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## Methodical Approaches to the Assessment of Innovative Region Susceptibility

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### Abstract

*In modern conditions, questions assessing the effectiveness of innovative development of regions are among the most urgent. The generalization of global and domestic experience in implementing innovations indicates a discussion of issues in this area. The paper aims to study the indicators for assessing innovation. The authors of the study on the basis of terminological apparatus of innovation management clarify the concept of "innovation susceptibility of the region," define the relationship with the existing interpretation of the categories and conceptual apparatus. Consideration of the theoretical aspects of innovation susceptibility necessitates the development of its quantitative and qualitative parameters of evaluation. Authors proposed a methodological approach to the evaluation of innovative susceptibility region tested in the territories belonging to the Siberian Federal District. Comparison with the system of indicators used in the international practice and the practice of the countries in the CIS, confirms the correlation proposed indicators with indicators measuring innovation. At the same time, the use of the values of individual parameters for the integrated assessment of the susceptibility of the region's innovation is a fairly complex task associated with the introduction of a heterogeneous database performance. The paper proposes a comprehensive model for integrating disparate figures, the weight value of each factor and to identify priorities for the development of the region to achieve the target value. Empirical IP-repetition made on the basis of the static data and the processing results of initial authors of qualitative parameters for 2001-2009 years, as the absence of a source of statistical information for the last 4 years, limited to the time period of the study. This technique allows not only formalizing and defining the level of development of complex socio-economic systems at the micro and macro levels, to identify the potential for growth, but also based on the specified management of different levels of development prospects, identify priority areas of growth.*

**Keywords:** innovation susceptibility, assessment indicators, innovation potential, innovative climate, target values, factor model

### 1. Introduction

The processes taking place in the global economy cause priority of innovative development. In the global economy two-poled business-economic system is formed. At one pole (USA and EU) there is the production of money, brands and know-how, on the other (China and other developing countries) - the production of goods. In the open market after Russia's WTO accession competitiveness is of major importance, which can be achieved at the expense of innovational development (Borodin, 2013).

Fundamentals of the theory of innovation development set out in the writings of I. Schumpeter (Schumpeter, 1982), B. Lundvall (Lundvall, 1992), R. Nelson (Nelson, 1993), K. Freeman (Freeman, 1995). The generalization of existing international and domestic experience of innovation implementation states quite clearly there is a number of discussions in this area. These questions include assessing the effectiveness of innovative processes.

The appeal to the results of Russian studies showed the presence of a variety of methodological approaches of the definition of indicators used for such purposes. In particular, focus on the innovative potential is done in the works of E.A. Utkin, G.S. Gamidova, S. Mityakov, O. Mityakova (Hamidov, 2000; Mityakov, 2005). The innovative climate is seen in the writings of the Ural scientists A.I. Tatarkina, I.M. Golovi, A.F. Suhovey (Tatarkin, Sukhovey, 2005). The innovative activity is described by V.N. Kiselev, R.A. Fatkhutdinov (Head, 2004; Fatkhutdinov, 2007). The innovation competitiveness questions are described by V.V. Ovchinnikov, T.G. Filosofova and V.N. Bykov. In world practice known publication by M. Muchie, A. Baskaran (Muchie, Baskaran, 2013), P. Intarakumnerd, J.Vang (Intarakumnerd, Vang, Lundvall, 2006), K.J.

58 Joseph, C. Chaminade (Joseph, Chaminade, Vang, Lundvall,2010).

59 At the same time, often used the term "innovative susceptibility" is not defined in any one source. The authors  
60 propose to consider innovative susceptibility of the region as presence and the ability of regional subjects and bodies of  
61 the executive power to create, execute and implement innovative processes based on existing conditions and resources  
62 within a particular and ongoing national and regional innovation policy (Vladimirova, 2011).

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## 64 2. The Main Part

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66 The concept of "innovation susceptibility" has a logical connection to the other categories of the conceptual apparatus of  
67 innovation management, such as the innovation potential, innovation climate, innovative activity, innovation  
68 competitiveness. The study proposed in the scientific literature, reference books, legal acts of innovative interpretations of  
69 a number of terminology suggests that rates of innovation have a certain relationship. It is clear that innovative  
70 susceptibility should create conditions for innovation, to which it is necessary to relate the availability of innovative  
71 capacity and consequently form the basis for the formation of innovative climate, implementation of innovative activity and  
72 innovation competitiveness. The innovative potential and innovative climate record the availability of resources,  
73 innovative activity and competitiveness - the impact of innovation. The innovative susceptibility represents the summation  
74 of resource component, the readiness of subjects to develop, implement and realize the innovation, and the effect of the  
75 interaction of these elements in the form of outcome indicators (Figure 1).

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## 77 3. Results



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80 **Fig. 1 -** The relationship of the concept "innovation receptivity" to the categories of the theory of innovation management

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82 Thus, this model is a complex multi-level system, forming an innovative competitiveness and investment attractiveness of  
83 the region. At the same time, innovation receptivity, being a sub-system that is focused on the building a rational strategy  
84 for the implementation of inno-ODL paradigm in relation to a particular region. Consequently, innovation competitiveness  
85 and management of innovation susceptibility should be related as the purpose and means.

86 The consideration of the theoretical aspects of innovation receptivity explains the need to develop its quantitative  
87 and qualitative evaluation criteria. The method of calculating the integral indicator of innovation receptivity, based on a set  
88 of private indicators (Table 1), the approach to the construction of an innovative rating susceptibility described in detail in  
89 (Vladimirova, 2011). For the purpose of testing the methodology, empirical studies have been conducted in the regions  
90 that are a part of the Siberian Federal District (SFD) (Vladimirova,2011).

91 The innovative susceptibility of the region is formed under the cumulative interaction of the two systems of factors  
92 reflecting, on the one hand, innovative climate in the region, and on the other - its innovative potential. The conducted  
93 terminological analysis suggests that the definition of "innovation climate" is a set of conditions that reflects the social,  
94 nature-geographic, communication, technological, scientific, technical, economic, financial, political and legal sphere of  
95 the region and in the synthesis can be represented as using indicators "regional standard field" and "infrastructure  
96 support" (Table 1).

97 In its turn, to the system of indicators that reflects the innovative potential of the region can be attributed indicators:  
98 the proportion of the population engaged in research and development; the share of innovation active organizations; the  
99 proportion of acquired research and development funds in their total cost; the share of domestic expenditure on research  
100 and development in the GRP (GDP); the share of expenditure on technological innovation in the GRP (WFP); the share  
101 of innovative products, services and works in GRP (WFP) and the proportion of the economically active population.

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**Table 1 - The system of private indicators to measure innovation receptivity of the region**

Index	Calculation method	Information base (State Statistics section of the report)
The share of employment in R & D	$\frac{\text{population of R \&D}}{\text{the total number of the employed population}}$	Research and innovation; Employment and labor
Share of innovation active organizations	$\frac{\text{number of innovation active enterprises}}{\text{the total number of registered enterprises}}$	Research and innovation; Companies and Organizations
The share of acquired research and development funds in their total value	$\frac{\text{value of acquired research and development funds}}{\text{the total value of fixed assets}}$	Research and innovation; National wealth
The share of domestic expenditure on research and development in the GRP expenditure on technological innovation	$\frac{\text{domestic expenditure on research and development}}{\text{GDP(WFP)}}$	Scientists investigated and innovation;
The share of expenditure on technological innovation in the GRP (WFP)	$\frac{\text{expenditure on technological innovation}}{\text{GDP(WFP)}}$	Gross Regional product; National wealth
The share of expenditure on technological innovation in the GRP (WFP)	$\frac{\text{volume of innovative products, services and works}}{\text{GDP(WFP)}}$	
Proportion of the economically active population	$\frac{\text{the number of economically active population}}{\text{the total number of the population}}$	Employment and labor
Regional standard field	$\frac{\text{a number of regional regulations on innovation.}}{\text{a general number of regulations on innovation.}}$	Internet sites data "Science and innovation in the region" and the Federal Portal Science and Innovation activities
Infrastructure provision	$\frac{\text{the number of available infrastructure institutions}}{\text{the number of institutions of leading regions}}$	

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At the same time the question of correlation appears about the proposed indicators in measuring innovation used in world practice. For the evaluation and comparative analysis of innovation of countries and regions it is widely used the technique of the experts of the World Economic Forum to assess the competitiveness, a technique of the Commission of European Communities (CEC), the method of the Organization of Economic Cooperation and Development (OECD), the methodology of the American Science Foundation (NCF) (11Innovation Measurement, 2014). In international practice, it is also widely known the techniques that form the so-called "Frascati Family". The syntheses and comparison of indicators is given in Table 2.

The calculation of indicators for the assessment of innovative region susceptibility on the above term, using traditional methods of univariate analysis is not difficult. Using the values of the individual parameters for the integrated assessment of the susceptibility of innovation in the region is a rather difficult task associated with the introduction of a heterogeneous data. The standard approach to the formation of summative evaluation of any economic phenomenon in the presence of heterogeneous quantitative terms is usually limited to the use of well-known economic and statistical methods of calculating the arithmetic unit, geometric unit by relative index of the process or the method of sums without the inclusion or inclusion into the system of the weight values, etc. The effectiveness of the model, describing the state of a complex socio-economic phenomenon, largely caused not only by the choice of quantitative and qualitative indicators, but also a mathematical algorithm allowing to generate a functional dependency. In addition, the model should fit in a technique that enables the management to solve the problem with the definition of a place in the region at the federal level and to identify potential opportunities to move the territorial education at any level of the outsider status into the leading one. Thus, there is a need to develop an integrated model that will take into account the diverse indicators, the weight value of each factor and to identify priorities for the development of the region to achieve the target value.

In our view, to solve the problem you should use the proposed by N.V. Shalanov (Shalanov,2005) and successfully tested by the author technique (Petrova,2006) which is based on the theory of potentials J. Huht and P. Meyer(Hunt ,1962; Meyer,1973) .

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**Table 2** - Indicators to assess the innovativeness

The system of indicators of innovative development of the Republic of Belarus (The State Program ...,2011)	Innovative susceptibility (Vladimirova,2011)	Indicators of the European innovation scoreboard (2010) (European Innovation Scoreboard, 2010)
1 The number of employees involved in research and development	2 The share of employment in research and development	Conditions for Innovation (Innovation Drivers) 1.1 Staff who have received a degree or higher education per 1000 population aged 20-29 1.2 Population with tertiary education per 100 population aged 25-64 1.3 The level of broadband (the number of broadband connections per 100 inhabitants) 1.4 Participation in continuing education per 100 population aged 25-64 1.5 The level of education of young people (% of population aged 20-24 with completed secondary education)
1 The share of innovation - active organizations in the total number of industrial enterprises	3 The share of innovation - active organizations	3 Innovation and Entrepreneurship (Innovation & Entrepreneurship) 3.1 Small and medium-sized enterprises (SMEs), developing their own innovations (% of SMEs)
2 Share of costs for equipment, tools and accessories for investment in fixed capital	4 Share of acquired research and development funds in their total value	There is no analogue
3 Gross domestic expenditure on research and development in GDP	5 The share of domestic expenditure on research and development in the GRP (GDP)	2 An investment in knowledge (Knowledge Creation) 2.4 Share of enterprises receiving public funding for innovation
4 Indices domestic expenditure on research and development	6 Share of expenditure on technological innovation in the GRP (WFP)	2 An investment in knowledge (Knowledge Creation) 2.2 Expenditure on business research and development activities (% of GDP) 2.3 The share of research and development costs of technologies
5 There is no analogue	7 The share of economically active population	4 Applications (Applications) 4.1 Employment in high-tech business (% of total labor force) 4.5 Employment in the manufacturing technology of medium and high level (% of total labor force)
6 Share of new products in total industrial output;	8 The share of innovative products, services and works in GRP (WFP)	4 Applications (Applications) 4.2 Share of high-tech exports in total exports 4.3 Sales of new exporting firms in foreign markets (% of total turnover) 4.4 Sales of new products firms (% of total turnover)
7 The share of certified products in the total volume of industrial productivity	9 there is no analogue	Intellectual Property (Intellectual Property) 5.1 EPO patents per million population 5.2 USPTO patents per million population 5.3 Triad patents per million population 5.4 The new trademarks per million population 5.5. New design elements per million population
8 Creating and certification of quality management systems according to ISO	10 Infrastructure provision	3 Innovation and Entrepreneurship 3.2 Innovative SMEs to cooperate with others (% of SMEs) 3.5 The cost of information and communication technologies (% of GDP) 3.6 SMEs using Innovation (% of MSP)
9 The deterioration of the active industrial fixed assets at end of year	11 There is no analogue	There is no analogue
10 The share of innovative products in the total volume of production in the total volume of industrial output	12 The share of innovative products, services and works in GRP (WFP)	4 Application (Applications) 4.2 Share of high-tech exports in total exports 4.3 Sales of new exporting firms in foreign markets (% of total turnover) 4.4 Sales of new products firms (% of total turnover)
11 The increase in financial expenses for research and development at the expense of the national budget	13 There is no analogue	3 Innovation and Entrepreneurship (Innovation & Entrepreneurship) 3.3 Expenditure on innovation (% of total turnover) 3.4. Venture capital in the initial stage (% of GDP) 2 An investment in knowledge (Knowledge Creation) 2.1. Public expenditure on research and development activities (% of GDP)
12 There is no analogue	14 Regional standard field	There is no analogue

