuring the demographic sustainability of the region. Potential of community creation.
- Effect on the economic sustainability of the site (services, ground floor).
- Increasing the availability of workforce. .
- Improving the quality of human resources (from the point of view of education).
- Increasing the potential for centers of community activities.
- Increasing service availability
- Production / production link at site (?)
- Security impact.
- Shared Infrastructure
- Potential for brand headquarters and tourism
- Managing an object on a personal responsibility basis
- Implementation of participatory activities beyond construction management, definition of architectural, energy and environmental objectives.

#### **4.4 Examples of social indicators**

- Impact on the environmental value of the site / green infrastructure.
- Improving Waste Management (Waste Quality).
- (No)Occupation of agricultural land.
- Impact on the climatic value of the site. Prevention of urban heat island (specific measures).
- Effect on energy sustainability (Quantifiable - primary energy, heating / cooling energy requirement, CO<sub>2</sub> equivalent). Carbon foot.
- Rainwater Utilization.
- Use of renewable energy sources.
- Impact on the availability of additional environmental infrastructure.
- Impact on the value of the technical infrastructure.
- Extending the potential of shared infrastructure
- Green roofs and facades
- Promoting sustainable mobility
- Recycling index.

## 5 CONCLUSION

There are many risks to the implementation of the Social Housing Act. One of them is that - in spite of large public investment - it will not fulfill its function. The threat of social exclusion is less dependent on the quality of the living space itself. For less technologically ambitious developers it is easy to build new housing units funded by public budgets. However, if the criteria described below aren't met, a new social ghetto may arise. More important than the qualitative parameters of housing itself is the social and economic sustainability of public space. A thorough analysis and effort to codify the local public interest should be an obvious part of strategic planning.

### Acknowledgement

The paper presents partial results of the research project (supported by Technology Agency of the CR - Omega programme) „Models of Social Housing, their spatial parameters and qualitative criteria“ processed at Czech Technical University in Prague.

### References

- Císař J. & Rektořík J. *Ekonomika bydlení I*. Brno: Masarykova univerzita.
- Further research results „Models of Social Housing, their spatial parameters and qualitative criteria“.
- Lux M. & Burdová P. (2000). *Výdaje na bydlení, sociální bydlení a napětí na trhu s bydlením*. Studie Národohospodářského ústavu Josefa Hlávky 2/2000. Praha: Národohospodářský ústav Josefa Hlávky.
- Lux, M. *Bydlení - věc veřejná :sociální aspekty bydlení v České republice a zemích Evropské unie*. Vyd. 1. Praha: Sociologické nakladatelství, 2002.
- Maier K. & Čtyroký J. (2000). *Ekonomika územního rozvoje*. Praha: Grada Publishing.
- Oxley, M. & Smith, J. (1996). *Housing Policy and Rented Housing in Europe*. London: Chapman and Hall.

### Contact information

Ing. arch. Ing. Petr Štěpánek, Ph.D.  
Czech Technical University in Prague  
Kolejní 2637/2a, 160 00 Praha 6, Czech Republic  
+420 602 555 040  
[petr.stepanek@cvut.cz](mailto:petr.stepanek@cvut.cz)

# MODERN STATE OF INSURANCE MARKET IN AZERBAIJAN REPUBLIC

*Talishinskaya Gunel*

## **Abstract**

Insurance - this is the sector of the economy, without which it is impossible to create a social state, with developed market relations. The presence of sustainable insurance market - a significant component of any successful economy. According the Harold D. Skipper, Jr. (2001) every country has insurance and its role varies depending on the economic, political and social conditions of each country. The insurance business, inherent in any economy, that operates on a market basis in recent years have a significant development in Azerbaijan. This is evidenced by the establishment of several dozens of insurance companies, the emergence of many new types of insurance, previously unknown in the domestic economy. In this paper, we discuss the current state of insurance and development of insurance companies of Azerbaijan Republic on the basis of statistical data.

**Keywords:** *Azerbaijan, insurance companies, risk, insurance markets, premiums, payments.*

## **1 INTRODUCTION**

All over the world in the developed national economies emerged a powerful financial services industry. Such financial processes (which have become irreversible) occur in Azerbaijan too.

The primary link, where leaking these processes, represents the economy unit: the insurance organizations, banks, financial institutions, etc. The corresponding such processes the scope of activities is called "corporate finance", and the management of cash flows has turned into financial management. Financial management seeks to achieve a stable financial situation of the company to expand and contribute the volume and range of the proposed insurance products. At the same time that the factors affecting the activities of Insurance companies, allows more detail and carefully take into account all the risks and to take measures for their timely reduction.

The economic essence of insurance is that the insurance is a system of economic relations, which includes a set of forms and methods of the formation of the trust funds, cash and their use to reparation in the various risks as well as for the provision of assistance to citizens when certain events of their life. In the economy, the insurance is on the one hand, the means of protection of business and the well-being of the people and on the other - income-generating activity. According Peter Zweifel, Roland Eisen (2012) the main role of insurance we can also derived from its economic functions. The economic functions consist of 6 various ways, which are: improving the distribution of risks, the protection of existing wealth, the cumulative capital, financial resources mobilizing, to ensure the management, to facilitate the public purse.

According to Felix Hufeld, Ralph S. J. Koijen, and Christian Thimann (2017) Insurance is the business of accepting insurable risks, managing them, and providing compensation for possible losses. Risk is the possibility of actual damage, injury, liability, or loss of existing value or status (property, health, life) as a consequence of an external event.

Insurance market - this sphere of economic relations, where the object of sale is the insurance coverage. The basis of market development appears assured reproduction - providing services to victims. As a prerequisite, the existence of the insurance market - there is a requirement for insurance and the insurer, that the insurance company becomes one of the subjects of the economic life of society. Regardless of the form of ownership and specialization in the insurance markets, insurance is subject to the law of value, the law of supply and demand. In all the countries with developed market economies there is no material or property interests, not secure insurance. The provision of transparent and useful information on the business entities and of their transactions is a prerequisite for an effective market economy. The minimum requirements for disclosure of information determine the quality and quantity of information that should be provided to the participants of the market and society as a whole. Government is also



considering the quality of the financial information disclosure of the subject of management as the priority status of the market.

## **2 THEORITICALBACKGROUND**

In the modern economy insurance supports the role of the financial stabilizer to compensate for damages to society, due to unforeseen random events, which are harmful to the state, business and people.

Insurance in Azerbaijan is still in the formative stage. This is evidenced by the number of companies and the volume of premiums collected by them. The volumes are growing, the quality of insurance products is improving, the market is constantly initiated new services, much attention is given to vocational education training. By the way, the success of some companies encourages the desire to growth lagging companies. The analytical data are also used for the development of strategic plans for the evolution of Insurance Companies, which may include the development of new types of insurance, new markets, the creation of new investment and financial schemes (Aliyeva L. 2011).

Today insurance is one of the fastest growing industries of the non-oil sector of the economy of Azerbaijan. In recent years, have been made serious reforms in the country's insurance market, which contributed to its development. The main changes are an increase in the minimum amount of the aggregate capital of insurance companies.

According to the information of Ministry of Finance of Azerbaijan Republic in 2015 year the amount of requests the aggregate fund of insurance companies operating by types of non-life remained at the level of 5 million AZN. At the equal level was formed the least possible size of fund of a new insurance company engaged in non-life insurance types. By January 1, 2015, the minimal size of capital of life-companies of Azerbaijan was 6.5 million AZN, from January 1, 2016 - 8 million AZN, from January 1, 2017 – increased to 10 million AZN. At the same level (10 million AZN) should be formed the least possible size of overall fund of the new life-company. Also, if the requests for a minimal size of the aggregate capital of reinsurance companies was 10 million AZN, it has been grown to 20 million AZN. Respectively, from March 1, 2014 the least possible size of fund of the insurance companies desiring to get a permission for reinsurance activity surpassed the minimal requirements for insurers by 2.5 million AZN, and from January 1, 2015 - by 5 million AZN.

Considering the structure of the authorized capital of all operating companies we can not ignore Pasha Insurance Company. Today, the share of Pasha Insurance in the total authorized capital of all insurance companies of the country is about 20%. It should be noted that the size of the equity capital of most companies is only slightly higher than the limit (5.5 million AZN), which, with increasing unprofitability, will inevitably affect their solvency.

Solvency is the most important indicator of the reliability of the insurance company, its financial stability and, consequently, the main indicator of the company's attractiveness to potential customers. In drawing up the rating of insurance companies, the solvency index is placed on the first place among other reliability criteria.

The finance of insurance companies provides its activities in the provision of insurance protection. Insurer generates and uses the insurance fund, covering damage the insured and financing its own costs for the organization of insurance business. In addition, in the market conditions, the insurer, as a rule, is engaged in investment activities, using a part of the insurance resources and own resources. As a result, the revolution of cash insurance is more complex than the companies in other sectors of the economy.

Insurance organization like any other business structure must remove from the activity a certain income. The income of the insurer is called the aggregate amount of cash flows in his account as a result of insurance and other not prohibited by the legislation of the activity. The mechanism producing the composition and structure of the income of insurance companies reflect the industry-specific and strategy of each individual enterprise. An insurance company may have income from insurance operations, investment and other operations (Sherbekova V.A., Kostyayeva E.V. 2009).

The main source of revenue for the insurance organization is investment activities which is carried out by use of the part of the insurance fund for commercial purposes. Despite the fact that the purpose of the insurance business is the provision of services, which are of great social importance and purpose of investment is making a profit. On the one hand, the insurance fund is a source of financing for investment activity, on the other hand, the profit from the investment activity may be directed to financing of the insurance operations: subsidies to unprofitable types of insurance, training for the staff, the evolution of development new types of insurance and others (Khudiyev N. 2001). The risky nature of the movement of the insurance fund also affects the investment activity, making serious demands on the liquidity of the invested funds. In order to avoid risks of causing major losses and obtaining income, each insurer must determine an effective investment policy that meets the requirements of The Law of the Azerbaijan Republic "About the Insurance Activity" (2007), adequately reflecting the structure of the insurer's liabilities, and carry out activities according to this Law.

Income from insurance operations is based on insurance payments. The insurance payment is the price of the sale of the insurance service, which should be distinguished from the calculation price. The cost of the insurance service is objective, and the price is formed under the influence of a number of factors: market conditions, state price policy, monopolistic agreements of insurers, dynamics of interest rate for credit, etc.

### **3 DATA AND DISCUSSION**

Each year the amount of the insurance market in the country is expanding, and its members, respectively, gain strength and experience. In the country, along with voluntary kinds of insurance are successfully developing all kinds of mandatory. This allows both insurers and regulators of the market from one year to come up with positive comments and a detailed statistical report on the growth indicators.