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Compiled by the authors according to (The State Program...,2011; Vladimirova,2011; European Innovation Scoreboard, 2010)

This technique allows not only to formalize and define the level of development of complex social and economic systems at the micro and macro levels, to reveal the potential for growth, but also, based on the set of different management level development of prospects, to identify priority areas of growth.

Summing of initial parameters in a complex hierarchical system using the theory of potentials produced by calculating the ratio between the result obtained by the formed functional dependence and the maximum possible or

146 desired value for the system.

147 The objective of this phase of the study is to describe two blocks of terms of the first level (Figure 1) and mixing  
148 them into a comprehensive assessment on the second level of the system.

149 On the basis of the static data and the results of processing by the authors the original quality parameters for the  
150 years 2001-2009 (Vladimirova,2011), it was decided to divide the dynamical rank into two periods 2001-2006 and 2006-  
151 2009, due to fracture-governmental stages of economic development of the country. Unfortunately, the lack of some  
152 statistical information for the last 4 years, limited time period of the study.

153 The comparative analysis of the Russian Federation and regions of the Siberian Federal District, found that in the  
154 Tomsk region the highest level of innovation receptivity is achieved. Therefore, as the target (threshold) values for the two  
155 time intervals 2001-2005 and 2006-2009, parameters of this RF subject are established. The value of the indicator  
156 "proportion of the economically active population" in the Krasnoyarsk region is higher than in Tomsk Region. As in the  
157 case like this as a reference you can use the maximum actual index achieved in a given period of time or remove this  
158 option from the model as reached the peak meaning.

159 In the tables №3 and №4 weighting parameters in the complex model on the block I «innovative potential of the  
160 region" were calculated and on the block II «innovation climate" for the two periods was calculated. For visual  
161 presentation of the results, the relative values in the block I are designed in ppm. The numbering of figures in the block is  
162 given in the order of their position and indicated by the symbol «i», a period of time is determined by the last digit of the  
163 year (1-5, 6-9) and marked «j», belonging to the unit - «k».

164 The calculation algorithm proposed standardization of each indicator (gr. 8-12 Table. 3 and gr.7-10 Table. 4) and  
165 the corresponding target values (Table 3 gr.13 and gr. 11 Table 4) using the standard deviation (gr.7 Table. 3 and gr. 5  
166 Table. 4), calculated by the dynamic rank. Standardized values are indicated by the symbol "x\*<sup>ikj</sup>". Further, the weighting  
167 values of diverse indicators in the block are defined according to the formula:

$$\beta_{jk} = \frac{z_{jk}}{\sqrt{\sum_{j=1}^n (z_{jk}^*)^2}} \quad (1)$$

168 A functional model is formed for each block and in general can be represented as follows:

$$y_k = \sum_{j=1}^n \beta_{kj} * x_{kj}^* \quad (2)$$

170 where  $\beta_{kj}$  - the weighting values of the coefficients;  $x_{kj}^*$  - private corrected figures for the unit.

171 **Table 3 - Calculation of parameters of a functional model based on data for the period 2001-2005**

Units	Indexes	symbols	Evidence in the context of data blocks ( $x_{kij}$ )					target value (reference) ( $x_{kj}^*$ )	standard deviation ( $\sigma_k$ )	Standardized value evidence years, ( $z_{kij}$ )					standardization of the target value ( $z_{kj}^*$ )	on 7-featured		on 6-featured	
			2001	2002	2003	2004	2005			2001	2002	2003	2004	2005		weight of standardized values ( $\gamma_{kj}$ )	rank	weight of standardized values ( $\beta_{kj}$ )	rank
			1	2	3	4	5			6	7	8	9	10		11	13	14	15
I innovative potential	share of population employed in research and development, %	X11	5,4	5,20	5,10	4,90	4,90	17,2	0,04	150,0	144,4	141,7	136,1	136,1	477,8	0,609	2	0,998	1
	share of innovation - active organizations, %	X12	2,8	4,30	5,30	5,70	6,70	14,5	1,76	1,59	2,45	3,01	3,24	3,81	8,25	0,011	5	0,017	4
	the proportion of acquired research and development funds in their total cost, %	X13	5,4	4,00	9,00	3,50	5,20	36,0	3,71	1,45	1,08	2,42	0,94	1,40	9,69	0,012	4	0,020	3
	the share of domestic expenditure on research and development in the GRP, %	X14	5,6	6,9	7,9	6,6	6,3	13,4	0,57	9,82	12,10	13,85	11,57	11,04	23,49	0,030	3	0,049	2
	the share of expenditure on technological innovation in the GRP (WFP), %	X15	2,1	1,00	3,00	5,50	3,20	7,8	2,22	0,95	0,45	1,35	2,48	1,44	3,52	0,005	6	0,007	5
	the share of innovative products, services and works in GRP (WFP), %	X16	3,0	2,6	8,1	7,7	10,3	25,2	9,15	0,33	0,28	0,88	0,84	1,13	2,75	0,004	7	0,006	6
	proportion of the economically active population, %	X17	5,1	5,20	5,25	5,29	5,38	5,4	0,01	588,6	600,2	605,9	610,6	620,9	620,9	0,792	1	X	X
II innovative climate	regional standard field	X21	1,6	1,6	1,6	1,6	1,6	1,0	0,00	X	X	X	X	X	X	X	X	X	X
	infrastructure provision	X22	4,0	4,0	4,0	4,0	4,0	5,0	0,00	X	X	X	X	X	X	X	X	X	X

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**Table 4 - Calculation of parameters of a functional model based on the data for the years 2006-2009**

Units	Indexes	symbols	evidence in the context of blocks years, $(x_{kij})$				target (reference) value $(\lambda_{target})$	standard deviation $(\sigma_{ik})$	standardized value evidence years, $(z_{kij})$				standardization of the target value $(z_{kj}^*)$	on 7-featured		on 6-featured	
			2006	2007	2008	2009			weight of standardized values $(\gamma_{kij})$	rank	weight of standardized values $(\beta_{kij})$	rank					
			A	B	1	2	3	4	5	6	7	8	9	10	11	12	13
I innovative potential	share of population employed in research and development, %	x <sub>11</sub>	4,70	4,60	4,00	3,90	15,6	0,125	37,6	36,8	32,0	31,2	124,8	0,056	2	0,964	1
	share of innovation - active organizations, %	x <sub>12</sub>	8,00	11,90	13,80	12,00	15,3	4,482	1,785	2,655	3,079	2,677	3,414	0,002	5	0,026	4
	the proportion of acquired research and development funds in their total cost, %	x <sub>13</sub>	4,70	9,90	5,70	3,00	38,9	6,467	0,727	1,531	0,881	0,464	6,015	0,003	4	0,046	3
	the share of domestic expenditure on research and development in the GRP, %	x <sub>14</sub>	5,3	6,3	6,2	7,6	22,7	0,672	7,881	9,368	9,219	11,301	33,755	0,015	3	0,261	2
	the share of expenditure on technological innovation in the GRP (WFP), %	x <sub>15</sub>	2,90	7,70	12,00	10,70	14,2	12,24 2	0,237	0,629	0,980	0,874	1,160	0,001	6	0,009	5
	the share of innovative products, services and works in GRP (WFP), %	x <sub>16</sub>	16,2	17,6	12,7	5,2	24,0	23,07 7	0,702	0,763	0,550	0,225	1,040	0,0005	7	0,008	6
	proportion of the economically active population, %	x <sub>17</sub>	5,35	5,38	5,33	5,46	5,5	0,002	2183,7	2195,9	2175,5	2228,6	2228,6	0,998	1	X	X
II innovative climate	regional standard field	x <sub>21</sub>	3,30	3,30	3,30	3,30	10,0	0,00	X	X	X	X	X	X	X	X	X
	infrastructure provision	x <sub>22</sub>	5,60	5,60	5,60	5,60	7,0	0,00	X	X	X	X	X	X	X	X	X

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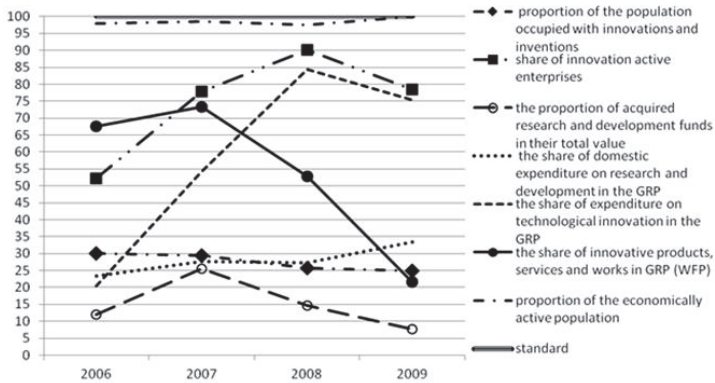
Let us analyze the terms of each block, forming a definition of "innovation susceptibility of the region." The study of innovative climate in the region through the system of quality indicators conducted by the authors in works (Vladimirova,2011). The obtained results allow us to conclude that this category is fairly static for short periods of time (up to 5 years) has no distinct dynamic changes, because it is formed under the influence of factors related to the legal framework and the availability of infrastructure in the region, and is a reflection of the sluggish bureaucratic system. The results of calculations carried out by Unit II in Tables 3 and 4, confirm the absence of variation in the characteristics in the investigated time interval, which excludes significant influence of this group of factors on the dynamics of changes in the complex index of "innovative susceptibility of the region." Consequently, the considered indicators do not have a significant potential in the interval 2005-2009, influence equally on innovation susceptibility of the region as a constant, so the authors considered it possible at this stage of the study to eliminate the impact of the innovation climate in the region on a general indicator.

Factors in group I, defining the innovative potential of the region, have both positive and negative dynamics of the interval 2001-2009 and significantly are different from the same values in the Tomsk region, indicating the unstable development of Krasnoyarsk region, reducing its attractiveness. For a more visual presentation of the achieved level as the unit results calculated in Table 4 by 6-factor system are performed in Figure 2. The standardized reference value on indicators is taken as 100 percent, and the standardized actual values of the terms of unit for each year are translated into a percentage of the standard for more convenient layout of indicators on the chart.