The current state of the insurance market in Azerbaijan can be defined using certain indicators that characterize its condition. According to the information of Azerbaijan Insurance Association from following figure we will discuss the premiums and payments of the insurance companies of Azerbaijan Republic during 2012 and 2016 years

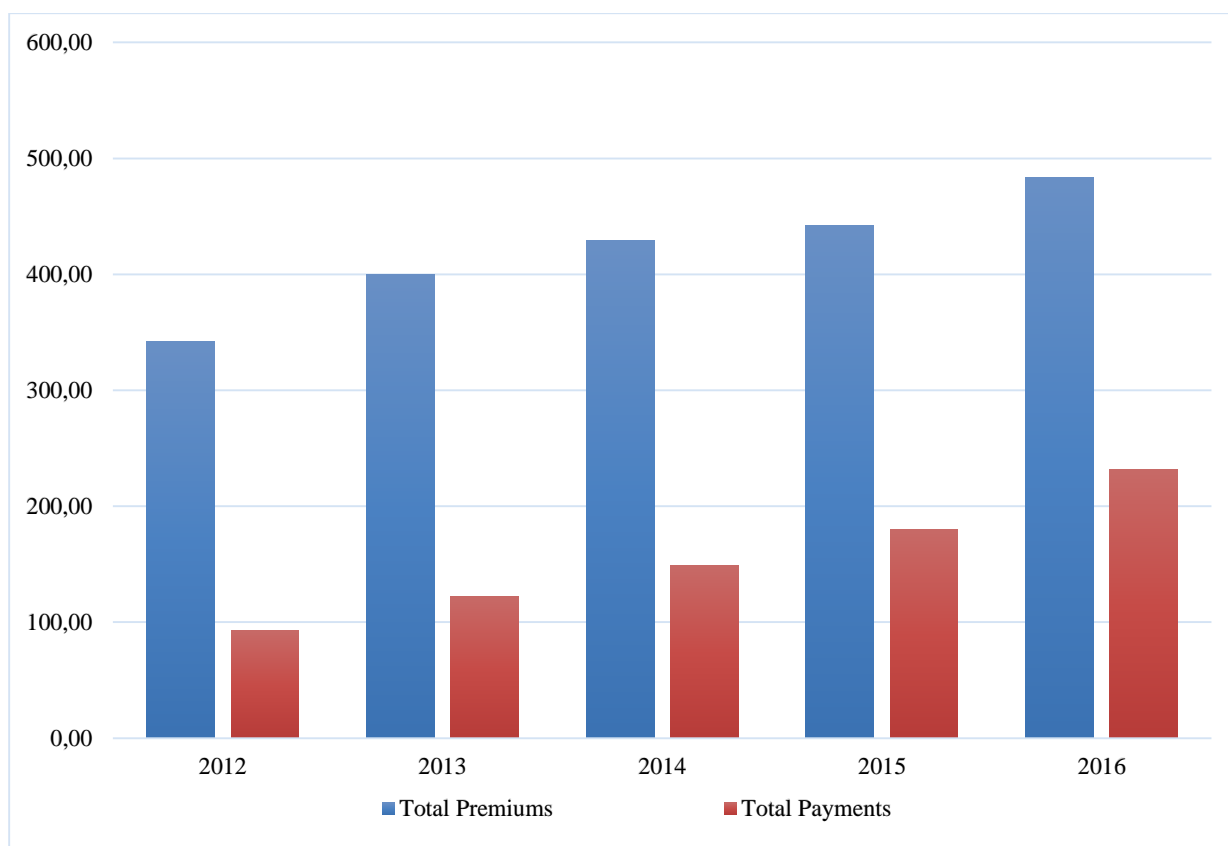


Fig. 1 – The dynamics of Insurance premiums and payments of Azerbaijan Insurance Companies in 2012-2016. Source: The statistical data of AIA

From the statistic data of insurance companies we noticed that the total premiums of companies in 2012 reached 342,5 million AZN, when total payments were – 93,8 million AZN. But compared the amount we can see that the premiums in 2013 increased and were – 400,5 million AZN, total payments – 122,8 million AZN.

The total amount of insurance premiums for 2014 compared with the same period of 2013 increased by 5.8% and amounted to 429,2 million AZN, which is equivalent to 263,0 million USD. For this period the share of insurance premiums in the GDP of the country amounted to 1,5%, at 0.5% more than for the similar period of 2013.

In 2014 year, the premiums of insurers to voluntary types of insurance amounted to 284,7 million AZN, 5,1% more than in the year 2013, the payments – 114,7 million AZN with growth at the level of 35,1%. In turn, fees for mandatory types of insurance were equal to 144,5 million AZN ( 7.3%), the payment – 42,5 million AZN ( 11.9%). In 2014, voluntary types of insurance were 66,3%, mandatory - 33,7% of the insurance market of the country.

During the 2015 year the premiums of the insurance companies of Azerbaijan were 442,9 million AZN, payments - 180,2 million AZN. In the past year payments of insurers have increased by 3.2%, payments - by 14.7%. In 2015, for every 100 AZN bonuses accounted for 40,7 payments against 36,6 for 2014 year.

In 2016, the insurance payments of companies reached 232,5 million AZN that at 29% more similar period of 2015. On the basis of 2016 the insurance premiums reached 484,8 that the 9 % more than in the past year. The premiums of insurers in Azerbaijan on voluntary types of insurance in 2016 had increased by 13,5%, for mandatory types - by 3%, the premiums for voluntary types of insurance amounted to 318,6 million AZN. The share of voluntary types of insurance had 65,7% of all premiums insurers. The premiums of insurers to compulsory types of insurance amounted to 167,3 million AZN, specific weight – 34,3%. The voluntary activities had 75,6 % of all payments of insurers in the reporting period. Their volume amounted to 179,4 million AZN and compared with the year 2015 increased by

32.1%. The payment of mandatory types increased by 30,1% - up to 57,8 million AZN, specific weight is equal to 24,4%.

The last 2 years in the insurance market of Azerbaijan were acted 24 insurance companies. In the following picture, we show the data about insurance premiums of top 10 insurance companies of the country.

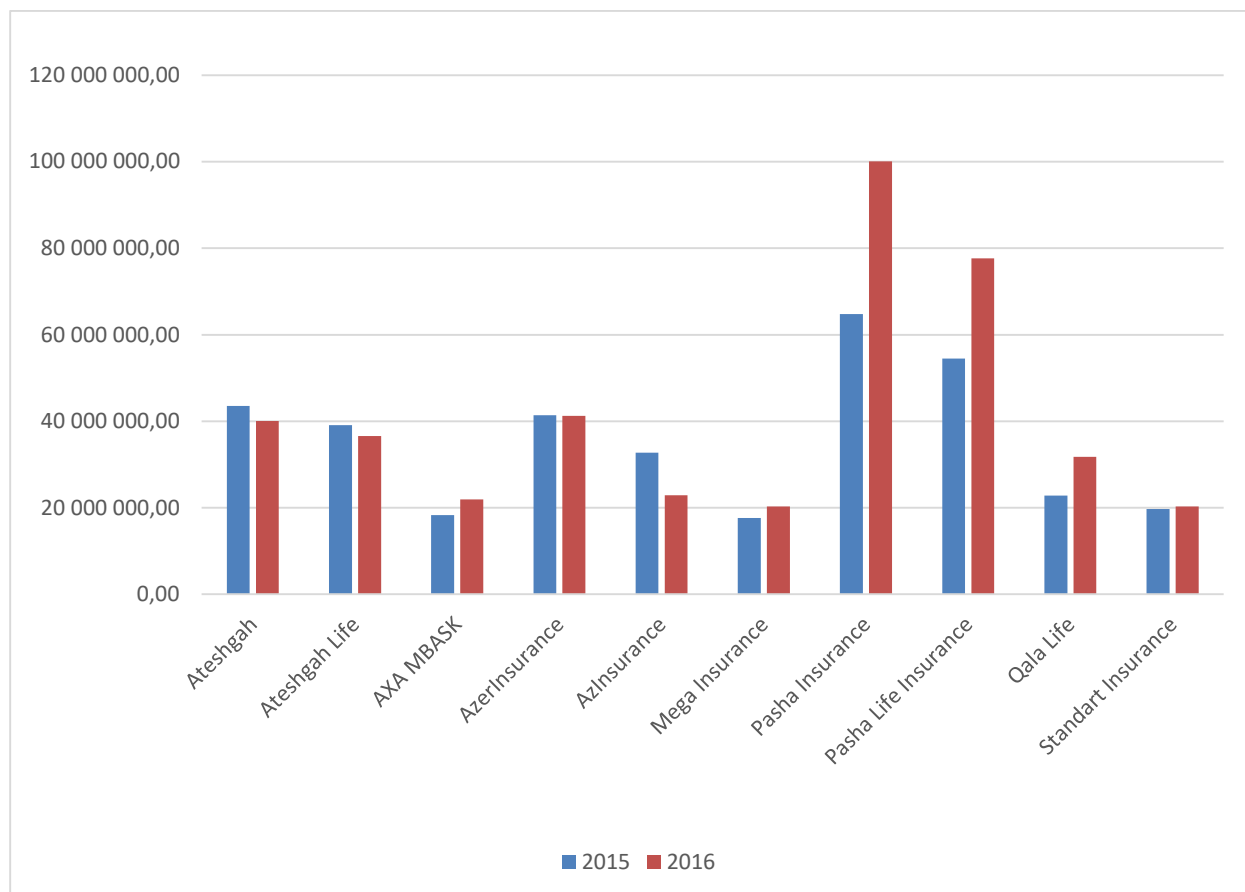


Fig. 2 – Insurance premiums of top 10 Insurance Companies in 2015-2016. Source: The statistical data of AIA

The statistical analysis shows that by the rating of insurance payments in the insurance market of the country for the 2015 and 2016 years in the first place allocated Pasha Insurance. The premiums of the Company for the 2015 were 64,7 million AZN, which in 2016 year increased and reached to 100,0 million AZN. Nowadays the authorized capital of the company reached to 30 million AZN and current assets to 43 million AZN. In the second place was Pasha Life Insurance with the positive growth of premiums. In the third place of insurance payments was Ateshgah Insurance which premiums in 2015 were 43,5 million AZN, but in 2016 had slowly decreased and reached 40,0 million AZN.

## 4 CONCLUSION

As is well-known, the insurance organization may have the income from the insurance operations and from investment activities. The proceeds from the insurance activities are formed on the basis of insurance payments. Insurance payments are primary income of insurance organization, the basis for the further circulation and source of financing investment activities. In this paper we analysed the amount of insurance premiums and payments of Azerbaijan in the recent 5 years. Despite the ongoing global financial crisis, insurance market in Azerbaijan continue to grow and develop. Participation of the insurer in investment activities have a large impact on both the source and the amount of insurance reserves and in their composition. It is important to remember, that the development of the insurance market and the development of insurance institutions - a symbol of a civilized state. Thus, the insurance business, inherent in any economy operating on a market basis, in recent Azerbaijan years has a

significant development . For example, evidenced by the emergence of many new types of insurance, the growth of the number of insurance customers, the volume of transactions in the insurance market. As for the future development of the insurance market, due to the overall economic growth in the country, due to the increase in cash resources, including consumer loans, the insurance market will grow. Today the banking market is one of the major providers of insurance services for enterprises, population. Accordingly will increase the role and the volume of services provided to this sector insurance companies.

## **References**

Aliyeva L. (2011). Insurance system in Azerbaijan as multiplier effect to economic and social processes. Baku. Qanun Press

Felix H., Ralph S. J. Kojien & Christian T. (2017). The Economics, Regulation, and Systemic Risk of Insurance Markets. New York city: Oxford University Press

Harold D. Skipper, Jr. (2001). Insurance in the General Agreement on Trade in Services Washington, D.C. The AEI Press

Khudiyev N. (2001). Insurance. Baku. Azerneshr.

Peter Z., Roland E. (2012). Insurance Economics. Berlin city: Springer International Publishing Company

Sherbekova V.A., Kostyayeva E.V. (2009). Insurance. Moscow. KNORUS

The Law of the Azerbaijan Republic “About the Insurance Activity” (2007)

[http://isb.az/wp-content/uploads/2015/03/sigorta\\_fealiyyeti\\_haqqinda\\_qanun.pdf](http://isb.az/wp-content/uploads/2015/03/sigorta_fealiyyeti_haqqinda_qanun.pdf)

<http://infobank.az/category/statistika/>

<http://www.trend.az/business/economy/>

## **Contact information**

Gunel Talishinskaya, Ph.D. Student

Scientific Research and Training Center of Labour and Sosial Problems of the Ministry of Labour and Sosial Protection of Population of Azerbaijan Republic

Azerbaijan, Baku, S. Bahlulzadeh 44

[gunel.talishinskaya@gmail.com](mailto:gunel.talishinskaya@gmail.com)

# ANALYSIS OF THE DEVELOPMENT OF HOTEL SECTOR IN THE REPUBLIC OF KAZAKHSTAN

*Zuzana Tučková, Dana M. Ussenova*

## **Abstract**

Currently, tourism has taken a giant leap to become one of the largest and most profitable sectors of the global economy. Simultaneously with increasing of total number of tourists was a noticeable development of tourism infrastructure and its main components has a noticeable development of hotel industry, striving to get their share of business. The hotel service industry plays an important role in society, providing opportunities for business meetings, meetings, conferences, as well as for recreation and entertainment. This trend of hotel development creates objective conditions for the so-called regional competition, which every year it becomes more noticeable: new resorts with inflated standards of service that makes the old tourism regions to improve their quality of service, as well as look for new ways of quality competition.

**Keywords:** *hotel services, tourism, Republic of Kazakhstan, occupancy, classification hotels by stars, SWOT analysis*

## **1 INTRODUCTION**

This tendency of tourism development creates objective conditions for the so-called inter-regional competition, which every year becomes more noticeable: there are new resorts with excessive standards of service that makes the old tourist regions improve their quality of service, as well as to seek new quality ways of competition. The increase of total tourists number has had a significant impact on the development of tourism infrastructure and its main component - the hospitality industry, seeking to get their share of business and tries to persuade customers to purchase their hotel services provided. In international practice hospitality industry is one of the most profitable. According to experts, the annual increase in tourism will be 4.2%. Among the foreign and domestic authors about the studying the overall hotel industry of tourism industry should be noted works of Skobkina (2007), Samoilova (2009), Volkov (2009), Dzhanzhugazova (2003), Yulgusheva (2004), Rakhimbekova (2003), Duysen (2002), G.N. Yulchieva (2004), which show the basic theoretical aspects of the formation and organization of the hotel industry. In general, over the past few years there is a positive trend of development of the hotel industry.

In almost all countries paid great attention to the development of this type of industries, but not in all countries, the industry gets a successful development. In this regard it is important to mention the role in shaping the tourism industry in the Republic of Kazakhstan of the hotel industry, whose main function is to place foreign and domestic tourists in hotel enterprises.

Experts predict a further increase in the values of the Republic of Kazakhstan on the world tourist market. However, dreaming about the effective use of tourism potential of the country, it is necessary to pay great attention to the pressing challenges - to create a modern infrastructure, industry of the accommodation sector that meets international standards.

## **2 ANALYSIS**

According to the implementation of the development of promising areas of the tourism industry of the Republic of Kazakhstan in 2010-2014 funding in the tourism industry was amount to 2012 - 269 625.0 thousand tenge, in 2013 - 269 625 thousand tenge and in 2014 - 268 825.0 thousand tenge.

The number of hotel companies in the Republic of Kazakhstan for the last 10 years increased almost 6 times (fig.1). The increase in 2005 - 2015 years of hotel companies is related to the development of tourism, increasing of the investment attractiveness of the republic, upgrading and reconstruction of their material-technical base. The largest numbers of accommodation enterprises are concentrated in

areas with developed infrastructure and tourist potential. In these areas there are large resorts, business centers, cultural and historical attractions of the country.

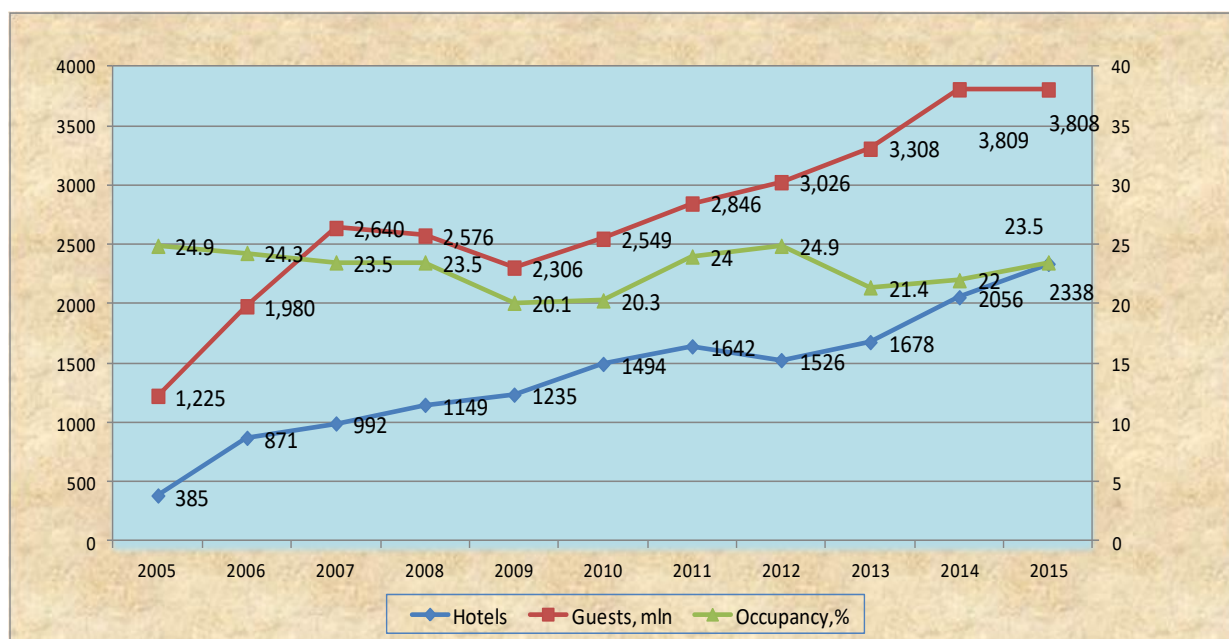


Figure 1 – Dynamics of hotel companies, guests and occupancy rate in 2005-2015 in the Republic of Kazakhstan.  
Source: Materials of the Statistics Agency of the Republic of Kazakhstan, 2016

The analysis shows that this growth has been uneven. From 2005 to 2010, the market for hotel services was characterized by an intense increase in the number of visitors served by hotel companies. Favorable investment climate, small business development and increase of the number of hotel companies contributed to this situation. The reduction of visitors in 2012 compared to 2011 due to the situation in the global economy. The most growth in the number of served visitors associated with an increase in flows to Kazakhstan of business travels of foreign citizens.

Dynamics of change served to visitors of hotel enterprises is characterized by steady growth. Thus, the total number of visitors by the end of 2015 compared with 2005 increased by 3,1 times.

As on January 1 of 2016 hotel companies served by 3,808 mln people, while in 2005 the same figure was 1,225 mln people.

Decisive in determining the income level of the hotel is occupancy level. If we calculate the possibility of accepting hospitality industry with the most favorable conditions, which means constant year-round occupancy of their visitors, the occupancy rate of hotels will be observed as follows: in 2007 the average occupancy rate was – 23,5%, in 2008 – 23,5%, in 2009 – 20,1% in 2010 – 20,3 %.

In 2011, in Kazakhstan, the average of occupancy factor in the hospitality industry was 25%. The highest occupancy factor in the republic in 2015 was in the following regions: Mangystau (92%), Atyrau (57%), Astana (32%), and Almaty (26 %).

Minimum occupancy is characterized in the East-Kazakhstan (12,7%) and Almaty (13,7%) regions, while according to international standards, it figures as 65-70%. It can be concluded that the basic foundations of domestic hotels are not used to their full capacity.

The occupancy factor in the hospitality industry in 2008 compared to 2007 is reduced by 1.8%, due to a decrease in the flow of tourists, and consequently a reduction in domestic business activity in the hospitality industry.

Another important factor negatively affecting to the occupancy rate of hotels in the country is the discrepancy of rates and the quality of hotel services.

The reasons of not full occupancy in the hospitality industry are:

- lack of effective demand for quality of hotel services;
- reductions of travels, symposia and seminars;
- low level of knowledge of new technologies in the hospitality industry;
- increase of percents in bank lending, which means the growth of payback period.

By the following diagram is possible to observe the distribution of accommodation facilities by regions of the country. In 2015 the most of hotels in the country was placed in the cities of Astana - 6.8% (160), Almaty - 6% (135), in the areas of: East Kazakhstan - 15.8% (371), Akmola - 11.4% (319), Almaty region - 13.1% (306) and Karaganda - 8.9% (208), the smallest number of accommodation facilities was noted in the North-Kazakhstan - 2.8% (fig 2).

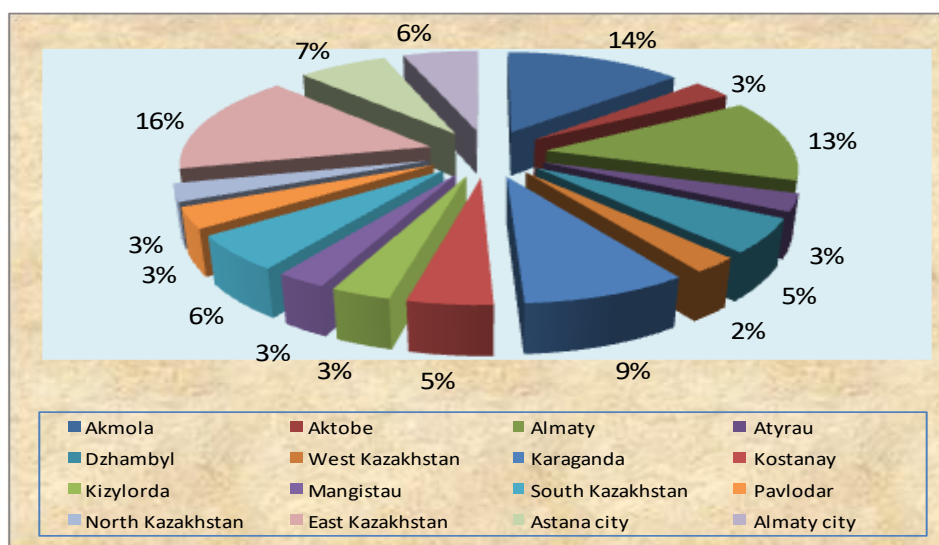


Figure 2 – Segmentation of hotel companies by regions in the Republic of Kazakhstan in 2015, %. Source: Materials of the Statistics Agency of the Republic of Kazakhstan, 2016

The problem of categorization of hotel services is one of the most important in terms of quality management. Currently, the official system of categorization of hotel services approved in 64 countries, 11 of them, it is under development in 58 countries – guests do not have a common boundary categorization.

According to standard of RK № 1141-2002 about «Classification and general technical requirements», the classification system by category is used in Kazakhstan. Categorization of hotels determines the stars, increase of the number of stars, according to the improvement of quality of services and equipment of hotels.

The dynamics of the distribution by category of hotel companies in the country is presented in Figure 3.



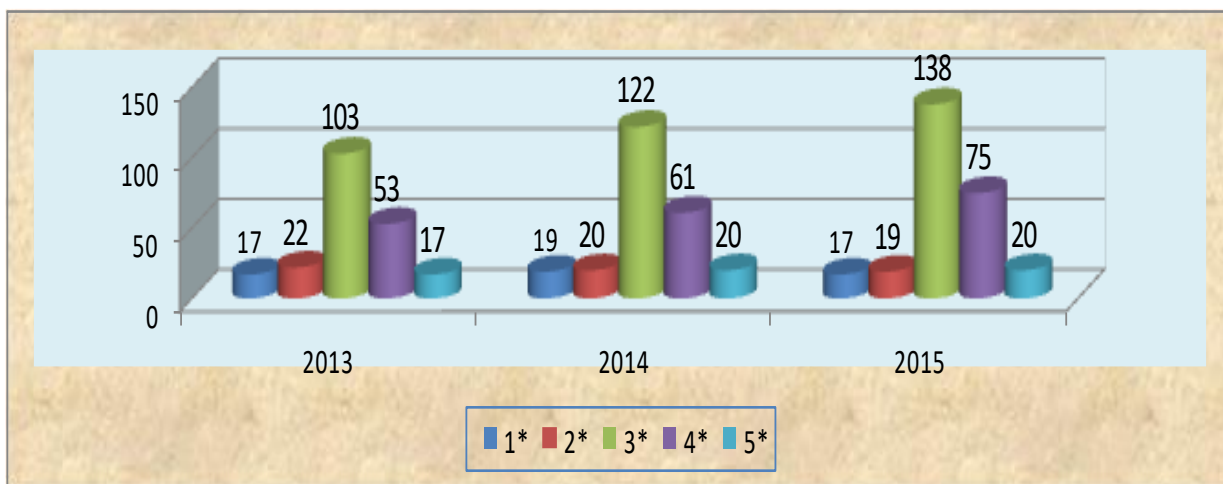


Figure 3 – Dynamics of the distribution by category of hotel companies in the Republic of Kazakhstan for 2013 – 2015 years. Source: Materials of the Statistics Agency of the Republic of Kazakhstan, 2016

Analysis of the structure of the hospitality industry categories in the Republic of Kazakhstan in 2013 - 2015 years shows that in the structure of hotel category the largest share in 2015 is accounted for three-star hotels - 138 (51,3%), compared with 2013 hotel enterprises classified as three stars, rose by 34%, the number of five-star hotels in the same period increased by 1.17 times and amounted to 20, 4-star - in 1,4 times and amounted to 75.