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**Figure 2** – The dynamics of the ratio actually achieved and target values of the indexes of the unit "innovative potential of the region"



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The largest gap between the reference value and the actual achieved level is observed in terms of "a share of the acquired fixed assets of investigations and developments in their total value." In terms of "a share of innovation active organizations" and "a share of the costs of technological innovation in the GRP (WFP)" in the period 2006-2008 there is a sharp jump, which correlates with the policy of regional authorities in terms of attracting of innovative technologies into the region. These two parameters are the most close to the level of the Tomsk region. The remaining terms of the block at the varying dynamics of development by 2009 are in the range of 22% to 34% of the target value.

According to the calculations potential functions are generated by two periods on the basis of the 7-and 6-factor system and using the equity method are converted into the following dependencies (Table. 5).

**Table 5** - The potential and adjusted functions of the innovative capacity of the Krasnoyarsk Territory

Years periods	The 7-factorial system	The 6-factorial system
Potential functions		
2001-2005	$Y = 0.605 * x_{11} + 0.011 * x_{12} + 0.012 * x_{13} + 0.030 * x_{14} + 0.005 * x_{15} + 0.004 * x_{16} + 0.792 * x_{17}$	$Y = 0.998 * x_{11} + 0.017 * x_{12} + 0.020 * x_{13} + 0.049 * x_{14} + 0.007 * x_{15} + 0.006 * x_{16}$
2006-2009	$Y = 0.056 * x_{11} + 0.002 * x_{12} + 0.003 * x_{13} + 0.015 * x_{14} + 0.001 * x_{15} + 0.001 * x_{16} + 0.998 * x_{17}$	$Y = 0.964 * x_{11} + 0.026 * x_{12} + 0.046 * x_{13} + 0.261 * x_{14} + 0.009 * x_{15} + 0.008 * x_{16}$
Adjusted functions		
2001-2005	$Y = 0.415 * x_{11} + 0.008 * x_{12} + 0.008 * x_{13} + 0.021 * x_{14} + 0.003 * x_{15} + 0.003 * x_{16} + 0.543 * x_{17}$	$Y = 0.91 * x_{11} + 0.02 * x_{12} + 0.02 * x_{13} + 0.04 * x_{14} + 0.01 * x_{15} + 0.01 * x_{16}$
2006-2009	$Y = 0.052 * x_{11} + 0.002 * x_{12} + 0.003 * x_{13} + 0.014 * x_{14} + 0.001 * x_{15} + 0.001 * x_{16} + 0.928 * x_{17}$	$Y = 0.73 * x_{11} + 0.02 * x_{12} + 0.04 * x_{13} + 0.20 * x_{14} + 0.01 * x_{15} + 0.01 * x_{16}$

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The analysis of the results leads to the following conclusions. Firstly, the ranking weight values of the parameters calculated by the seven- and six-terms (with the exception of the indicator "proportion of the economically active population") for two periods, does not change the priority of the factors in the resulting models, forming the system. The greatest influence on the innovative potential of the region has a share of the economically active population. Reaching the target value of this parameter, the second most important was "the share of population employed in research and development" (2nd place in the 7-factor system and 1st place in the 6-factor system). These two parameters are interdependent and this function confirms this. The next most important factor is the "share of domestic expenditure on research and development in the GRP." The cumulative effect of the three main components in a 7-factor system in the interval 2001-2005 was 97.9%, in the interval 2005-2009 - 99.4%. The transition to a 6-factor system did not change the picture - parameters "proportion of the population engaged in research and development" and "the share of domestic expenditure on research and development in the GRP" formed a comprehensive assessment of the unit by 95% and 93% at two time intervals, respectively. The share participation of other factors is not significant.

Second, the rank of the weight values of function parameters for two analyzed periods did not change, which suggests that this trend continues today. Therefore, formed additive models allow calculation of an integrated

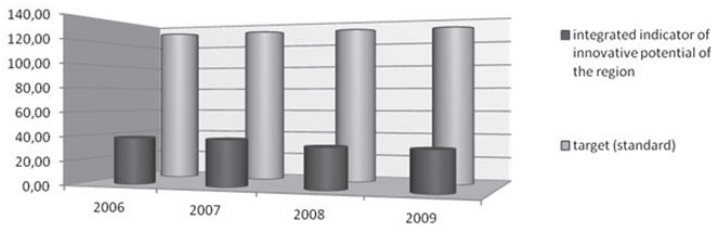
235 assessment of innovation potential of the region for six and seven-factor system and allow the system to forecast the  
236 short-term period.

237 In the next stage of research, it is necessary to assess the status and dynamics of innovation receptivity region in  
238 order to identify weaknesses in its development and the development of activities to achieve the desired (target) level.  
239 The calculation of the potential function of the unit, conducted according to the 2006-2009 period allows to create a  
240 comprehensive assessment, which determines the position of the subject and the leader of the region (Table 6). The  
241 comparison of this result for the region with the data allows to determine the standard deviation from the set point of  
242 growth, which is referred to as "the growth differential". In a relative form, this parameter is reflected in the index  
243 "achieved level." For controlling the block "innovation potential" at the regional management there is a need to determine  
244 the required and sufficient level of adhesion of the function to achieve a given parameter, which is reflected by the  
245 indicator "the necessary level of differential growth." The methodological justification for the use of the listed parameters  
246 and testing calculation algorithm is developed by the authors in their research (Petrova, 2006).

247 **Table 6 -** The potential function on the block "Innovation potential of the region"  
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Indicators	Calculation methodology	Years			
		2006	2007	2008	2009
Potential values of the functions	$y_k = \sum_{j=1}^n \beta_{kj} * z_{kj}$	38,38	38,07	33,38	33,12
The target value of the potential function	$y_k^* = \sum_{j=1}^n \beta_{kj} * z_{kj}^*$	129,48			
Growth differential	$D_{ik} = y_k^* - y_k$	91,09	91,41	96,10	96,36
Achieved level, %	$C_{ki} = \frac{y_k}{y_k^*} * 100$	29,65	29,40	25,78	25,58
The required level of growth differential, %	$ID_{ki} = \frac{y_k^*}{y_k} * 100$	337,32	340,15	387,86	390,93

250 The results of the ratio of potential values of the functions and the target level are reflected more clearly in Figure 3.  
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253 **Fig. 3 -** The dynamics of the ratio actually achieved and the target value of the complex index of the innovative potential  
254 of the region  
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258 The received results indicate that the achieved level of innovative potential in the Krasnoyarsk region in 2009  
259 corresponds the target values only 25%. For four years, the gap between the performance in the Krasnoyarsk and Tomsk  
260 region increased by more than 4% (25,58 - 29,65). To achieve the parameters of the leading region it is necessary to take  
261 measures to raise the level of index that form the potential for innovation.

#### 262 4. Conclusion 263 264

265 Thus, the authors consider two sets of terms of the first level, characterizing the innovation climate and innovation  
266 potential of the region (Figure 1). The analysis of the dynamics of the innovation climate in the region allowed to conclude  
267 the absence of significant shifts in their development and consequently, stagnation of the regional control system. To  
268 detect changes in the system of management of innovative climate in the region a more detailed study of the system  
269 parameters is required. The algorithm of influence of groups of factors in the absence of dynamics in their development  
270 as a constant in the general characteristic of innovative potential of the region is formed by two vectors. Reaching a block

of reference value by the terms constant acts as a catalyst for the process, even when there is no visible change in the short-term dynamics. In the Krasnoyarsk Territory the values in the block in the interval 2006-2009 in terms of "infra-structural support" and "regional standard field" make up just over 80% and 30% of the reference values (Table 4), which significantly slows down the development of innovative technologies. And if the first indicator reflects the result of the development of the region for several decades, the second is a direct reflection of the effectiveness of modern management. Such a scenario for the block development is unacceptable for fulfilling the potential of the subject of federation as an innovative platform, since the development of the economic system in the implementation of innovative development objectives should be sustained.

The investigation of the second block of the first level of "innovation potential of the region" showed a mixed trend changes in its terms, which affected the decrease in integrated assessment, and showed a significant deviation of the achieved level of the target value of the potential function (Table 6).

Thus, the development of a comprehensive evaluation of innovation susceptibility of the region on the basis of the study makes it possible to identify the main trends to improve the management of innovative activity in the subjects of the Russian Federation.

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## An Investigation of the Relationship Between Corporate Brand Value and Future Stock Returns in the Listed Companies in Tehran Stock Exchange (TSE)

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### Abstract

Competition has gained a major increase, and global market has come into spot light. In so happening, the national industries have to add to their competitive advantages. Brand value is one of the strategic tools which will bring commitment, repeated use, adding to the economic value for the shareholders and increases the domain of economical activities in the different geographical locations. From the investment domain, the most important factor for an investor is the stocks returns. Stock returns means all the cases earned because of stock keeping along with the capital gain. This study was aimed at investigating the relationship between companies brand value and stocks' future returns in the accepted companies of Tehran's stock exchange during the years of 2005 to 2012. The population under study was consisted of all the accepted companies of Tehran's stock exchange. 80 companies were selected for the purpose of this study. The sampling method was based on systematic deletion. The data of the study was of a compound type. In order to test the hypothesis of the study, the multiple regressions were used. The results of the study showed that there is a negative and significant relationship between brands' value and stocks' future returns. The results showed that among the variables such as company size, book value ratio, and market Value ; the only statistic which was positive and meaningful was the statistics of book value to market Value . This shows the positive effect of this variable on the stocks' future returns.

**Keywords:** Brand value, Future stock returns, Firm size, Book value to market value ratio.

### 1. Introduction

In recent decades, the role and importance of intangible assets have increased as the level of competition among the companies has also increased. Brand value as an intangible asset is one of the most important factors in making a distinction in a company, and creating competitive advantage. The performance of a brand value has a direct relationship with the performance of an organization. In this way, the constant evaluation of that can be regarded as a powerful management tool which helps the managers toward reaching their general and strategic objectives in an organization. One of the greatest mistakes that a company may commit is name limitation, commercial notation, and running the company as a part of the marketing management duties. In this way, in most companies (especially the accepted companies of stock exchange which are working at two fields of marketing and finance for the purpose of financially supporting and receiving people's capital and one of the important duties of them is to facilitate the procedure of capital allocation) the discussions about the companies' name, and commercial notation is being regarded as one of the most important intangible assets. From the view point of investment, the most important case is stock returns. returns means the result of all the earned cases which were the result of keeping shares along with the capital gain. Investors have always been searching for the type of information which can help them toward predicting the future returns of their share. In other words, the most important factor which is into the investors spot light and the users of financial information is stock returns. That is why predicting the future returns of the shares is of great important at the time of decision making. In recent years, the great amount of the finance related researches and accounting investigations have been done around the issue of share returns and the effective factors on it. In this study, the aim was to investigate the relationship between commercial name, and the future returns of the shares in the accepted companies of Tehran's stock exchange. The main question of the study is: is the value of commercial name (brand is the true English equivalent for this word. In

57 some texts commercial name is used) effective on the future returns of the shares?  
58