Considering the specificity of the Kazakhstan market of hotel services, it should be noted that the prices for services are very high. Now 4-5 star hotels can not offer a lower cost of living because of the fact that management of the hotel strives to offers the maximum number of services, based on this fact, most number of visitors are served at the hotels with no category 41.7% and at 3 star hotels 23.6%.

The structure of the hospitality industry by ownership has undergone significant changes. Analysis of the hospitality industry by ownership shows that quantitatively private placement of objects are dominate. International classification of hotels in capacity shows that small hotels in Switzerland and Austria hotels are less than 100 beds, medium - 100-200 seats, large - more than 200 seats, low in the Czech Republic - to 120, medium - up to 500 seats, large - more than 500 seats, in the USA small - up to 100 rooms, the average - up to 500 rooms, large - over 500. In Kazakhstan, small is a hotel with a capacity of 10 to 100 rooms.

It should be noted that the structure of the hospitality industry in 2015, most are small enterprises - 72.3%, medium - 19.7%, and the smallest proportion has large enterprises - 10.1%. The number of large enterprises last three years increased almost to 1.17 times due to the advent of the Kazakh market brands and increase the investment attractiveness of country.

Despite the rise of investment attractiveness of Kazakhstan, in the hotel business investment remained insufficient. According to the hotel industry market analysis, potential investors are not attracted by the hospitality sector, especially the economy class hotel, which has the greatest demand. The causes are dear land and real estate.

The demand for local hotel market of average level, which would meet international standards and provide a fairly complete range of additional services, needs to raise correct concept constructing and development of the hotel management. To implement it, the support of local government offices, in terms of allocation of land on concessional terms to finance activities as well as the introduction of exemptions on customs duties and taxation is needed.

### 3 CONCLUSIONS

The state of tourism activities in the country affects the low level of development of tourist infrastructure (hotels, campsites, tourist centers, roads, transport, tourist routes). There is no system of scientific and advertising and informational support to promote national tourism product in the domestic and foreign markets. At the same time to develop the infrastructure sector, there should be a system of investing. Despite the fact that tourism is recognized as a priority sector for investment, conditions that encourage the inflow of private investment into the sector, including from abroad is not involved.

An analysis of the hospitality industry in the RK in 2015 can be summed up as follows:

2338 hotels (with individual entrepreneurs) served 3,808 mln people;

the largest number of accommodation facilities are concentrated in the city of Astana - 8.4%, Almaty - 8%, Eastern Kazakhstan - 16%, Akmola - 14.9%, Karaganda and 13.7% - 8.3% of areas ;

in the structure of hotel category the largest share in 2015 is accounted for three-star hotels - 138 (51,3%), the smallest – one-star hotels - 17;

the average occupancy of hotel companies was 23,5% .

Table 4 – SWOT analysis for the hotel industry in the Republic of Kazakhstan. Source: author

<p><b>STRENGTHS</b></p> <ul style="list-style-type: none"> <li>• Natural and ecological, historical and recreational potential</li> <li>• Location of the hotel in the business district and recreational</li> <li>• Suggestions of hotel services, depending on the purpose of tourist travel</li> <li>• Offer hotel services by travel agencies</li> <li>• Safety and security</li> <li>• The growth of inbound and domestic tourism</li> </ul>	<p><b>WEAKNESSES</b></p> <ul style="list-style-type: none"> <li>• Infrastructure and quality of services</li> <li>• Discrepancy of price and quality</li> <li>• Lack of awareness guests</li> <li>• Narrow range of additional services</li> <li>• Low quality</li> <li>• High price</li> <li>• Lack of domestic brands</li> <li>• Low qualification of staff</li> <li>• Marketing Information System</li> </ul>
<p><b>OPPORTUNITIES</b></p> <ul style="list-style-type: none"> <li>• Development of new hotel products</li> <li>• Registration to Internet sites (booking.com)</li> <li>• Development of domestic brands</li> <li>• Connecting are plenty of hotels to global networks</li> <li>• Implementing new information technologies</li> <li>• Market expansion</li> <li>• Achievement of international standards</li> <li>• Attractiveness for investors</li> </ul>	<p><b>THREATS</b></p> <ul style="list-style-type: none"> <li>• Competition from individual accommodation facilities</li> <li>• Inelastic pricing</li> <li>• Economic and political uncertainty</li> <li>• Rising of tax burden in tourism</li> <li>• Changes in the demand and preferences of guests</li> <li>• Increase in the number of hotel rooms</li> </ul>

The matters of tourism and hotel business development have been specified in "The concept of development of tourism industry in the Republic of Kazakhstan" (Department of Tourism Industry of the Republic of Kazakhstan , 2016). The development of tourism services due to the implementation of the Strategy of Kazakhstan's top fifty most competitive countries in the world tourism industry, together with the hotel sector is defined as a priority sector. However, the hotel business in the Republic of Kazakhstan needs of government support and measures to improve the quality of hotel services.

## References

- Duysen, G. (2002). Basis for the formation and development of the tourism industry in Kazakhstan. Almaty.
- Rahimbekova, Zh. (2003). *International Hospitality Industry: Study Guide*. A: Cossack universiteti.
- Volkov, J. (2009). *Hotel and travel business*. Rostov n / D: Phoenix.
- Yulchieva, G. (2004). The Organization of the hotel industry in a globalized economy. A: Classic, CAU.
- Samoilov, E. (2009). Management of competitiveness of enterprises in the sphere of hospitality. (dissertation thesis). Moscow.
- Skobkin, S. (2007). *Management in Tourism*. M. Masters.
- Skobkin S. (2010). Enterprise development strategy of tourism and hospitality : studies. allowance. – M: Masters.
- Dzhandzhugazova, E. (2010). *Marketing in the Hospitality Industry*. M: Academia.
- Website of the Statistics Agency of the Republic of Kazakhstan (2016). Available at <http://www.stat.gov.kz>
- Website of the Department of Tourism Industry of the Republic of Kazakhstan (2016). *The concept of development of tourism industry in the Republic of Kazakhstan*. Available at <http://dep-turizm.mid.gov.kz/ru/kategorii/koncepciya-razvitiya-turistskoy-otrasli-respubliki-kazahstan-do-2020-goda>

## Contact information

Ussenova Dana M.,

M.e.sc., senior teacher

Faculty of Economics, Marketing Department, Academician Y.A. Buketov Karaganda State University, Universitetskaya 28, 100028, Karaganda – Republic of Kazakhstan

Telephone number +7 7212 770384

Faculty of Management and Economics, Tomas Bata University in Zlin, Zlin, Czech Republic

E-mail [magdina79@mail.com](mailto:magdina79@mail.com)

# REFORMATION OF THE GERMAN ACCREDITATION SYSTEM - STATUS QUO

*Susann Wieczorek, Peter Dorčák*

## **Abstract**

For many years, there has been a heated discussion within the Federal Republic of Germany regarding the subject of accreditation within the European University system. Based on the decision 1 BvL 8/10 of the Federal Constitutional Court, a reformation of the German accreditation system is required and has to come into effect at latest on January 1st 2018. The focus of the present elaboration is devoted to the reorganisation of the accreditation procedure, describes the current state and real scenarios which will be critically discussed.

**Keywords:** *Higher education accreditation, Bologna process, educational policy, education system, German accreditation system, German accreditation procedures*

## **1 INTRODUCTION**

The 21st century will be determined by a fast-paced environment, shorter procurement processes and elevated service, changes carried out within the shortest timeframe in the most different branches, as well as within the educational sector. By the means of the Bologna declaration, Europe was supposed to grow together. The accreditation process was thought to be an essential part of this reform leading to a common European standard and aiming for the external quality assurance in the university sphere. That's why the university sphere has experienced a basic change which is not looked upon an advancement.

The present elaboration aims to indicate and discuss the development within the current state of the accreditation system of the Federal Republic of Germany while showing possible future trends and scenarios, in particular before the background of the new strategy „education within the digital world“, outgoing from the decision 1 BvL 8/10 of the Federal Constitutional Court on February 17th, 2016.

## **2 ACCREDITATION -STATUS QUO**

In 1998 a European organization was formed in order to reform the educational sector, which led to the in Bologna adopted educational reorganisation, briefly: the Bologna reform (Zinger, 2012, p. 15). The European university sphere stands for an unlimited mobility within a common transnational educational sphere (Stüber, 2010, p. 23) as well as for the homogeneity of educational certificates (Ternes, 2010, p. 11). The concept intended for every European nation to adopt this procedure independently and to fulfill the obligations of the Bologna declaration (Education minister conference, 2016a). An improvement of the quality of the traditional apprenticeship and study was hereby the main goal. From the reverse, the Bologna declaration stands for the reduction of state management and the aspiration of elevated transparency (Wilhelm, 2009, p. 57).

In 2001, the area of quality assurance was promoted in Prague by other measures aiming for the development of a high-quality frame, where the accreditation and the certification are of important meaning (European Higher Education Area, 2001, p. 2). In 2003, the quality assurance system was discussed once more, containing the following points: Definition of competence, program evaluation, procedures for the accreditation and certification as well as international relations and cooperations (European Higher Education Area, 2003, p. 2). In 2007, the guideline called „standard and guidelines for the quality assurance within the European university sphere“ (ESG) was introduced. On the second Bologna policy forum in Vienna in 2010, it was decided that academic teaching shall be based on freedom and autonomy by the teacher (European Higher Education Area, 2010, p. 1).

Today, the European university sphere already counts 48 member states (European Higher Education Area, 2017) and symbolises the harmonisation of the European university experience which aim it was to form a uniform and political reform within Europe (Zinger, 2012, p. 15). The historical developments have shown that the quality assurance and the accreditation have a high value attached by which this subject will also in the future be questioned critically again and again.

## **2.1 German accreditation process**

In the Federal Republic of Germany, a model has existed since the implementation of the European university sphere with a multistage accreditation model (Ternes, 2010, p. 11) which is decentral organized (Education minister conference, 2015a) and relies on peer reviews (Education minister conference, 2016a). By agreeing on the common contract, the education minister and arts conference 1998 agreed on a beyond borders accreditation of courses which was introduced after a test phase. The formation of a committee, the accreditation council was regarded as inevitable, and has been recognized as a public initiative since 2005.

The German university rector's conference, is based on a voluntary union of German universities, and the education minister conference which represents a constant conference within the federal republic of Germany. In the same year the beyond borders university accreditation was decided upon as a quality assurance instrument for the Federal Republic of Germany. Hereby the accreditation as a new and central element for the safeguarding of the external quality in study and apprenticeship, based on a common European standard, was adopted (Education minister conference, 2016a).

The first step was formed by the university rector's and education minister conference which set in place the second level, the „Foundation of the accreditation of courses of study in Germany“, in addition to the accreditation council and the Foundation council (Foundation related to the support of the university rector's conference, 2016b). The Foundation council supervises the realisation of the accreditation council compliant with the law and contributes to the high-quality development of study and apprenticeship (Accreditation council, 2015b). The accreditation council formed the central committee (Accreditation council, 2015a), with the understanding of having a status as the sole council legally deciding the accreditation of courses of study (Federal Constitutional Court, 2016). The duties of the accreditation council on the one hand the quality assurance of universities and the quality assurance of the accreditation agencies which must dispose of an accreditation license. The origin of the accreditation council can be traced back to the legal guideline „Foundation of the accreditation of courses of studies in Germany“ of February 15th, 2005 as well as in special arrangements between the council and the accreditation agent. Therefore, ten accreditation agencies complete the executive authority within the German accreditation procedure which is based on the guidelines regarding the accreditation council as well as the „common structural guidelines of the education minister conference“ (Accreditation council, 2015a).

The accreditation is, as already explained, a beyond border and university-covering procedure which is applied to investigate the quality assurance of university related systems carried out scientifically and autonomous. In addition, it is necessary that representatives of the professional practice as well as students are involved with this process (Education minister conference, 2016a).

At this point a detailed approach of the German accreditation procedure may be necessary: In the first step the universities make a choice of the available accreditation agencies, relevant in this connection are in particular the estimated costs per procedure. After this selection follows the contract closing. The university provides documentation in which the quality and the quantity of the course of studies to be accredited is indicated, and submits this in a timely manner to the accreditation agency. The agency selects a group for the evaluation of the relevant study courses. After that, the accreditation commission of the respective accreditation agency decides on guidelines or recommendations of the course of studies to be accredited. After the successful accreditation, i.e. after exhibition of the accreditation document, the reaccreditation must be carried out in in. three to five years (Federal Constitutional Court, 2016).

At the present time, it can be mentioned that in the Federal Republic of Germany a total of 2.192 universities have carried out the system accreditation with their courses of studies and 7.734 courses of studies the program accreditation successfully (Foundation for the support of the university rector's

conference, 2016a) which can be arranged in eight study fields (Foundation for university licensing, 2015)

Engineering

Sciences, Mathematics, IT

Agriculture

Medicine and Health Care

Law and Economics

Social Sciences and Sport

Languages, Art and Design

Teaching

## **2.2 Growing criticism**

The criticism of the European university sphere grows steadily, so that also the ministers of the participating countries, had recognised in 2010 the insufficient realisation on European terrain (Flemish Ministry of Education and training, 2010). The real intention of the accreditation procedure stood in the quality assurance of universities and the strengthening of autonomy. However, this autonomy (Wiarda, 2016a) could not be reached by the various decisions. Already in 2009, the German university association expressed criticism regarding accreditation, it stated that „the accreditation in Germany was expensive, bureaucratic, slow, ineffective, and hostile to the autonomy. This dreadful state of affairs is continued by the compulsion to the regular reaccreditation" (German university association, 2009). The reformation and establishment of these new control instruments which stand in connection with the Bologna declaration are considerably more difficult to be implemented than anticipated by the founding fathers in 1999. Consequently, the desired and expected ends which were anticipated with the accreditation are often missing or far from being reached. The central reasons for this lie in the prevailing internal organisational structures of the universities (Kaufmann, 2013, p. 11). At the same time, within the scope of the accreditations procedure, enormous organizational administrative expenditures are demanded of the universities themselves (Ternes, 2010, p. 35).

## **2.3 Jurisdiction regarding the German accreditation procedure**

After the court decision 1 BvL 8/10 of the German Federal Constitutional Court from February 17th, 2016 the German accreditation system should be reformed. With the complaint of a private university which went forward against a decision of a program accreditation of an accreditation agency the procedure was put under close scrutiny (Federal Constitutional Court, 2016). The legislator announced that the current ruling regarding the accreditation procedure was compliant with the essential quality assurance guidelines, the Federal Constitutional Court however found that „according to the current regulations“ a transfer of the accreditation decision to other actors, such as accreditation agencies, was non-compliant with the basic law (Article 5, paragraph 3, sentence 1, Basic Law of the Federal Republic of Germany) and was therefore unconstitutional (Federal Constitutional Court, 2016). The legislator shares furthermore the view that the quality assurance of courses of studies correspond to the fundamental right of scientific freedom. The Federal Constitutional Court decided in this regard that a certain qualification is necessary for a university certificate by which a comparability to the company atmosphere is made possible. In this regard the quality assurance was deemed to be a basic condition. Further the legislator is responsible for the quality assurance within universities, „in which the decision-making powers and rights to participation, influencing controls, information and control are so constructed that dangers for the freedom of teaching are avoided“ (Federal Constitutional Court, 2016). In addition, an essential legal regulation and instructions was demanded which should give explanation about the duties and their conversion within the involved institutions by which scientific connections can be reviewed (Federal Constitutional Court, 2016). Since the decision by the Federal Constitutional Court has been made public, numerous petitions have been encountered which advocated for the abolition of the accreditation itself. The Heidelberg petition (Wiarda, 2016a) attained especially large

attention. On December 8th 2016, a concept was decided on by the education minister conference which outlined that the accreditation procedure shall be based from now on a constitutional-compliant basis (Education minister conference, 2016a). The education minister conference integrated this reorganisation on the same day into its strategy regarding „education in the digital world“. Within this strategy, an action concept has been integrated for educational processes to do justice to the challenges of the professional work-life (Education minister conference, 2016b). According to the statements of the education minister conference, the accreditation treaty intends in particular for the external quality assurance of courses of studies and contains marginal changes of the present accreditation procedure.

The formal contents of the reorganisation of the treaty regarding the accreditation procedure should be limited at this point to the essentials: The accreditation council will be left to 1) completely decide the accreditation decisions, therefore a new task description of the accreditation council and the agencies is required (Education minister conference, 2016a). In consequence the accreditation council decides from now on the basis of standardised consultations and decision recommendations. Besides, the agencies take over merely the organisation of the consultant's reports and the decision recommendations (Wiarda, 2016a). From it results 2) that it is required that an increase of the scientific staff within the accreditation council is carried out, so that the technical questions are answered to the majority by the scientific relevant field (education minister conference 2016a). Therefore, the accreditation council should assume from now on the following composition (Wiarda, 2016b):

A deputy of the HRK

A deputy of the accreditation agencies, without a vote

Two international experts with experience in accreditation procedures

Two students

For members of the provincial government

Five representatives of the corresponding field of work

Eight Professors recommended by the HRK; they possess in subject related questions a double vote and should be representative of the eight to be accredited fields of study.

With the decisions which the accreditation council recommends or declines only two decisions should take effect: „Statement on the observance of the minimum standards“ as well as „investigation and consultation under technical points of view“ (Wiarda, 2016b). The task separation is to be carried out by 3) between the assessment of formal and technical criteria. In this context the occupational relevance finds attention. The possibility of alternative instruments for the quality assurance is granted in 4) The accreditation or licensing of the agencies should be made with the help of a registration 5) easier on the basis of the European Quality Assurance Register (EQAR).

This new concept which must still be ratified by the Prime Minister's conference this year, already comes into effect with the approval of 13 instead of 16 federal states. If this should be the case, the federal state which has abstained from the approval of the treaty can still join after the vote according to article 18, paragraph 2 of the treaty (Education minister conference, 2016a). Presently, the state contract cannot be looked upon as finished, because it is uncertain whether it can be ratified by 16 federal states.

## **2.4 Methods of research**

The methodological approach will be strengthened by the ratified decision in March 2017 so that the scenarios presented can then be considered as realistic or non-realistic. This approach is followed by a qualitative survey using the Delphi method of all stakeholders: Accreditation Agencies, Accreditation Council and Universities. In the case of universities, those professors who have already passed an accreditation and reaccreditation procedure should be consulted. At this point, the experience of each group should be assessed. Through the two-level survey, can the answers of the respondents' opinions in 2017, that's mean before the deployment of the new accreditation system, and one year later, in 2018, be compared with the new procedure. At the same time, other stakeholders from European member

states are to be consulted about this new approach in the accreditation process. These opinions are intended to provide an outlook for subsequent discussions.

## **2.5 Reorganization of the accreditation procedure**

In this segment the already mentioned procedural changes of the accreditation system should move in the centre of the focus and possible scenarios be described. On the one hand it must be assumed that the introduced concept of the state contract will not receive the necessary 13 approvals votes of the federal states this year. Consequently it does not come to the ratification of the state contract which would have the consequence that another concept of the state contract would have to be worked out by the education minister conference by which the reorganisation of the accreditation procedure must come into force according to the decision of the Federal Constitutional Court at the latest as of 1/1/2018 which remains doubtful. On the other hand, it is assumed that the future procedure is ratified by the Prime Minister's conference in 2017, which would lead to the necessary of forming a fully new accreditation council. The main attention is devoted to this factor and the following four scenarios are based on this assumption. The author has determined the following questions:

How does the new procedure look like?

How does the accreditation council guarantee the quality of its decisions?

Which personal resources are provided next to the 23 representatives?

Which costs arise from the reorganization?

Which changes should be anticipated by the agencies and by the universities?

Which legal questions remain untouched by the procedures in other countries?

Based on these questions, four scenarios seem possible. A claim to have fully all aspects fully covered is not made.

### **2.4.1. Scenario 1**

In the first scenario, it is assumed that the accreditation council follows the duties set by the Federal Constitutional Court. It leaves the essential duties concerning the care and the on site-implementation with the universities and the agencies, and relies increasingly on the decisions of the agencies. On account of the missing resources of the accreditation council, the accreditation decisions could be judged in support of the decisions worked out by the agencies as merely positively without further checks. Obvious the accreditation council could be in this scenario a seal procurement agency.

### **2.4.2. Scenario 2**

The second scenario is based on the first. The accreditation council is well put up with personnel, so that at least eight professors from the relevant fields combined with 15 additional employees of the accreditation council review the documents provided by the universities and agencies and under the principle of the freedom of science are provided with a quorum. A visible saving potential will stand out with the agencies, the one or the other agency could decide to close its doors in order to save financial resources.

### **2.4.3. Scenario 3**

The third scenario also starts with the preceding example. The accreditation council is well composed; however the eight university professors and employees cannot master the numerically high amount of the accreditation procedures. The documentation, reports and decisions of the courses of studies on the part of the agencies and universities are very extensive and time consuming and hardly manageable. At this point, it should be reminded once again of the high number of to be accredited courses of studies and universities by which the accreditation council acts in future in the role of the expert in document review in the areas of accreditation and reaccreditation.



#### **2.4.4. Scenario 4**

The fourth scenario builds, like the previously given examples, on the preceding scenarios and stands for the extension of the accreditation council. From the demonstrated numerically high number of the to be accredited courses of studies and universities, consequently eight professors and 15 representatives will not master this workload alone, because it is to be understood that these eight people cannot fully cover eight study fields completely and decide therefore on these recommendations. This can lead to the result that more people will be involved in these decisions, which may make it more difficult to reach consensus.

### **3 FINAL CONCLUSIONS**

This elaboration has shown that outgoing from the decision of the Federal Constitutional Court the accreditation system will go through a reorganisation while the currently prevailing accreditation procedures correspond to the essential quality assurance claims, at the same time the legislator „according to the current rulings“ may not transfer the accreditation decision on to other actors. This is not compatible with the basic law and therefore unconstitutional. The court expressed that the accreditation council shall make in the future all accreditation decisions. How exactly the future accreditation procedure will look like, is actually already known from the concept of the state contract, which still requires the approval of the Prime Minister conference in 2017. If not at least 13 of 16 federal states agree, the procedure would go once again over to a political state of uncertainty. Currently it is not foreseeable where which way the accreditation procedure will go, but a new reform must become law by at latest 1/1/2018. Probably there will be a limitation to this new system of accreditation in other European countries, especially in those countries which are pursuing a state procedure. Currently, no definitive decision can be taken on the extent of the reorganized German accreditation procedures, it is right now to early, so that no final critical assessment has been carried out at this point.