## 59 2. Theoretical Framework and Literature Review 60

61 Brand or the so called commercial name has changed into one of the hot topics in the field of marketing. In the decisions  
62 related to buying the issue of brands value setting is of great importance. Sometimes the estimated value of the brand of  
63 a company comprises the significant value of the physical properties of a company. Brand is effective in the thinking style  
64 and the view point of the user. A suitable brand is the reason of growth is a company. In this way, evaluating a brand is a  
65 highly value task (Interband, 2011). Brands are important intangible assets which can be effective in the performance of a  
66 company (Morgan & Rego, 2009). Park, MacInnis and Priester studies in 2006 show that brands can be useful in  
67 decreasing the uncertainty level in the people's lives as a manageable issue. It also enables people to effectively control  
68 the gaining of expected results. Hence, they believe that brands can carry an effective sense which helps the people to  
69 do their daily activities in a better way (Loken and colleagues, 2002). Brand name is the most valuable intangible asset of  
70 a company. The main priority of the managers in the companies has been to expand the brand name. This has been their  
71 priority for over 1 decade. The concept of the value of the brand name has been included in some features such as  
72 having information about the brand name, fidelity to the brand name, perceived quality, and the symbol of the brand  
73 name. The especial value of a brand name is regarded as a key concept in creating competitive advantages in a  
74 company. That is why the value of a brand name is important in the process of future earnings (Hsu et al., 2013). In  
75 evaluating a brand there are two dimensions to be talked about. One is the internal dimension and the other is external.  
76 In naming the external dimensions one can refer to tax, balance sheet, authorization, mutual funds, bankruptcy, funding,  
77 integration, possession and its relationship with investors (Interbrand, 2011). In naming the internal dimensions these can  
78 be named: brand monitoring, budget allocation for the marketing activities, domestic licensing, portfolio management of a  
79 brand, and much more. Brand value can be analyzed from 2 perspectives; Marketing, and financial. The especial value of  
80 a brand means the value added which is received by a brand. Aaker has defined the brand value as: the collection of  
81 assets and liabilities which are related to brand, and is added to the value of the good or product of a company or is  
82 deleted from the value of that product in a company. These are also mentioned by Azizi and colleagues, 2011. Most  
83 marketing managers know about the brand, marketing concepts, customers' needs, advertising and the related issues;  
84 they also have a great experience in performing them, but what is making problem for them is their inability in making use  
85 of the marketing concepts for the purpose of promoting the brand value. All of such problems are because they don't truly  
86 know about the brand value as one of the most important intangible assets of a company. What these people know is the  
87 tangible properties of a company. This issue can also be observed in the type of companies which are trying to receive  
88 financial support and advantage by means of offering their shares at financial markets. These days the existing  
89 companies of stock exchange try to sell their shares by means of underwriting contract. It is clear why most people go  
90 toward the type of companies which are more well-known and are more reliable (Qanvati, 2009). Hsu and colleagues  
91 (2003) had a research investigation which was titled as "the effect of brand names on the financial performance". They  
92 sought 100 well-known brands in all around the world during the years of 2001 to 2010. The researchers used s&500p  
93 index to measure their data. The results showed that there was a positive and significant relationship between brand  
94 value and the financial performance of the companies. Belo and colleagues (2013) had an investigation named as "brand  
95 or commercial names as the wealth and value of a company". They investigated the type of companies which receive  
96 fees for their advertisements. They showed that the companies which have had more investments regarding their brand  
97 have moderately received more returns in their shares. In contrast, the companies which have had fewer investments on  
98 their brands have moderately received lesser amount of returns during a year. The results showed there is a strong  
99 relationship between advertisement fees and shares' returns in a business company.

100 Chemmanur and Yan (2011) in a research which was named as "advertisement, knowing about the investor, and  
101 share returns" tested Merton's (1987) theory of knowing the investor in a new field. The new field was the effect of  
102 advertisement on shares' returns. In this study the effect of size, book and market Value and others were of controlled  
103 variables. The results showed that customers' knowledge (gained by advertisement) will lead to promotion in shares'  
104 returns in the advertisement year. In contrast, it will bring decrease in shares' returns in future years (the years after the  
105 advertisement year). Qasemi and colleagues (2014) in a study named "the common effect of brand value and  
106 advertisement in cash flow statement of the accepted companies of car making and its accessories" investigated brand  
107 values and advertisement fees of 5 companies which were in the name list of Tehran's stock exchange during the years  
108 of 2001 to 2010. The information related to cash statements were elicited from financial bills. Linear regression was used  
109 for the purpose of analyzing the data. The results of the study showed that there is a relationship between the dependent  
110 variable (cash flow) and the common effect of the brand value and advertisement. Brand value had a positive effect on

cash flow statements. There was also a negative effect on advertisement, the common effect of advertisement and brand value and on cash flow statements. Ukiwe (2009) in a study named as “ the common effect of advertisement costs and brand values on the financial performance of the companies” investigated the effect of brand on shares’ returns and ROA of 17 international computer companies in the annual list of inter brand. They sought the years of 2000 to 2007. The data was including: the advertisement costs and brand value of these 17 companies and their ROA and shares’ returns which was elicited from the Morning Star Financial Reports. The results of this study showed that there is a positive relationship between ROA, brand value, and the advertisement costs. Madikizela (2007) in a study named “on the investigation of the especial value of a brand on the ROA of southern Africa companies” studied a sample of 21 brand names in different industries such as banks, long and short term insurances, food industries and many more. They sought the years of 2003 to 2006. In 2006, among the brands the Markinver brand was named as the top brand. Linear regression and correlation was used. The results showed that the relationship between brand value, ROA, and shares’ prices was acceptable in some industries.

### 3. Population and Sample

The population under study was consisted of all the accepted companies of Tehran’s Stock Exchange. The sampling was done based on systematic deletion. The selected samples were supposed to have one of these features.

- The information which was related to advertisement costs was supposed to be along with the financial lists.
- The information which was related to financial lists and their further information notes was supposed to be continually at hand during the time of the study.
- The shares of these companies must have been activated in the stock exchange during the years of 2005 to 2012. In the case of suspension, the suspension time must not be more than 3 months.
- Their fiscal year must end to 29th of Esfand ( 20th of March) in each year.
- The data must not be from banks, investments, leasing, and financial intermediation industries. This is because the nature of their activities is different.

Based on the mentioned features, a sample of 80 companies was chosen from the accepted companies of Tehran’s stock exchange during the years of 2005 to 2012. The data were elicited from: financial lists, some soft wares (such as Tadbir Pardaz, Rah Avard e Novi), the web site of securities and exchange organization (SEO),. In order to analyze the data and elicit the required results EXCEL and Eviews 7 was used.

#### 3.1 Research hypothesis

The main hypothesis: brand value has effect on the shares’ returns of the accepted companies of Tehran’s Stock Exchange.

Hypothesis 1: Company size has an effect on stocks future returns in the accepted companies of stock exchange.

Hypothesis 2: the ratio of book value to market Value is effective on the stocks future returns of the accepted companies of stock exchange.

#### 3.2 Methodology

It is a practical research study with a descriptive type of information. Correlation method was used to analyze the data. In order to test the models of the study the following model was used:

$$\text{Equation 1: } R_{i,t+1} = \alpha + \alpha_1 \text{size}_{i,t} + \alpha_2 \text{BM}_{i,t} + \alpha_3 \text{CBV}_{i,t} + e_{i,t}$$

In this equation:

$R_{i,t+1}$  : the future returns of the I company in the period of t+1

$\text{CBV}_{i,t}$ : The change inbrand value

$\text{size}_{i,t}$  : The size of I company;

$\text{BM}_{i,t}$  : the ratio of book value to market Value of each share of the I company in the t year

$e_{i,t}$ : Total waste

$\alpha$  : the coefficient is on the model

164 3.3 Variables of the study

165

166 **Brand value:** in 1989 brand value was defined as: The increase in value due to the performance of marketing activities  
167 by a firm. This value added can be regarded as the financial property and a collection of good behaviours which is  
168 defined by customers and other members. (Marvati et al., 2012; p.8). Value added of a company is computed as the  
169 following: based on Park and MacInnis (Stated in Davis 2006 in page 240).

170 Equation 2: A change in brand value including growth rate

171 
$$CBV_{gr} = \frac{Me * R}{1 + (1 + gr) * Me}$$

172 gr = Is the growth rate which is computed by Equation 3:

173 
$$gr = ROE * (1 - d\%)$$

174 
$$ROE = \frac{\text{Net Income}}{\text{The Market Value of The Share Owners right}}$$

175 
$$d\% = \frac{DPS}{EPS}$$

176 Me = Is the marketing efficiency which is computed by Equation 4:

177 
$$\frac{R}{C_m} * Me =$$

178 Cm = Marketing costs

179 R = Is the total sales which is computed by Equation 5:

180 
$$R = P * Q$$

181 P Selling price = Q Amount of Selling

182

183 3.4 Company size

184

185 Company size is defined through different measures. It can be market Value value, asset value, amount of sales,...  
186 logarithm of net sales recorded in profit and loss is regarded as a measure for company size and is computed based on  
187 equation 6:

188 company size in the year of t = log( amount of net sales of a company at the end of t year)

189

190 3.5 Company Value

191

192 Company value is composed of two sections. First section, is the book value at the t time. And second section, the  
193 measured value of the net income is defined as: "the value which is because of future economical results. (Wang, 2008).  
194 The criterion of evaluating this variable is the ratio of book value to market Value . In order to compute the company  
195 value, the book value of each share of the i company, and the data related to market Value of each share of the i  
196 company in the year of t which was collected by means of Tadbir software was entered into Excel. Then, it is computed  
197 based on equation 7.

198 Equation 7:

199 
$$\frac{\text{Book Value Of Each Share}}{\text{Market value Of Each Share}} = \frac{B}{M}$$

200 **Stock Returns:**

201 The returns of one investment on the common stock includes the cash dividend which is paid in year. And is any  
202 type of change in the market Value value which is shown at the end of the year. (Dastgir, 2008, p.232).

203 Equation 8: 
$$R_{it} = \frac{P_{it} - P_{it-1} + D_{it}}{P_{it-1}}$$

204 R<sub>it</sub>: The rate return on stock of i in t period

205 P<sub>it</sub> : The price of the share i in t period

206 P<sub>it-1</sub>: The price of the share i in t-1 period

207 D<sub>it</sub>: divided per share of i in t period which is given to the share owner.

208

209 4. Results of the Study

210

211 The regression model of the study was analyzed based on compound data. Based on the usage of the compound data  
212 and for the purpose of selecting between panel and compilation data in analyzing the model, the F.Lymr model was used.  
213 The probability amount of F.Lymr was computed as 0.333 and because this was more than 0.05, the compilation method  
214 of analyzing the data was used.

215 The main hypothesis: the results showed that the significance level for brand was  $p=0.033$ . This means that there  
216 is a significant relationship between the future stock returns and this variable. In other words, there is a significant  
217 relationship between brand and the future stock returns at the certainty level of 95%. Though the relationship was  
218 significant, it was an inverse relationship.

219 Hypothesis 1: the results of the test of this hypothesis showed that the p value was 0.071 (higher than 0.05), so;  
220 the relationship was not significant. Therefore, this hypothesis is rejected.

221 Hypothesis 2: the results of this hypothesis showed that the significance level of the ratio of book value to market  
222 Value was  $p=0.000$  which is lesser than 0.05. It shows the existence of a significant relationship and therefore, this  
223 hypothesis is confirmed.

224 **Table 1:** The summary of the results based on the regression model  
225  
226

$R_{i,t+1} = \alpha + \alpha_1 size_{i,t} + \alpha_2 BM_{i,t} + \alpha_3 Log CBV_{i,t} + e_{i,t}$				
Sig-level	statistic t	index	sign	variable
0.169	1.375	0.219	$\alpha_0$	intercept
0.071	1.803	0.270	SIZE	Company size
0.000	5.341	0.183	BM	The ratio of book value to market Value
0.033	-2.131	-.311	CBV	Change in Brand value
11.665		statistic F	0.059	The index of investigation R2
0.000		Sig level of F statistic F	1.910	Durbin-Watson statistic

227 **Source:** the results of the study  
228  
229

230 The investigation index shows that about 5 percent of the future stock returns is defined by the regression model. It  
231 shows that about 5 percent of the changes are depicted by the regression model.

## 232 5. Conclusion

233  
234 In today's era an appropriate name has the ability to change the performance of a company. As an intangible asset, it is  
235 one of the most important properties of a company in a competitive economic system. Brands and investigating the  
236 amount of relationship between brands and performance indexes can be regarded as a criterion for benefactors of the  
237 organization such as shareholders, creditors, employees, and other people. In another way, it is important for investors  
238 who want to know about the measuring dimensions and identification aspects of a brand and other intangible assets  
239 which are advantages in financial statements. Keller says that there are 2 main motivations in studying about the brands:  
240 one is the financial motivation for the purpose of evaluating the brand value in the fiscal and calculation aims. The other is  
241 the elicited motivation for the purpose of Karater marketing. This begins by the common perceptions of the customers. In  
242 other words, brand equity is based on the user of a good. In this study, the financial dimension of the brand has been  
243 investigated. The results of the tests shows the reverse and significant relationship which exists between brand and the  
244 future stock returns. The probable reasons of this relationship could be that there are companies with fewer  
245 advertisement costs and they reveal fewer amounts of information to the investments. That is why the future returns of  
246 their stock is higher than those companies which reveal more information to their investors. The studies show that long  
247 term effects of advertisement have got negative effects on the brands. These are: the increase of costs, losing the brand  
248 value. Aker in 1996 proved that frequent advertisement will decrease the brand value in the long run, and this will have  
249 negative effects on the brand value. The results also showed that the only statistic which was positive and significant  
250 among all the mentioned variables was the ratio of book value to market Value . It shows that this statistic has an effect  
251 on the future stock returns. The results of this study also were similar with the findings of Chemmanur and Yan (2011). It  
252 was also in agreement with Belo et al., in 2013. The results of this study and the results of Yukio(2009) in computer  
253 industry which showed that brand value has got an effect on the stock future returns are in agreement with each other,  
254 but their coefficient of determination index was weak. The results are also in agreement with Madikizela (2007). Also the  
255 study is similar with the results of Qasemi et al., (2014).  
256  
257  
258  
259  
260



## 6. Suggestions

### 6.1 Practical suggestions

- Investors are suggested not only to take care of the profiting companies but also to the brand and the amount of expenses which are spent for the purpose of advertisements in a company. It is because the brand values and the expenses spent on advertisement are effective on the stock returns.
- Marketing and financial managers are advised to closer their financial and strategic planning to each other for the purpose of planning and determining the objectives of the company. They are advised to have collaboration within these fields.

### 6.2 Suggestions for future research

- The results of this study are at the level of all of these companies. It means, small and large companies both were analyzed. It is probable that each of these small and large companies show different results when they are studied separately. The researchers are suggested to make use of the companies which are in a similar range. They are also advised to make use of other variables such as place, and advertisement method when computing the brand value of the companies.
- In this study, the relationship between marketing variables of the brand value and the financial variable of the future stock returns was analyzed. There are other marketing variables, too. And they are all effective in the financial performance of a company. It is suggested to study the effect of these variables, too.

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## Institutional Basics of Tariffs in Housing and Communal Services: Cross-Country Analysis

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### Abstract

The aim of the article is a review and summarizing methods of tariffs in housing and communal services in foreign countries, and also reasoning of opportunity to use of state marketing in the regulation of tariffs and the main directions of its usage, both in Russia and abroad. The result of this article is the formulation of conclusions and predictions for further development of tariff setting, as well as the social consequences of this policy in the sphere of housing and communal services. The institutional character of the social practices of HCS, according to the authors, is associated with the provision of living conditions for the population in the sphere of material practices and with the finding of ways to optimize the economy of the industrial and postindustrial societies. In the service social practices HCS special factor is the change of goal setting, re-orientation of social action for the client from the process that is not always connected with rational components of the social actions of individuals, and also with the operation of irrational components. Besides, there is a kind of "soft" technologization in the service social practices of HCS. Pricing policy in the sphere of housing and communal services detects a contradiction, on the one hand, between a wide range of services and agents that shows the democratization processes in the maintenance and strengthening of processes of self-administration, and on the other side of rising prices and low quality of services provided.

**Keywords:** State marketing, tariffs, housing and communal services, social practice tariff.

### 1. Introduction

The research topic is in line with international trends of increasing of the role and relative weight of categories sector of human activity and social life. Services housing are an integral part of industrial relations, including relations of production, transfer, exchange, distribution and consumption of specific (in the form of services) vitally important goods which are related to the field of personal and collective consumption.

Foreign experience in the aspect of opportunity of its usage in the conditions of Russian specificity is not sufficiently studied and necessitates special studies. That is why it is necessary to conduct polyaspecific cross-country analysis of the institutional basics of tariffs. This will allow us to develop the concept of the forming of institutional system of housing and communal economy in the countries which realize the transition to civilized forms of management, and also to determine the principles of development of market relations in the process of interaction of subjects of the market with regard to the adaptation of foreign experience and the imperative of institutional improvement of the Russian practice.

Let us examine the impact of institutional changes in housing and communal services (hereinafter referred to as HCS) on the process of its delivery and distribution of the financial burden on the population. Implementation of reforms in HCS and the development of a new system of social subsidies for HCS services in RF and further socio-economic policy and the stability of society are not finished.

In the economic and social context housing and communal utilities (hereinafter - HCA) are an important factor in the reproduction of the main productive force of society - labour force, the creation of gross national product and national income, economic growth, increasing economic efficiency; in social context housing and communal services is resultative

58 factor in the stabilization of the level of living of the population in the period of consolidation of market relations, its  
59 subsequent growth, improving the quality of life, the full realization of the principle of social justice.

60 Institutional design and development of effective strategic organizational and economic mechanisms of  
61 development of the sphere of housing and communal services in today's economy plays an important role in society life.

62 Institutionalization of elements of socio-economic reality strengthens the social practices of everyday life in any  
63 country. Institutionalization of HCS is adequate to ongoing social processes, which testifies to the needs of society in  
64 organizing.

## 65 66 **2. The Main Tendency in the Development of Tariffs in European Countries and in Russia**

67  
68 Key trends in the development of markets of services of HCS in European countries over the last two decades can be  
69 summarized as followings:

- 70 - the decentralization of the system of management utilities HCS with the transfer of responsibility to local  
71 authorities;
- 72 - the privatization of most companies operating in the water supply system, heating, gas and electricity;
- 73 - the structural reform of HCS in a part of separation of kinds of activity (generation, transmission and  
74 distribution) of companies which operate in this market, with the aim of promoting competition in potentially  
75 competitive sectors;
- 76 - the establishment of the current regulatory regime, which main purpose is the creation of optimal conditions of  
77 modernization of the infrastructure of HCS while maintaining a balance of interests of operating companies  
78 and consumers.

79 Since 1999, the electricity market in the UK operates in the mode of competition. Since 2001, all the companies  
80 were divided into four activities, each of which will require a separate license for production, transmission, distribution and  
81 supply of energy (Electricity prices – Price systems, 2006; Eurostat Statistical books, 2007).

82 The main condition of entry into the market of provision of housing services in the UK is the licensing of all types.  
83 And also institutional specifics for companies in this market are:

- 84 - agreement on prices limits on power transmission, distribution of electricity is reviewed every 5 years. (in  
85 Germany - 5 years, in Finland - 4 years);
- 86 - compensation scheme for network operators, providing high quality services to consumers (The Electricity  
87 Distribution Customer Service Reward), which is designed to highlight and promote the company which carry  
88 out their activities most effectively and demonstrate best practice in relation to consumers. (1 million pounds );
- 89 - the introduction of a new model of regulation of tariffs - the RIIO model (Revenue = Incentives + Innovation +  
90 Production) (revenue=incentives+innovation+outputs). The RIIO model will be applied in reviews for price  
91 regulation from April 2013 (Decision' document: our final decision on the RIIO model, [http://www.ofgem.  
92 gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf](http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf), 2013).

93 Distinctive and positive side of tariffs in Germany is that the lowering of reducing the amount of income, which  
94 stimulates the most efficient operation, is placed. Since January 1, 2009 incentive regulation, which replaced the old  
95 system of tariff regulation based on the cost method of tariff calculation was enacted (The decree on incentive regulation,  
96 <http://www.gesetze-im-internet.de/aregv/index.html>, 2012). Incentive regulation involves the determination of the  
97 maximum allowed revenue (permissible revenue cap) of network operators (StromNEV, [http://www.gesetze-im-  
98 internet.de/stromnev/\\_11.html](http://www.gesetze-im-internet.de/stromnev/_11.html), 2012 ). The basis for its determination became the costs of network operators in 2008.  
99 The regulation period is 5 years, for operators of gas supply networks the first period lasts 4 years. The aim of the new  
100 regulatory system is the creation of incentives to increase efficiency of functioning of the energy sector (GasNEV,  
101 [http://www.gesetze-im-internet.de/gasnev/\\_10.html](http://www.gesetze-im-internet.de/gasnev/_10.html), 2012).

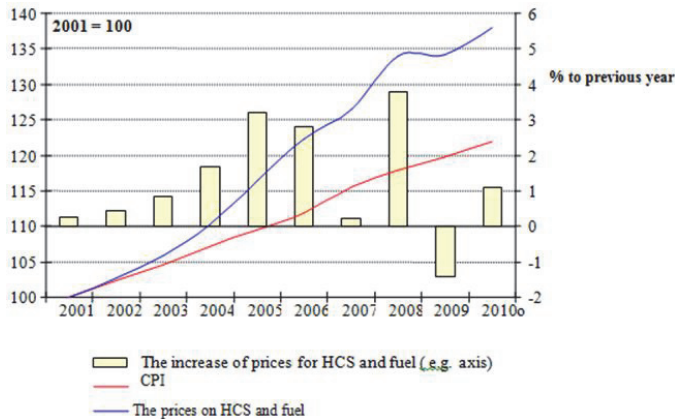
102 Later on each year, the maximum income will be adjusted to reflect market prices for the relevant services.  
103 Moreover, the amount will be reduced by 1.25% per year. This reduction is aimed to increase the productivity and the  
104 efficiency in the sector. The system of bonuses and penalties provides additional incentives for network operators to  
105 reduce costs: if costs exceed a fixed level for the previous year, the network operator will incur 25% of additional costs; if  
106 the cost is lower than the target value, it can save 25%.

107 An important role in the regulation of the sector of water supply and water removal play industry and professional  
108 associations. In Germany there are six major associations - Association of municipal enterprises of HCS (Federal  
109 Network Agency. Monitoring Report, 2009), the Association of enterprises in the sector of water supply and water  
110 removal (Federal Network Agency. Annual Report, 2009), Association in the field of energy and water suppliers  
111 (Association of Local Utilities, <http://www.vku.de/other-languages/english.html>, 2015), Association of supplying water from

112 reservoirs (German Association for Water, <http://www.dwa.de/portale/dwahome/dwahome.nsf/home?readform>, 2015),  
113 Associations of water management in Germany (German Association of Energy and Water Industries, 2015), the  
114 Technical-Scientific Association in the field of gas and water supply in Germany (Association of Drinking Water from  
115 Reservoirs, <http://www.trinkwassertalsperren.de/>). These associations have developed a system of benchmarking in the  
116 sector of water supply and sanitation (German Alliance of Water Management Associations, [http://www.dbvw.  
117 de/txt110.ph](http://www.dbvw.de/txt110.ph)).

118 In the European Union dynamics of prices for complex for housing and communal services and fuel during the  
119 2000s was positive, both in nominal and in real expression excluding 2009. In other words, the rate of growth of prices for  
120 housing and communal services and fuel exceeded the rate of consumer inflation. However, the scale of this annual  
121 excess was small, being within 5%. In the first half of the 2000s the acceleration in the rate of growth of prices for housing  
122 and communal services was observed, in real terms they reached a peak in 2005. Subsequently, after some delay, a new  
123 peak in 2008 took place - on the wave of pre-crisis overheating of the global economy. In the 2009 year of crisis, despite  
124 the fact that the index of consumer prices in the EU rose by 1.5%, rates for utility services remained almost unchanged,  
125 which resulted to reduction of the cost of housing in real terms in the past decade. However, in 2010, according to  
126 preliminary estimates, the rise in nominal and in real terms was resumed.