Nonetheless, the aim is to create a uniform standard of accreditation for Europe so that all graduates can enter the professional life on the same conditions and, on the other hand, companies can expect the same standards from all European graduates.

## References

- Akkreditierungsrat (2015a). *Funktionsweise des Systems*. URL: [www.akkreditierungsrat.de/index.php?id=system&L=1robots.txt#](http://www.akkreditierungsrat.de/index.php?id=system&L=1robots.txt#)
- Akkreditierungsrat (2015b). *Aufgaben der Stiftung*. URL: [www.akkreditierungsrat.de/index.php?id=aufgaben&L=1robots.txt#](http://www.akkreditierungsrat.de/index.php?id=aufgaben&L=1robots.txt#)
- Bundesverfassungsgericht (2016). *Wesentliche Entscheidungen zur Akkreditierung von Studiengängen muss der Gesetzgeber selbst treffen*. URL: [www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/DE/2016/bvg16-015.html](http://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/DE/2016/bvg16-015.html)
- Deutscher Hochschulverband (2009). *DHV will zu Boykott gegen Programmakkreditierung aufrufen*. URL: [www.hochschulverband.de/cms1/pressemitteilung+M53b7fb95070.html](http://www.hochschulverband.de/cms1/pressemitteilung+M53b7fb95070.html)
- European Higher Education Area (2001). *Towards the European Higher Education Area. Communiqué of the meeting of European Ministers in charge of Higher Education in Prague on May 19th 2001*. URL: [http://media.ehea.info/file/2001\\_Prague/44/2/2001\\_Prague\\_Communique\\_English\\_553442.pdf](http://media.ehea.info/file/2001_Prague/44/2/2001_Prague_Communique_English_553442.pdf)
- European Higher Education Area (2003). *Realising the European Higher Education Area*. URL: [http://media.ehea.info/file/2003\\_Berlin/28/4/2003\\_Berlin\\_Communique\\_English\\_577284.pdf](http://media.ehea.info/file/2003_Berlin/28/4/2003_Berlin_Communique_English_577284.pdf)
- European Higher Education Area (2010). *Bologna Policy Forum Statement*. URL: [http://media.ehea.info/file/2010\\_Vienna/83/2/Vienna\\_BPF\\_Statement\\_597832.pdf](http://media.ehea.info/file/2010_Vienna/83/2/Vienna_BPF_Statement_597832.pdf)
- European Higher Education Area (2017). *European Higher Education Area and Bologna Process*. URL: [www.ehea.info](http://www.ehea.info)
- Flemish Ministry of Education and Training (2010). *Erklärung von Budapest und Wien zum Europäischen Hochschulraum*. URL: [www.ond.vlaanderen.be/hogeronderwijs/bologna/links/language/2010\\_Budapest-Wien-Erkl%C3%A4rung.pdf](http://www.ond.vlaanderen.be/hogeronderwijs/bologna/links/language/2010_Budapest-Wien-Erkl%C3%A4rung.pdf)
- Kaufmann, B. (2012). *Akkreditierung als Mikropolitik: zur Wirkung neuer Steuerungsinstrumente an deutschen Hochschulen*. Springer-Verlag.
- Klomfaß, S. (2011). *Hochschulzugang und Bologna-Prozess. Bildungsreform am Übergang von der Universität zum Gymnasium*. Wiesbaden: Verlag für Sozialwissenschaften.
- Kultusministerkonferenz (2016a). *Akkreditierungsstaatsvertrag der KMK sichert größtmögliche Qualität von Studiengängen und Mobilität für Studierende*. URL: [www.kmk.org/aktuelles/artikelansicht/akkreditierungsstaatsvertrag-der-kmk-sichert-groesstmoegliche-qualitaet-von-studiengaengen-und-mobilitaet-fuer-studierende.html](http://www.kmk.org/aktuelles/artikelansicht/akkreditierungsstaatsvertrag-der-kmk-sichert-groesstmoegliche-qualitaet-von-studiengaengen-und-mobilitaet-fuer-studierende.html)
- Kultusministerkonferenz (2016b). *Strategie "Bildung in der digitalen Welt"*. URL: [www.kmk.org/aktuelles/thema-2016-bildung-in-der-digitalen-welt.html](http://www.kmk.org/aktuelles/thema-2016-bildung-in-der-digitalen-welt.html)
- Stiftung für Hochschulzulassung (2015). *Die Studienfelder im Überblick*. URL: [www.wege-ins-studium.de/de/chstudieren/chstudienfelder/studienfelder097.htm](http://www.wege-ins-studium.de/de/chstudieren/chstudienfelder/studienfelder097.htm)
- Stiftung zur Förderung der Hochschulrektorenkonferenz (2016a). *Akkreditierte Studiengänge und Hochschulen*. URL: [www.hs-kompass.de/kompass/xml/akkr/maske.html](http://www.hs-kompass.de/kompass/xml/akkr/maske.html)
- Stiftung zur Förderung der Hochschulrektorenkonferenz (2016b). *Aufgaben und Struktur*. URL: [www.hrk.de/hrk/aufgaben-und-struktur/](http://www.hrk.de/hrk/aufgaben-und-struktur/)
- Stüber, J. (2009). *Akkreditierung von Studiengängen: Qualitätssicherung im Hochschulrecht vor dem Hintergrund der internationalen Entwicklungen im Bildungssektor, insbesondere des Bologna-Prozesses*. Lang.
- Ternes, D. (2010). *Qualitätsmerkmal 'Gender' bei der Akkreditierung und Reakkreditierung von Studiengängen: Exploration an den Fachhochschulen in Rheinland-Pfalz*. Kovac.

Wiarda, J. (2016a). *Akkreditierungsrat mit DFG-Standards? Neuer Staatsvertrag vor dem Abschluss*. URL: [www.jmwiarda.de/2016/09/19/akkreditierungsrat-mit-dfg-standards-neuer-staatsvertrag-vor-dem-abschluss/](http://www.jmwiarda.de/2016/09/19/akkreditierungsrat-mit-dfg-standards-neuer-staatsvertrag-vor-dem-abschluss/)

Wiarda, J. (2016b). Staatsvertrags-Entwurf: Bundesländer wollen Akkreditierungs-agenturen entmachten. URL: [www.jmwiarda.de/2016/08/17/staatsvertrags-entwurf-bundesländer-wollen-akkreditierungsagenturen-entmachten/](http://www.jmwiarda.de/2016/08/17/staatsvertrags-entwurf-bundesländer-wollen-akkreditierungsagenturen-entmachten/)

Wilhelm, K. (2009). Verfassungs-und verwaltungsrechtliche Fragen der Akkreditierung von Studiengängen. Duncker & Humblot.

Zinger, B. (2012). Das Hochschulstudium nach Bologna. Zwischen Strukturreform und didaktischer Neuausrichtung (Vol. 11). kassel university press GmbH.

### **Contact information**

Susann Wiczorek, Peter Dorčák

University of Economics in Bratislava, Faculty of Business Management

Department of Management

Dolnozemská cesta 1/b

852 35 Bratislava

Slovakia

e-mail: [susann.wiczorek@euba.sk](mailto:susann.wiczorek@euba.sk)

4915252827431

e-mail: [peter.dorcak@euba.sk](mailto:peter.dorcak@euba.sk)

# THE USE OF FINANCIAL CONTROLLING INSTRUMENTS IN A PARTICULAR COMPANY

*Jana Zlámalová*

## **Abstract**

This contribution is focused on the application of selected tools for financial controlling of a specific company. Financial controlling is an integral part of the controlling system of business management. Controlling is used in companies as an efficient tool to manage individual processes in many fields. There is a special focus on the application tools of controlling in a specific company to eliminate shortages, which were discovered from the analysis of current company conditions. Another aim is to improve financial management of a company, by suitable tools of financial controlling that will develop effective management of a company.

*Keywords: controlling, financial controlling, planning, analysis of deviations, reporting.*

## **1 INTRODUCTION**

The level of a company relates to decision-making skills of managers. In today's conditions, when there is huge competition in markets and dynamics of work environs puts work managers under increasing pressure. They are overloaded by tasks, have big responsibilities and demands are higher and higher. With regards to the current situation on the market, most companies are trying to secure competitive abilities. So it is necessary to be focused on rationalization of production, increasing productivity and quality of products and limitation of operations that give no value to the company. System of controlling is one of the most effective tools helping to achieve goals. Tools of controlling can, during effective implementation and correct use, eliminate weak spots and ensure effective production process. Ensuring required quality for affordable prices contributes to higher satisfaction of customers, which is base of competitiveness of every single product or provided service.

In practice controlling is often incorrectly understood as supervision. Controlling is not only supervision but it is also a system of management based on complex information and an organisation's combination of managing and organisational and control process, where the goal is to improve and make more effective management as a unit. Controlling has that quality, that its tools are possible to be applied in every single company, when they are correctly chosen and correspond with the needs of a specific company. When correctly applied, they contribute to higher economic stability and ensuing development and better results. Another advantage of controlling is that interconnects knowledge and information of various business fields and thanks to that, it comes better orderliness, and top management has all necessary materials for correct decision making. Today controlling is already an essential part of modern management. There is a special focus on the application tools of controlling in a specific company. Aim is to improve financial management of a company, by suitable tools of financial controlling that will develop effective management of a company.

The theoretical part of the work proceeds from the analysis of today's problematic conditions and from literary research dealing with controlling and financial controlling. Another part describes the methodology that focuses on used methods. On the basic of outline analysis and evaluation for assessment of current conditions, correct financial tools are selected. These include short term financial planning, monitoring of costs and sales, developmental trends and basic indicators of financial analysis. The piece focused on outcomes deals with the evaluation of current conditions, the application of controlling tools and an evaluation of a level of individual indicators. In the economic conclusion is the evaluation of main contributions by means of a compressive summary about financial and economic conditions of company and risks are assessed.

## 2 THEORETICAL OUTCOMES

Nowadays as the marketing environment is constantly changing and competition is increasing, factors of company achievements are changing too. To compete, companies are using modern and flexible technologies that ensure high quality of products, flexible reaction in terms of customers' demands communication with them and as the creation of good working conditions for their employees that will contribute to achievement of the business's output goals or support competitiveness.

The term "controlling" is treated differently by every author different. There is no single general definition of controlling. Kerzner (2013) sees controlling like a three-level process of measuring a progress in direction to the goal, evaluation of what is needed to be done and the taking of necessary corrective measures to achieve or exceed set goals. He sees the three following steps: are measuring, evaluating and removing mistakes.

Horváth (2003) reported the system of controlling has four parts: philosophy of controlling, tools of controlling, organisation of controlling and process of controlling.

Eschenbach (2000) reported the main aim of controlling is to secure the vitality of company. Secondary goals are ensuring ability of anticipation, adaptation and abilities of coordination. Eschenbach (2011) in his second book adds to these secondary goals one more: ensuring the feasibility of plans.

Eschenbach (2000) reported the effectiveness of controlling is higher when the controlling system is faultless, more formalized and stronger. From goals, indicators of system effectiveness are dedicated. The success of controlling is decided by the controller that is doing the controlling and as well how the management is using it. The position of controlling is influenced also by the size of a company, the concept of controlling and the diversity of tasks and the overall system of departments. The independence of this department is always important. The controller must have the possibility to accomplish his tasks objectively and independently and must have access to company top management and be able to cooperate with them and he must have various means of recourse. Situating controlling at highest levels in hierarchy is ideal.

Havlíček (2014) reported financial controlling serve to continuous evaluation of financial plans and financial goals. Financial controlling is focused on aims determined in financial planning and we can differentiate it on financial strategical and financial operative controlling.

Financial controlling is understood by Chodas (2012) as the controlling of cash flow and thus securing daily liquidity. According to her, financial controlling represents the controlling of constant and circulating assets and is divided into controlling of working capital, controlling of debts and reserves and controlling of liquidity.