127



128  
129

130 **Figure 1** – Dynamics of nominal and real rates for public utility services in the EU-27 and the consumer price index, 2001  
131 - 2010 (source - Eurostat data)

132

133 Examining the dynamics of tariffs for specific HCS, significant caveat should be made concerning the methodology of the  
134 European statistical system, namely the weights of the various components. According to classification COICOP  
135 (classification of individual consumption by purpose - ed.), approved by the UN, which conduct surveys of household  
136 budgets in category "Housing services, water, electricity, gas and other fuels" includes the costs of the rental of dwellings,  
137 as well as "imputed rent for housing services". This leads to the fact that the share of this category in the structure of  
138 consumer spending depends on the development of the rental market and the share of households living in rented  
139 housing, as well as calculation methods "contingent rent". In Russia the share of rent in the structure of expenditures for  
140 housing and communal services, even taking into account the rent for housing in the state and municipal Fund, is  
141 significantly less than 10% (according to the methodology of calculation of the price index Rosstat), and is not calculated  
142 "imputed rent". But in European countries, the rent is of great importance in the framework of consumer expenditures for  
143 housing and communal services, accounting for about one third of the price index for services of this group.

144

145

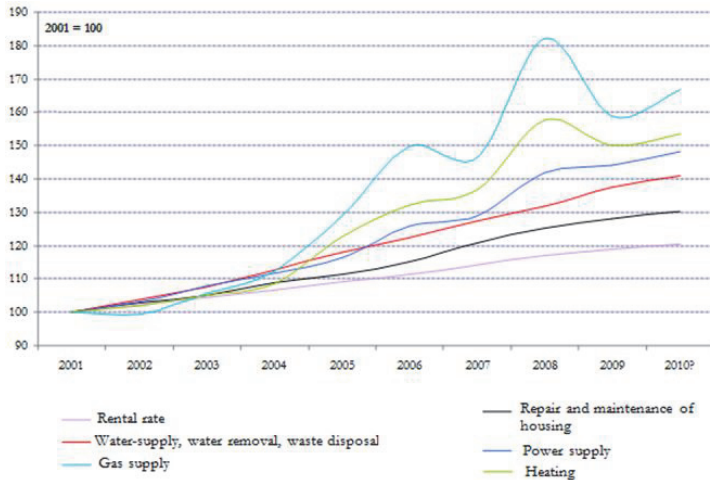
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**Figure 2** – Dynamics of tariffs for private housing and public services in the EU-27, 2001 - 2010, 2001 = 100 (source - data Eurostat)

The rental rate is the factor that significantly inhibits the growth of average prices for housing and communal services in European countries. Each year it grows only 2 to 2.5 percentage points, and in 2009 - 2010, the growth rate was even lower. Prices for repair and maintenance of housing, which are another important factor when calculating the price index for housing and communal services, are also increasing steadily, but slowly, and at a rate of 2 to 4% per year, except for 2007, when they increased by almost 5%, and the period 2009 - 2010, when the rate, in contrast, slowed and even decreased in 2010 according to estimation to less than 2%. Services of water supply, water removal and waste disposal are rising a bit faster, but too slowly.

The main factor of significant fluctuations of the magnitude and the rate of growth of tariffs in the EU became prices for electricity, gas and fuel. Prior to 2003, on average, they increased annually by about 4%, moving within a single trajectory with other HCS. But in 2004, the tariffs for services of this group increased by 6.5%, in 2005 - 2006 by approximately 10% per year, after a disappointing 2007, the growth rate in 2008 again exceeded 10%, but in 2009, a drop of almost 4% was recorded.

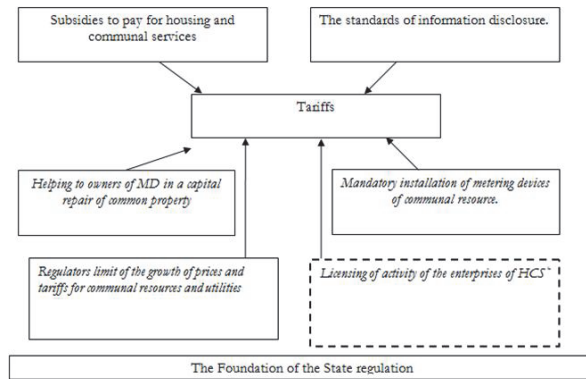
The logic of the reform of HCS is based on change-over to payment services in accordance with their actual scope and quality. Payment at a reduced standard does not encourage saving measures, including the installation of metering devices. On the other hand, the overestimation of the tariff causes complaints of citizens-consumers of utilities.

In accordance with the standards of HCS of the Russian Federation, the volume of municipal services is calculated on the basis of consumption norms, or on the basis of meter readings.

In order to analyse the reasons for the increase in charges for public services, multifactorial nature of its calculation should be noted.

Monitoring data approved by the local government of standards indicate a significant difference in the consumption standards of public services, as between territorial entity of the RF, and between municipalities within the same region. It is necessary to indicate that, besides that there are a general an algorithm and established methods for calculating of tariffs, standards of consumption of utility services, approved by local authorities for the same for all parameters (design features, territorial factors and other) buildings in different municipalities can differ significantly. Taking into account that the ratio of the consumption of utility services has a physical meaning and primarily depends on the design features of buildings and climatic conditions, a large dispersion of values within a specific territorial entity of the RF spoke about the diversity in approaches to the regulation of the regulations by local authorities in the definition and adoption of standards.

In Russia, the tariffs for housing and communal sphere are shaped by a number of factors, shown in figure 3.



**Figure 3 – The institutions affecting tariffs of housing and communal services of the Russian Federation**

The price improvement of mechanism for providing HCS to consumers, differentiating of their value depending on the location of housing, degrees of comfort, land improvement are the regulator of marked economic transformation. In order to avoid non-payment for services and social tensions in the country the citizens' solvency must be taken into account and social protection of the population must be ensured, which makes state regulation of price and tariff policy in the formation of the market of HCS. This would have a beneficial effect on the population's attitude to growth of tariffs. Negative social response also receives the quality of services, it does not change for the better.

It is evident from figure 3, the state is not required only by the participant (subject) HCS along with the sellers and consumers, but also performs on the market the specific role of the dominant entity. Not dealing directly with the satisfaction of the needs of members of society, it must regulate this process and to facilitate the effective achievement of a compromise between the interests of all participants with minimal cost society. This is due to the need to address economic and social processes in unity and cooperation. Thus, the state, unlike private enterprises, is interested in the efficient functioning of the economy as a whole. On the other hand, the state can be considered from the point of view of the provision of important social services (security, environmental protection and so on). That is, it is a specific company that provides a broad range of services.

The above facts indicate the necessity of providing marketing approach to state management in the sphere of HCS, both in general and when carrying out certain activities, regardless of their size. For successful practical solutions to complex public problems achievements in different fields of knowledge need to be effectively used. Among them is the marketing.

The decisions of state authorities without an objective and reliable information, extensive discussions and consultations in society, often cause considerable resonance and dissatisfaction with certain social groups. Therefore, to improve the efficiency of government without active use of marketing seems to be quite problematic, and the complexity of market processes and the active intervention of the state now require allocation in the system of marketing such varieties as state marketing (German Technical and Scientific Association for Gas and Water, [www.dvgw.de/english-pages/dvgw/](http://www.dvgw.de/english-pages/dvgw/)).

The aim of public marketing must be, first and foremost, the maximum satisfaction of material and spiritual needs of citizens within the allocated public expenditure. State marketing should examine needs and interests, i.e., the essence, structure, ranking, factors and trends.

Marketing in the activities of state agencies has certain characteristics, because these agencies are not always directly satisfies these needs, but only indirectly contribute to this. In comparison with tasks that solves marketing at the level of the individual enterprise, the purposes of government marketing is much bigger and more complex. So, if on HCS enterprise marketing provides sales and promotion of a narrow range of services of this company, at the state level it multidirectional that requires a comprehensive and balanced approach to the needs of the subjects. Besides, it is necessary to take into account such factors such as environmental, political and other. In the temporary plan state marketing activities designed for much more long term.

The second reason, which causes the need for active use of marketing, is the necessity of active influence on consumer preferences. The state can and should influence the formation of the correct consumer behavior of citizens in housing and the consumption of HCS. On the other hand, it should encourage manufacturers to the satisfaction of

229 rational demand through complex state of marketing activities and tools. This means that the state marketing should be  
230 socially oriented. The main directions of state policy in the sphere of HCS should be to support and develop of  
231 competitions of organizations that provide relevant services.

232 For solutions of problems of HCS private enterprise has limited capacity and resources. Therefore, the state should  
233 take responsibility for solving complex and large-scale problems. To ensure the necessary level of competition the state  
234 has effective regulatory tools, which can be divided into direct and indirect. Therefore, the marketing concept of the public  
235 administration should provide more efficient and qualitative identification, formation and satisfaction of consumer's needs  
236 in the sphere of HCS.

237 One of the functions of government marketing can be also legislative regulation of the marketing (advertising)  
238 activity of subjects of the market of HCS in order to avoid negative impact on consumer preferences, creation of  
239 conditions for fair competition on the market.

240 The marketing tools should be used effectively at all stages of preparation, adoption and implementation of  
241 managerial decisions, including the adoption of effective laws. In particular, the tools of marketing communications that  
242 will allow to make a more open and democratic system of government must be used.

243 Public marketing must be used completed with all the tools of public administration, for example, planning, to  
244 identifying and finding ways to satisfy the real needs of people.

245 To make good management decisions and ensure effective functioning of the HCS the government bodies need  
246 not only general information about the condition of the market of HCS, but also specific data about individual companies,  
247 which can be obtained through public or private research organizations.

248 Thus, the state marketing should become an integral part of the system of state management in the sphere of  
249 HCS, and its main problem is the maximum satisfaction of the reasonable needs (interests) of the population at the  
250 expense of producers of services for which the state should create the most favorable conditions for development.

251 State marketing should be used primarily to solve the following main tasks:

- 252 - clarification of goals and problems for the development of sphere of HCS;
- 253 - analysis and forecasting of public demand for HCS;
- 254 - formation of positive image of HCS as sector of the economy;
- 255 - the development of competition, ensuring equal conditions for all subjects of the market activity;
- 256 - legislative support and the creation of appropriate conditions for the implementation of laws;
- 257 - stabilization of the market of HCS.

258 In Russia, the individual elements of the marketing are already in use in state bodies activities, however, this usage  
259 is not always complex and focused, and for their practical implementation is often lacking the necessary resources.  
260 Today at the level of ministries begin work on the creation of units that perform various marketing functions. Their tasks,  
261 working methods and activities will differ from the activities of the marketing departments of businesses. But the point is  
262 not only in the creation of separate divisions, but in the transition to the marketing concept of public administration, which  
263 involves the extensive use of marketing techniques at all stages of adoption and implementation of managerial decisions.  
264 Thus in this complex all the levers of public administration should be used: legal, organizational, financial, etc.

266 **Table 1** – The growth rate of consumer prices, nominal income and tariffs for HCS in Russia for the period 2002-2012, in  
267 % to previous year (Drugov, A. A., Safin, A. R., Sendetzky S. C., 2005; German Technical and Scientific Association for  
268 Gas and Water, [www.dvgw.de/english-pages/dvgw/](http://www.dvgw.de/english-pages/dvgw/))  
269

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
CPI	15,1	12,0	11,7	10,9	9,1	11,9	13,3	8,8	8,8	6,1	6,6
Per capita nominal income of the population	28,9	31,0	24,0	26,5	25,7	23,6	18,6	13,0	5,2	2,8	8,4
HCS tariffs	48,8	28,7	23,5	32,7	17,9	14,0	16,4	19,6	13,0	11,7	9,4

270  
271 **Source:** Federal state statistics service of the RF  
272

273 Thus, the analysis of data of the Table shows that the growth rate of consumer prices always has a social character and  
274 background. However, for socially vulnerable segments of the population, particularly for pensioners, it was a constant  
275 concern, which was forced to raise pensions, benefits, wages in the government payroll ; perhaps even above a realistic  
276 level according on the fiscal capacity of the country.

277 In the mid-2000s, the situation seems to have reached a relative stability: since 2003, the growth rate of nominal  
278 income is almost always (except for 2005) exceeded the growth rates in the housing sector, and in 2010 - 2011 the

279 growth rate of tariffs was reduced to quite low levels, even taking into account inflation, but although still slightly exceeded  
280 them. However, in 2011 - 2012, the growth rate of the real price of HCS relative to the previous year were significantly  
281 below 5%, which is quite a normal situation for European countries.

282 But in 2009-2010, the situation has changed not for the better: the growth of HCS increased again. In 2009, the  
283 nominal growth rates reached a maximum level for the last four years.

284 Statistical data on specific housing and communal services indicate that approximately up to 2005, the services  
285 can be divided into two categories: electricity and gas, on the one hand, and other essential housing services, on the  
286 other hand.

287 The cost of services of electricity and gas to 2005 increased by about twice slower than in other utility services. In  
288 the second half of the 2000s, the growth of tariffs for gas and electricity became close in with indicators for other services,  
289 and in 2010 even can considerably surpass them coming near to 22-23% compared to the previous year, while water and  
290 heating can grow only by 15-20%, and the maintenance and repair of housing - and at 10%. Particularly noticeable in  
291 recent years are increasing gas prices, and in this the tendency to their planned exit on the same level with European  
292 (including, of course, the transport component) can be noticed.

293 The increase of tariffs for housing and communal services in itself is a significant factor in the acceleration of  
294 inflation. The direct contribution of the growth of tariffs for HCS in consumer inflation in recent years was steadily about  
295 1.5 percentage points. Thus, the reduction of the rate of growth of prices for HCS 2 times will help to reduce the overall  
296 rate of inflation by about 0.7-0.8 percentage points.

297

### 298 3. Social Practices in Reforming the HCS in Russia

299

300 Tariffs in the sphere of housing and communal services should be considered as part of social practices in the HCS  
301 sector. Let's refer to the question of the process of institutionalization of social practices on the example of housing and  
302 communal services. In the process of institutionalizing there are some social problems in the society, the reason is the  
303 divergence of interests of the whole society with the interests of specific individuals in the housing arrangement and  
304 reproduction of HCS, the need for housing and communal services has both mass and individual character, and the latter  
305 runs the risk of not being recognized as socially significant. Such institutions perform their own functions and standard  
306 operations, they can be not seen for a long time, do not present values and do not perform functions that meet the needs  
307 of society in a particular cultural dominance.

308 The need for social recognition of the Institute of public utilities, as significant for the economic and social  
309 functioning of society is obvious, it is from the work of this institution largely depends on the representation of the  
310 population of the stable development of society.

311 The reforming of HCS in Russia affects a very wide range of relationships, which involved a majority of the  
312 population of cities and towns. The housing reform provides for radical reform of the system of housing management, i.e.  
313 the whole social institution, which is based on the reconstruction of the interaction and relations between participants in  
314 the market. According to researchers of A. C. Yermishin and L. C. Klimenko, "the social importance and significant  
315 positive externalities characterize HCS as a socially significant private benefit, production and financing of which is  
316 accompanied by formation of special relations and institutions." (The availability of housing and communal services in  
317 Russia: Myths and reality, 2010).

318 As can be seen, the results of social surveys the reforming of social institution can lead to social instability (In  
319 June, the rating of the main problems of the country is headed by the situation in the housing sector, //http://mrr-sro.ru/  
320 2013).

321 To ensure social stability of the state and the territorial entity of the RF of local authorities used a variety of tools,  
322 namely:

- 323 - federal, regional, municipal, local development programs for major repair: dilapidated housing, communication  
324 networks, water supply, cleaning and transportation of wastewater, and so on;
- 325 - the provision of public subsidies to pay for housing and communal services of the Russian Federation subjects  
326 and local authorities;
- 327 - the tariff policy, i.e., the pricing services of housing are formed on the territory of the municipality and approved  
328 by a regional body to monitor tariffs.

329 Considering each of these tools let's refer to the official statistics and reports on Russia and the Rostov region (In  
330 June, the rating of the main problems of the country is headed by the situation in the housing sector, //http://mrr-sro.ru/  
331 2013).

332 Implementation of Federal and social programs is a priority aims of the ministry of housing and utilities for the 2011



reporting year, the current 2012 year and the planned period 2013 - 2015, from the Constitution of the Russian Federation, Federal laws concerning housing and communal services reform in the period 2007-2013 such aims are:

1. Improving the living conditions of citizens, creating a safe and favorable condition of their living;

2. Creating the conditions to bring the infrastructure in accordance with quality standards, providing comfortable living conditions of the population of the Rostov region, improvement of the ecological situation. The main indicator of the improvement of living conditions of citizens, is the index of "Proportion of multi-apartment houses with wear of more than 31%, in which were overhauled, in the total number of apartment houses requiring major repairs". Metric values amounted in 2010 to 2.8% (while the target value of 2.5%), in 2011 to 1.4% (while the target value of - 1.1 percent); in 2012 and 1.1%, for the planning period: 2013 - 0,6%, 2014 - 0,65%, 2015 - 0.7 percent (Russian statistical Yearbook, 2014).

Analysis of social stability, regional tariff policy on the level of territorial entity of the RF was held in various studies (Nerovnya, I.E. and Oboimova N.T., 2012; Nerovnya I.E. and Oboimova N.T., 2012). It should also be considered the prescriptive regulation, which happens with the help of regulations of the regional government. For example: comparing indexes of consumer prices (tariffs) with other types of services, it should be noted that the rate of growth of prices for HCS ahead also medical services and the price for pre-school education. In the Rostov region a resolution, dated 27.06.2012 No. 56 "On approval of the coefficients of the rising cost of housing and communal services for 2013 - 2015" was adopted and approved the coefficients of the rising cost of housing and communal services for 2013 - 2015, they are presented in the Table:

**Table 2** – The coefficients of the rising cost of housing and communal services for 2013 - 2015 in the Rostov region, Russia (The decision of the Government of the Rostov region dated 27.06.2012 No. 56, <http://special.donland.ru>, July 2014)

Type of Service	2013 год (к 2012г.)	2014 год (к 2012г.)	2015 год(к 2012г.)
Heating	1,150	1,271	1,411
Water-supply	1,116	1,233	1,364
Water removal	1,116	1,233	1,364
Hot-water supply	1,150	1,271	1,411
chemical water treatment	1,116	1,233	1,364
Recycling (disposal) of solid waste	1,138	1,285	1,449
Electricity (budget consumers, including street lighting)	1,116	1,239	1,375
Gas supply with natural gas (budget users)	1,150	1,323	1,521
Boiler-furnace fuel and coal	1,093	1,149	1,200
The removal of liquid waste	1,116	1,233	1,364

The highest rates of growth of tariffs by 2015 are projected to supply natural gas: the annual growth rate is 15% of the amount, the maximum established by the RF Government. Services of heating and hot water on 1,411, power supply on 1,375 points, this group of services are in the same complex JSC "Donenergo", i.e. setting of the tariffs will be carried out almost at the maximum permissible rates of growth of tariffs.

#### 4. The Necessity for Implementation of Marketing Approaches in the Housing and Communal Sector in Russia

Russia's solution to the problem of deducing the HCS from the crisis through the development of market relations in this sphere continues more than 20 years without significant results. One of the big problems in the housing and utilities reform, limiting its development, is the lack of measures for the establishment of market-oriented housing organizations. In the housing law, the literature only the most General approaches to the de-monopolization and development of market relations in the sphere of HCS, involving the separation of the functions of ownership, management and maintenance of the housing stock, the necessity for funding and involving in this sector organizations of all forms of ownership are developed. The implementation of these approaches already puts housing organizations in new conditions that require their management knowledge and skills. However, management methodology, adapted to the peculiarities of the activities of housing organisations and to ensure its market orientation, is missing.

The development of the marketing methodology and its adaptation to housing will equip management housing organizations with the knowledge and skills they need for survival and successful functioning in market conditions. There is an objective necessity for the introduction of marketing management in practice of housing organizations of HCS.

376 Implementation of priority measures of the reform of HCS, such as financial recovery of enterprises, modernization of  
377 fixed assets will not be successful in the absence of market-oriented housing organizations, ensuring their economic  
378 interest due to the high degree of social adequacy activity.

379 The introduction of marketing management in the sphere of housing determines the necessity for the development  
380 of its methodology towards solving existing problems and its adaptation to the peculiarities of the functioning of the HCS  
381 organizations. The main problems of marketing management, which are of fundamental importance, are essential from  
382 the point of view of their successful implementation in housing are followings (Novikova, N.G., 2005; Oboimova N.T.,  
383 2012):

- 384 - lack of the concept of strategic marketing, which would not only provide the interrelated development of  
385 marketing strategies but also their implementation;
- 386 - the absence of a holistic concept of the analytical system, which would allow to combine the efforts of all levels  
387 of management in the direction of obtaining information to substantiate and to test marketing solutions, as well  
388 as would contribute to the integration of marketing in the management of housing organizations;
- 389 - the problem of assessing the quality of marketing management;
- 390 - absence of model in marketing management, which would allow to take into account all the features of ruling  
391 housing organizations of new generation.

## 392 5. Conclusion

393 Housing and communal services (HCS) is complex which represents the largest industry in the Russian economy, whose  
394 share in fixed assets is more than 26% and includes 56.6 thousand enterprises and organizations, municipal, private and  
395 mixed to provide (HCS). Currently, the population of Russia is provided by 16 types of housing and 41 species utilities.