A study by Rajnoha et al. (2015) concentrates on business performance management and measurement is a relatively complex and difficult process, which is currently undergoing significant changes in terms of both theory and practice. Previously used indicators, methods and models, largely based on financial indicators and methods of financial management, have been gradually modified and improved to provide owners and managers with a sufficient true and fair view of business performance. System in the company may favour the comprehensive and elaborate system of strategic planning, which further subsequently reflected in higher business performance.

Micheli & Mari (2014) is aimed at the secure long-term prosperity and company performance should be at least equal importance with which they dealt with the operational and financial problems. The need to establish links between planning, decision, action and results has generated substantial interest in the measurement of organizational performance as a performance is a notion that permeates contemporary societies, as it is used to assess the quality of individual and collective efforts.

The implementation of financial controlling is the topic of an article of Chmutova and Maskimova (2014). It speaks about the importance of the process of identification of qualitative constitution during the financial controlling, where candidates have these competences: personal (initiative, communication skills, creativity, purposefulness and responsibility); manager competences (ability to work in a team, conflict management, ability to lead people, strategic thinking, ability to plan team work and distribute rights and responsibilities and coordinate operations); specific manager skills (ability to decide in

conditions of uncertainty and dynamics, analytics skills, ability to manage new trends and methods of work and use them, abilities and skills to create authorized delivery, special knowledge – theoretical solutions and recommendation of modern science with focus on implementation of controlling).

A study by Iseri-Say et al. (2008) is devoted to the issue how the adoption of management tools (the study considered the group of 25 tools) influences organizational performance. Their findings show a significant positive relationship between competitive positioning, organizational integrity, performance capabilities, customer equity, financial results and adoption of management tools and techniques.

A study by Afonina (2015) is devoted to a more balanced impression of organizational performance we used the combination of financial and non-financial outcomes. The need of non-financial measures has been mentioned in many studies. The study provides the evidence how strategic management tools and techniques can affect performance.

The research of Kruml and Duspiva (2015) between small and medium companies in the manufacturing industry in the Czech Republic show that less than two thirds of companies want to use controlling in any form. That means that here exists a space big enough for the expansion of this effective tool to small and medium companies. Secondary research that changed its analysis, evaluation and comparison of financial directions showed that companies with using controlling reach better results.

Kruml and Duspiva (2015) reported two thirds of 57 researched companies do not use financial controlling. That means that there is still enough space between small and medium companies for expansion of such an important tool for administration. Companies that use these tools reach better results in indicators like liquidity, ROE, total ration of debt to GDP and productivity of work. On the other hand, they were worse in dynamics of profit before taxation and ROA. It indicates that companies with financial controlling put emphasis on the effectiveness of management and use more leverage for higher debt; that might be related to the practical application of controlling in administration and direction and decisions of management.

Sedliaciková, Vacek and Sopková (2015) reported the level of knowledge in financial controlling as well as the execution of control in economical practice is, in general, low. From an empirical point of view, the article „How Slovak small and medium enterprises perceive financial controlling” shows that 41,9% from small and 55,2% from medium companies don't find financial controlling and financial operating as identical fields. 11,6% small and 37,2% medium companies are engaged in financial analysis and prognosis. Methods of financial planning are executed by 9,7% of small companies and by 40% of medium companies. Inspecting operations that support economic activities with use of liquidity use 4,8% of small and 16% of medium companies. Financial regulation techniques focused on analysis and monitoring of roots of divergences in cash flow are engaged in 6,5% of small and 35,7% of medium companies.

A study by Skokan et all (2013) is aimed at the bigger companies pay more attention to strategic management and have more often prepared detailed strategy than smaller enterprises. Strategic planning is definitely reasonable activity of any company, since enterprises who did prepare detailed strategic document proved in 80 % of observed performance parameters better results than enterprises without written business plan. Enterprises who did prepare brief, partial, concise strategic document proved only in 40 % of observed performance parameters better results than enterprises without written business plan, so there is necessary to put impact on proper strategic planning in all significant business areas.

Parnell (2013), who confirms that retail SMEs with high strategic clarity will outperform those with moderate strategic clarity, but SMEs with low strategic clarity outperformed those with moderate strategic clarity.

### **3 METHODOLOGY**

Zlámalová (2016) the tools of financial controlling have been implemented in a company that does not want to be named. This company specializes in manufacturing of specific and demanding plastic pressed parts by the squirting of thermoplastics. This company was established in year 1991 in the city of Zlin. Its legal form is Ltd. This company employs about 50 employees. The main business is repairing

mechanical parts of machines for plastic manufacturing, manufacturing of plastic materials, buying goods for reselling, mediation business in fields of trade, manufacturing and services and meditation business in fields of engineering, plastic business and electro technics.

The chosen company is subjected to an analysis with the current application controlling tools both from a strategic and an operative point of view. These attributes will be evaluated: using tools for planning, comparison of plans and reality, evaluation of control process, analysis of deviations, the cause of deviations and then a proposal of measures and follow-up reporting. From the analysis of the current situation of application controlling tools of the company will emerge possibilities for improving.

Zlámálová (2016) the purpose was to suggest the installation of chosen tools of financial controlling. The chosen financial tools for this company are indicators of financial analysis, monitoring sales growth and expenses, developmental trends, short term planning and analysis of deviations and reporting. Any increase of takings and expenses and financial analysis indicators and their development will be monitored quarterly; the development of selected indicators will be expressed graphically for better clarity. trends related to costs and profits are developmental, so we will monitor development of individual items quarterly and for easier orientation, will express it graphically with individual items compared to one another. The short term planning is composed of the sales plan, expenses and management results. These plans are created three months ahead; for first month a more detailed plan is formed. At the end the deviations are determined by discovering causations and measuring suggestions. The reporting contains discovered information from previous analysis and development.

Zlámálová (2016) based on the economic analysis, it was found that the part of circulating property on whole actives is a little less than 80% and little less than 50% of whole assets are debts – and those primarily debts from business relations. Supplies are one fifth of the whole assets. Foreign sources create most of whole total liabilities whereas the highest parts on foreign sources have short term liabilities, or a little bit less than 40%. The share of sales from the sale of their own products and services are high, estimated at 80%. One half of total costs are created by the consumption of material and energies; the extent of this item is higher annually. Since 2012, the company has been profitable. The participation of clean working capital on circulating assets in last two years is about 50%. The debts of the company are much higher than recommended values: in year 2011, it was nearly 80% but during the years since, it has constantly decreased and now is a little bit higher than 60%. Long-term foreign sources of the total foreign sources took approximately one fifth; it shows that the company has a high percentage of short-term foreign capital. To focus on liquidity, the company achieves its recommended values only in the last monitored year. Indicators of profitability show that the company was in the year 2011 unprofitable, but for the rest of the monitored years profitable. The time of supply turnaround is between 25 to 33 days. The time of debt turnaround is more than two months and the time of liability turns around in two months. The Z-score indicator says that the company has a satisfying financial situation since year 2012. The curve of its Z- score is higher than the recommended level of 2,99. The indicator index IN reaches in the last two years values higher than the marginal value 1,6 and proves that company is creating values.

## **4 RESULTS**

The chosen company was analysed in detail against the current application of controlling tools. In this company there is not a controlling department, nor is this company using any controlling tools for strategical or operative controlling. From a strategical point of view, the company has only formed a SWOT analysis: they know their strong and weak sides, opportunities and threats. From an operative viewpoint, the company uses tools for planning only marginally. The company is comparing data annually and as well plans of actuality only in some fields. The process of planning is not connected to the process of control, analysis of deviation, creation of their causation or follow up reporting. Data are compiled for purpose of the obligated final accounting needed for banks.

The company draws up only obligated final accounting as a balance of profit and loss report. Reports are oriented only on history and are not focused on the future of company and are drawn up quarterly. The company does not follow any indicator, like liquidity, activity, profitability, debts, etc.

The company plans on basis of arranged orders. After they receive an order, the company creates a buying plan of material, time when manufacturing begins and the process of distribution as well. Every year, the company creates a plan of sales, plan of manufacturing and a plan of supplies and that is on the basis on of arranged orders and basic data from the previous year. These plans do not serve as a basis for follow up control, but are only nominal. The company draws up reports of profits and losses quarterly and sends this document to the bank where they have their credit. Every year a plan is created and that is only with a focus on the comparison between the first plan and reality.

Another weakness is that company does not follow and does not evaluate any indicators: liquidity, rate of return, activity and debts, etc. These indicators evaluate development in time and show financial health of the company and would show weak points that need to be eliminated. The company then does not follow developmental trends of the most important items and they do not seem to care about the growth of takings and expenses in view of individual items. Another field is planning: the company creates only the most important plans, which are nominal and then do not work with them anymore: they do not analyse them, compare them, define deviations of plans and reality, look for problems or offer steps for their elimination. The most important problems following information obtained from analysis become the basis for installation of chosen tools of financial controlling.

From the analysis of the current situation of using controlling tools of company, there were identified the following critical spots of controlling in the analysis of company.

Use of financial analysis indicators for more effective management.

Sales and expenses growth evaluation

Developmental trends evaluation

Creation of Forex management proposals

Creation of short term planning

Analysis of deviations for better management

Proposal and creation of regular plans and comparison with reality, analysis of deviations and proposals for improving

Proposal of effective reporting

These deficiencies are possibility limiting the efficiency of improvement of the economic management of the company. Suitably chosen tools for this company are then stated. Stated proposals come from the actual needs of company. Into consideration is taken as well regard for the field of business, size of the company, financial situation and future development of the company. Because of the extent of the article, I focus here only on the most important ones.

The company does not look to sales and expense growth: that is the reason why I suggest treatment and evaluation of sales and expense growth development. I recommend the creation of quarterly evaluations and due to the fast rate of sales growth. Rate of sales and expense growth must be managed. During the growth of sales, assets are circulating assets and that increases pressure on financing. At the same time, fixed expenses are increasing and investment expenses as well. Unmanaged enormous growth of sales leads to the overheating of a company, which is why I suggest evaluating profit, expenses, material demands, wage demands and service demands. All these items play important parts in results of management and are connected to sales. I recommend comparing mutual connection, profitability and expense of sales and then mutual connections with material wage and service demands. I propose comparing an actual quarter with its previous quarter as well as with the same quarters of the last year – and then to create a prediction for following quarters. Predictions are based on current levels and future development. To determine the company level on basis of these indicators, I suggest reporting for easier orientation with individual indicators shown by graphs.

The company regularly checks sales and compares them year-on-year. Every year, a plan is created which is then compared to reality, but only in such a way that evaluates if all goals were achieved or not. Its purpose is only indicative. The same situation applies in the case of costs and the resulting economic activities. Results of economic activities proceed from reports of profit and loss and are



checked quarterly. For this reason, I suggest creating a plan of sales, plan of costs and plan of economic activities.

Planning of sales, costs and economical activities is the basis for whole system of planning process. I suggest to create these plans three months ahead, and for the first month of the period, a detailed sales plan. The detailed plan is divided into individual products, individual items, materials, services, etc. This plan will be modified monthly. The plan of sales comes first from arranged obligations and demands of customers regarding the last period and then will be modified on the basis of future expected development of company, then competition, economic development, etc. A one-year plan of sales is divided in these items: year plan, plan of cumulative, plan for individual months and percentage of year performance for quarters. A detailed monthly plan contains the year plan, cumulative plan, month plan, and percentage for year performance of the month.

To determinate deviation, we must compare plans and reality. I suggest to compare exactly that. By this comparison, it will be shown the amount of deviation. The resulting analysis of deviation will indicate reasons of deviation and suggest actions to eliminate deviation sources. This leads to accuracy improvement in the planning process. When the toleration limit is exceeded, the deviation analysis will be executed. I suggest observing deviations from plans on the basis of determined plans. These deviations will be expressed absolutely and relatively. Form comes from monthly sales planning and is composed of the monthly plan, reality and absolute deviation as well as in relevant amounts. With the help of a plan, comparison with reality will determine the amount of absolute deviation and perceptually will be expressed the amount of relative deviation. If the deviation article exceeds the tolerance limit, the deviation analysis will be executed, when will then indicate the reason of formation, after which an action will be suggested. In following table (Tab.1), the proposal of form for analysis of plan fulfilment that comes from monthly planning of economic activities is shown. The form is divided from plans, reality, absolute and relative deviation and from tolerance deviations in relevant amounts.

Table 1 Plan fulfilment analysis (Self processing)

Analysis of the performance plan							
Indicator		Units	Annual	1st month	2nd month	3rd month	Quarter
Sales	Plan	Thous. CZK	122 430	9 341	11 515	7 984	28 840
	Reality	Thous. CZK					
	Absolute deviation	Thous. CZK					
	Relative deviation	%					
	Tolerance deviations	%		20%			
Costs	Plan	Thous. CZK	110 576	8 242	9 973	7 054	24 317
	Reality	Thous. CZK					
	Absolute deviation	Thous. CZK					
	Relative deviation	%					
	Tolerance deviations	%		15%			
Profit	Plan	Thous. CZK	11 854	1 099	1 542	930	4 523
	Reality	Thous. CZK					
	Absolute deviation	Thous. CZK					
	Relative deviation	%					
	Tolerance deviations	%		20%			

Deviation analysis will pass all items and indicators that exceeded the fixed plans. The goal of deviation analysis of real and planned values is to get information, why there was deviation and where the roots of this deviation lie. Reasons of deviation formation have various origins. Mostly, it is a change in external conditions in the market, by the competition. Another reason of deviation is wrong planning of the leading worker, who did not see all factors, possibilities and company status during the planning or else determined an unattainable goal Deviation connected with expenses and profits is created because of changes in input or selling costs or the quantity of change of sold items and products. This analysis is created quarterly. The following (Tab.2) shows determination of deviations in sales plan.

Table 2 Determination of deviations by sales plan

Item	Name month					
	Plan	Actual	Tolerance		Variance	
			Absolute	Relative	Absolute	Relative
Thous. CZK	Thous. CZK	Thous. CZK	%	Thous. CZK	%	
Goods	145		30	20%		
Products B	80		16	20%		
Product C	105		22	20%		
Sales of goods	330		220	20%		
product A	1 035		210	20%		
product B	1 485		300	20%		
product C	1 294		260	20%		
product D	1 365		275	20%		
product E	956		195	20%		
product F	865		175	20%		
Sales of own products	7 000		1400	20%		
Service A	664		65	10%		
Service B	336		34	10%		
Revenues from sales of services	1 000		100	10%		
Long-term assets	0		30	8%		
Fixed assets B	0		30	8%		
Revenues from sale of fixed assets	0		30	8%		
Sales of material	0		5	10%		
Other operating income	1 000		200	20%		
Interest	0		0	5%		
Foreign exchange gains	11		1	5%		
Total revenue	9 341		1900	20%		

The biggest shortcoming of this company is that no one cares about watching individual indicators and their development. That is the reason why I recommend focusing on watching individual indicators: liquidity, debt, activity etc. Then I recommend focusing on sales and expense growth development in relation to individual items. The comparison of these items gives the company an overview about how the company is developing and what to focus on. Then I recommend to be focused on developmental trends of individual indicators in time, like for example sales, profit, expenses, material expenses, personal expenses, etc.

For better clarity, faster orientation and easier imagination I suggest covering into reporting as well graphical statement of selected indicators. Then there is a possibility to include into the analysis a comparison of several years, quarters or months. Mentioned reports can be customized to the various and actual needs of company in dependence on priority. A necessary part of the reports should be as well the comparison with plan and comparison with values for a comparable period in the previous year. Individual reports are of course filled with proper comments that point out on the biggest changes and unwanted developments. This comment has added information that is impossible to read from the tables or a graph. The conclusion should be a summary and emphasis on indicators and quantity, and on achieved goals and those that did not achieve required aims. And then to describe correctional rules leading to situation improvement.

Annual reporting focused on a year evaluation of development in individual indicators and items allows a compact overview for company development. Evaluated are year plan fulfilments of sales, expenses, economic activities, deviations determination and reasons of their origins, and corrective actions are made.

Quarterly reporting is created from individual items and indicators development. Evaluations of financial analysis indicators, sales and expenses growth and development trends come from their quarter development. At the same time, the current quarter is compared with previous quarters and as well with the same quarter of the previous year. Plans for fulfilment of sales, expenses, economic activities results come from monthly fulfilment. Absolute and relevant deviations are determinate and compared with tolerance deviation. When this deviation is exceeded, an analysis is made to find the root causes and

corrective actions. After discovery of the new reality, plans are changed. This leads to better management and higher company effectivity.

Zlámálová (2016) in next table (Tab. 3), a development overview for indicators of financial analysis in individual years is demonstrated. Statistics that are between recommended values are highlighted by green and statistics that are out of this bound are highlighted by red.

Table 3 Financial analysis indicators development (Self processing)

Indicator	Plan	2012	2013	2014	2015*
<b>Liquidity</b>					
Current ratio	1,5 - 2,5	1,1	1,28	1,57	1,71
Quick ratio	1 - 1,5	0,72	0,89	1,18	1,27
Cash ratio	0,2 - 0,5	0,03	0,09	0,26	0,51
<b>Indebtedness</b>					
Total indebtedness	30 - 60%	0,77	0,71	0,61	0,56
Debt ratio	< 1,6	3,4	2,55	1,6	1,35
Long-term sources/Fixed assets	> 1	1,41	1,8	2,92	3,3
Interest coverage	> 5	5,68	13,05	38,05	44,01
<b>Activity indicators</b>					
Asset turnover	> 1	2,74	2,65	2,69	2,81
The stock turnover period	30 days	33,76	33,32	30,73	34,3
Turnover of receivables	60 days	60,8	67,08	72,4	75
Turnover time commitment	60 days	77,87	57,81	58,57	60,45
<b>Overall indicators</b>					
Z-score	> 2,99	3,263	3,655	4,202	4,7
IN05	> 1,6	1,317	1,882	3,385	5

## 5 DISCUSSION AND CONCLUSION

The purpose of this article was to submit suggestions for improvement in the management of the company with help of selected indicators of financial controlling and to get a complex overview about company development as a unit and to create better conditions for decision making of top management.

The main benefit of this work is in the provision of whole overview about financial and economical company management, and as well as creating materials for following better decision making about the company's future. Financial controlling tools application leads to gaining and widening of the information skills of existing information, thanks to correct analysis of the current company level and development evaluation, and thanks to correct development prediction for future external and internal environments. On that basis, a plan should be created for the following period to prevent possible additional expense and risk inception. By regular calculations of basic economic indicators and following their comparison with a plan and with time, management has a better possibility to react immediately. By following control where evaluation and comparison is made, we can isolate mistakes and eliminate shortages that are repeating themselves, and a company can get advantage against the competition. This company with help of these tools will get a lot of fully-fledged and useful information that leads to effective management, and will prove important materials for management. In the upshot, it will correct implementation of financial controlling tools expenses saving and increasing profit.

Everything has risks. These risks present themselves in every phase. It is impossible to prevent all the risks and find them in time. Some risks are impossible to easily eliminate and must be counted for future as possible risks. I find the main risk in personal field and technical and financial field. The main risk I see is the personal unwillingness to change old methods and to accept new. Possible aversion and resistance can have negative influence on the whole implementation and application of these tools. There can be an unwillingness of employees to cooperate or to help. It is important to inform all employees with new tasks about their defined duties that relate to this project and to highlight efficient benefits of them. It is needed to persuade them about the importance and meaning to their company and to themselves individually. If the company will do everything honestly, it will eliminate the risks – or it might also eliminate all risks.

It is important to understand everything, as it is a benefit for the company as a unit and as well as for top management, in that it brings valuable information for planning and decision making about company future. All the changes should be purposefully enforced and used. Risks should be prevented and eliminated so their impact is as small as possible.

## References

- Afonina, A. (2015). Strategic Management Tools and Techniques and Organizational Performance: Findings from the Czech Republic. *Journal of Competitiveness*, 7 (3), 19-36 <http://doi.org/10.7441/joc.2015.03.02>.
- Eschenbach, R., Güldenber, S. & Hoffmann, W. (2000). *Controlling* (1st ed.) Praha, ASPI Publishing. ISBN 80-85963-86-8.
- Eschenbach, R. & Siller, H. (2011). *Controlling professionell: Konzeption und Werkzeuge* (2nd ed.). Stuttgart, Schäffer-Poeschel.
- Havlíček, K. (2014). *Small business: management & controlling*. Kijv, Universitet Ukraine. ISBN 978-966-388-494-3.
- Horváth, Péter (2003). *Das Controllingkonzept: der Weg zu einem wirkungsvollen Controlling-system*. (5th ed.). München: Deutscher Taschenbuch Verlag.
- Chmutova, I., Maksimov, M. & Maryna, V. (2014). Formation of the Project Team on Introduction of Financial Controlling into Banking Activity. *Business Inform.* 279-285. ISSN:2222-4459.
- Chodasová, Z. (2012). *Corporate Controlling: management tool* (1st ed.). Bratislava, Statis. ISBN 978-80-85659-70-2.
- Iseri-Say, A., Toker, A., & Kantur, D. (2008). Do popular management techniques improve performance? *Journal of Management Development*, 27 (7), 660-677. DOI: <http://dx.doi.org/10.1108/02621710810883580>.
- Kerzner, H. (2013). *Project management: a systems approach to planning, scheduling, and controlling*. (11th ed.). Hoboken, New Jersey: John Wiley & Sons.
- Kruml, L. & Duspiva, P. (2015) Effect of Controlling on the Economic Performance of Smes in the Czech Republic. *Scientific Papers of the University of Pardubice, Series D: Faculty of Economics and Administration*. 22(34), 63-74. ISSN:1211-555X.
- Micheli, P., & Mari, L. (2014). The theory and practice of performance measurement. *Management Accounting Research*, 25, (2), 147–156. doi: 10.1016/j.mar.2013.07.005.
- Parnell, J. A. (2013). Uncertainty, Generic Strategy, Strategic Clarity, and Performance of Retail SMEs in Peru, Argentina, and the United States. *Journal of Small Business Management*, 51(2), 215-234. <http://dx.doi.org/10.1111/jsbm.12010>.
- Rajnoha, R., & Lorincová, S. (2015). Strategic Management of Business Performance Based on Innovations and Information Support in Specific Conditions of Slovakia. *Journal of Competitiveness*, 7 (1), 3-21 <http://doi.org/10.7441/joc.2015.01.01>.
- Sedliacikova, M., Vacek, V. & Sopkova, E. (2015) How Slovak Small and Medium Enterprises Perceive Financial Controlling. *Procedia Economics and Finance*. 26. 82-85. doi: 10.1016/S2212-5671(15)00842-4.
- Skokan, K., Pawliczek, A. & Piszczur, R. (2013). Strategic Planning and Business Performance of Micro, Small and Medium-Sized Enterprises. *Journal of Competitiveness*, 5 (4), 57-72 <http://doi.org/10.7441/joc.2013.04.04>
- Zlámalová, J. (2016) The project of implementation selection of financial instruments in a particular company. Zlín. Master thesis. Tomas Bata University in Zlín, Faculty of Management and Economics, Department of Business Economics. Supervisor of Master thesis Petr Novák.

**Contact Information**

Ing. Jana Zlámalová, MBA

Tomas Bata University in Zlin, Faculty of Management and Economics

Mostni 5139, Zlin, 760 01

E-mail: [jzlamalova@fame.utb.cz](mailto:jzlamalova@fame.utb.cz)

## **Conference proceedings**

DOKBAT 2017 - 13th International Bata Conference for Ph.D. Students and Young Researchers

Edited by: Ing. et Ing. Monika Hýblová

Published by: Tomas Bata University in Zlín, Faculty of Management and Economics

1st edition

2017

Cover by: Mgr. Iva Honzková

Published electronically

The conference proceedings have not undergone language correction.

ISBN: 978-80-7454-654-9