- 396 1. Russia's transition to a market economy determined the necessity for radical changes in the content and the  
397 mechanism of state regulation of the management of housing and communal services as the material basis of  
398 the provision of vital utility services to the population and organizations. Due to the large gap in income and  
399 social problem of the growing weight of the elderly population it is necessary to develop the mechanism of  
400 pricing as more transparent and Pareto-optimal in order to support tariffs of HCS.
- 401 2. Economic policy of administrations (municipalities) should include the preparation and implementation of  
402 priority of urgent measures with regard to bringing economically justified tariffs in accordance with the existing  
403 conditions (dynamics of income and purchasing power of the population and level of development of the  
404 regulatory framework) and to be directed to the stabilization of the system of control of housing.
- 405 3. While using any of the methods of regulation of tariffs (for one year, long-term) mandatory standards for  
406 quality of services, works and basic standards resources (fixed assets, labor costs, material costs, and so on)  
407 necessary to ensure high-quality delivery of heat, electrical energy, water, wastewater treatment, recycling  
408 (disposal) MSW should be developed and established. Only after establishing such regulations it is possible to  
409 develop terms of reference for the development of the production program for public utilities, adopt and  
410 monitor implementation of such a program, and to be confident in establishing economically justified tariffs  
411 (Rate = Production/sales Volume).
- 412 4. However, in the absence of a clear and reasonable methodology for determining consumption norms  
413 established at the Federal level and clear regulation of their use in situations of presence/absence of  
414 household and/or individual metering of resource, such transfer will not give a positive effect.  
415 There are calculations for management companies and HOA with RDF and the OCC for the resource in the  
416 absence of metering devices.  
417 The introduction of new organizational and legal forms of management and operation, changing institutional  
418 environment industry creates preconditions for the investment attractiveness of enterprises of HCS. For the  
419 effective functioning of management companies, development of concession relations required institutionally  
420 mature regulatory and methodological support.  
421 Market reforms in the country's economy changed significantly the structure of money expenditure of  
422 population, social welfare and the demand for consumer goods and services. As a result, the contents of  
423 housing and communal services are changing, as well as forms of supply and demand for these services in  
424 terms of scope and quality component. Today enterprise utility services are not adapted to market conditions  
425 which find expression in the lack of competitiveness of services, cost principles farming, insufficient  
426 management and customer service.
- 427 5. Having Considered the process of institutionalization of the HCS as a reflection of public perceptions about the  
428  
429

430 stable development of society and conducting relevant research, we note that the social practice of service  
431 utilities take into account the historical and international experience in providing various kinds of service.[8]  
432 There are sustainable forms of social practices within the social service Institute, in implementing of housing,  
433 through which a housing were organized, where people realize their needs in security that ensures the  
434 continuity of social ties within a social organization.  
435 Pricing policy for public utilities detects a contradiction, on the one hand, between a wide range of services  
436 and agents that shows the democratization processes in the maintenance and strengthening of processes of  
437 government, and on the other hand, rising prices and low quality of provided services.  
438 6. The concept of socially responsible marketing and marketing interaction with consumers is exactly that  
439 methodology, following which the activities of housing organisations will allow them to become market-  
440 oriented, align their economic interests with the interests of the institutional actors of the market environment,  
441 and on this basis to ensure institutionally mature state of housing. Thereupon, the development marketing  
442 management methodology in the HCS sector in the conditions of formation of market relations is very  
443 important.  
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## Development of Testamentary Inheritance Institution in Albania

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### Abstract

Inheritance is an ancient institution recognized by the Roman law in the Twelve Tables (303 BC) in which the testamentary right was given priority. The testament, in its written form, was initially observed in wax tables, then called "praetorian testament", which as a historical period corresponds to the Classic one (late period of ancient Rome). The testament is a legal action made by the testator through which he disposes his property after death. The testament is an action upon death, personal, that can only be done by the testator and not another person. Generally there are two forms of testaments, ordinary and special testaments. During the years 1912-1929, testamentary inheritance was regulated according to the religion the testator belonged to. The Civil Code of 1929 defines testament as a revocable act through which the testator disposes all or part of his property, referring to the time after his death, in favor of one or more persons. During the communist dictatorship, testamentary heirs could be legal heirs, state authorities and social organizations, but in any case it was not allowed to dispose property via testament in favor of the church or religious institutions. Pursuant to the Civil Code in force, the testament is a legal action arising out of death or *mortis causa*. In such cases when the testator disposes only a part of his property, for the property which is not disposed by testament, legal inheritance shall apply. This paper analyzes the testament institution in Albania during various periods up to the Civil Code in force, that of 1994.

**Keywords:** Inheritance, testament, *mortis causa* action, etc.

### 1. Introduction

Inheritance is an ancient institution recognized by the Roman law in the Twelve Tables (303 BC) in which the testamentary right was given priority. The testament, in its written form, was initially observed in wax tables, then called "praetorian testament", which as a historical period corresponds to the Classic one (late period of ancient Rome). This form of testament was highly improved with the passing of time and became the basic template not only for many of the countries applying Continental Law, but also in other countries as well. The person stating the transfer of his property by presenting the tables and confirming that the writing contained herein expressed his last will, also required the approval from the people who were present to appear as witnesses thereof in case it was necessary, by addressing them a call. This call gave the name to the entire action which was then called *testamentum*<sup>1</sup>. Inheritance relations themselves were born when ownership was born, and shall exist as long as the right of ownership will cease to exist. Such relations are developed following the steps of society development and originate back to the primitive society. However, we cannot say that during that time there was an Inheritance Law *per se*. The inheritance institution may be considered as the point from which diverse and complicated problems arise in the private international law, not only with regards to the opinion of different doctrines, but especially due to the divergences between different legislations and due to practical difficulties resulting as a consequence thereof.<sup>2</sup> The Testament is a one-sided statement of the testator's will, given in a form as prescribed by the law, which aims to create a new order of inheritance and not that envisaged by the law. This is a *mortis causa* action and through it, a part or the entire property may be disposed, or one or more legal heirs may be expelled from inheritance or they may be charged with different obligations. The Testament is a highly personal action and this paper shall address this institution by analyzing its development in different periods in Albania.

### 2. Post Independence Inheritance Institution and Pursuant to the Civil Code of 1929

During 1912-1929, Albania applied the norms of the Turkish Empire to regulate inheritance relations. Such norms were based on Sheriat, the sacred law deriving from Kuran. Testamentary inheritance was regulated according to the religious

<sup>1</sup> Juliana Latifi "Trashëgimia me testament, vështrim krahasues", Shtëpia botuese Lilo 1999, fq.16

<sup>2</sup> Agim Tartari "Trashëgimia në të drejtën ndërkombëtare private", botim i Kumit, 2010 fq.11

54 norms that the testator belonged to.

55 By way of testament one could dispose a part of the property or only special types of property, such as *mylk*<sup>3</sup> and  
56 not completely, but only 1/3 of it. In case the testator would dispose through testament a larger share of *mylk* property,  
57 then the testament validity for such part which exceeded 1/3 depended on the satisfaction of the legal heirs. Another  
58 restriction for the testator with regards to his testament was the fact that if he disposed his estate through testament only  
59 to the benefit of one of the heirs, the testament would be applied only in case the other heirs approved it<sup>4</sup>. In 1922  
60 Albania approved the Decree-law on testaments (dated 05.04.1922) which regulated property inheritance through  
61 testament. Based on this law, one could also dispose through testament 1/3 of the property and in cases when there  
62 were no legal heirs, one could leave 2/3 of its property, whereas 1/3 passed to the state. The Civil Code of 1929 defines  
63 the testament as a revocable act with which the testator disposes all or part of his property, after death, in favor of one or  
64 some persons<sup>5</sup>. The capacity to make a testament was vested only to those who reached the age of 18 years old and  
65 were not divested of their capacity to act. People who could not make a testament, even though not being divested from  
66 the capacity to act, due to their health condition or mental development were not able to understand the importance of the  
67 action they were going to make and the consequences resulting thereof. Such Code envisaged two types of testaments,  
68 the ordinary and the special one. The provisions of the Civil Code of 1929 envisaged two forms of ordinary testament, the  
69 holographic testament and the notary act<sup>6</sup>. The holographic testament, to be valid, should be entirely handwritten and  
70 signed by the testator, as well as bear the date, month and year of its writing; whereas the notary act testament could be  
71 public or secret. The public notary testament was drafted by the notary in the presence of four witnesses, or in the  
72 presence of two notaries and two witnesses and should be signed by the testator, the notary or notaries as well as the  
73 present witnesses. The secret notary testament could be written by the testator himself or by another person and should  
74 be signed at any time by the testator and submitted safely covered in the presence of four witnesses<sup>7</sup>. Special testaments  
75 were further divided into: a) testaments made under exceptional circumstances; b) testaments made during sea voyages,  
76 when the ship was in the sea or in foreign ports and it was not possible to communicate with the Albanian land. a)  
77 Testaments made under exceptional circumstances could be made by the person through a written letter taken from the  
78 notary or justice of peace, or neighborhood or village priest in the presence of two witnesses.

79 In this case the testament should be signed by the person who received it, and when allowed by the  
80 circumstances, by the testator and the witnesses. The testament prepared in this form had no force when a month  
81 passed from the time the testator regained the freedom to make a testament in the ordinary form and did not do it<sup>8</sup>. b)  
82 Testaments made during sea voyages, when the ship was at sea or in foreign ports and it was not possible to  
83 communicate with Albanian land; In cases when the ship was in open sea or in foreign seaports, where there were no  
84 diplomatic agents or Albanian consuls, the testament written by the testator was taken in the presence of two witnesses  
85 in the ships of Albanian state by the administrative officer or ship commander or their vices. In private ships it was taken  
86 from the captain or owner of the ship, or from their representatives. The Testament was prepared in two original copies  
87 and it had to be signed by the persons receiving it as well as by witnesses. Such testament was valid when the testator  
88 died in the sea or within a month from the day he had landed and did not have any possibility to make an ordinary  
89 testament. According to the Civil Code of 1929 the legal reserve referred to legitimate descendants, ascendants, siblings  
90 of the testator who benefited their part, and the testator could neither dispose them through testament nor charge them  
91 any condition or encumbrance<sup>9</sup>. In contrast with this code, the Civil Code in force provides the legal reserve only for minor  
92 children of the testator or other minor heirs, who inherit by representation, as well as other persons disable to work in  
93 case they are called in inheritance.

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<sup>3</sup> *Mylk* property as per the Ottoman Law is the property under full private ownership of the owner, free of any dependence from the state and church, be that real or not.

<sup>4</sup> Ardian Nuni, Luan Hasneziri E drejta civile III (Trashëgimia), Tiranë 2010, fq.270

<sup>5</sup> Article 429 of the Civil Code of 1929 provides: "The testament is a revocable act with which anyone, as per the rules prescribed by law, dispose for the time after his death, all or part of his property in favor of one, or more persons".

<sup>6</sup> Article 507 provides: "The Law recognizes two forms of ordinary testaments: the holographic testament and the notary act testament", (emphasis added).

<sup>7</sup> Article 515, 516 of the Civil Code of 1929.

<sup>8</sup> Article 523 of the Civil Code of 1929.

<sup>9</sup> Article 536 of the Civil Code of 1929.

### 3. Inheritance Institution during Communism (1944-1954, Decree No 1892, dated 05.07.1954 "On Inheritance" and Civil Code of 1982)

Testamentary heirs could be legal heirs, state organs, as well as social organizations. When there were no legal heirs, it was allowed for the property to be disposed through testament in favor of other persons, but not to the church.<sup>10</sup> Property could not be disposed in favor of religious institutions in cases when there were no legal heirs, due to the hostile attitude shown towards such institutions and religion in general. Decree No 1892, dated 05.07.1954 "On Inheritance" defines testament as a one-sided juridical action conducted by the testator himself through which he deposes his wealth after death<sup>11</sup>. The capacity to make a testament arised to everybody who reached the age of 18 years old and as a person under this age when he/she was married. For 14-18 year old minors, the testament could only be made for the property they had gained through their work.

It was not allowed to dispose property through testament to persons whose capacity to act was revoked upon a final court decision, as well as to the persons who while doing the testament were not able to understand the importance of their action. The Decree on inheritance under article 41 provided that the notary act was a valid form for the testament. The testament was made through an edited act or certified by the notary and signed by the testator. The testament should have the form of notary act; otherwise it would be invalid.<sup>12</sup> Expectance from this Decree were the testaments edited in regions where there were no notary offices or which were made by one person serving the military service or in an Albanian ship which was sailing or situated in a foreign harbour. In such cases the testament was certified by the chair or secretary of the country or city people's council, by the commander of the military unit in which the testator was part, when hospitalized for treatment by the hospital director, and when aboard a ship by the ship's captain<sup>13</sup>. In contrast with the Civil Code of 1929, this decree did not recognize the testament written by the testator himself, thus the holographic testament. With the changes made in 1960 regarding the testament form, it was accepted that the testament could also be written by the testator himself (holographic testament), article 41. The testator could not dispose the entire or part of his wealth to any person. First of all he is obliged to dispose such property through testament only to those persons indicated by articles 21, 22 and 23 of the Decree on Inheritance. Only when there is none of the heirs mentioned in such articles (i.e., children, offsprings of children, spouse, parents, siblings, and persons with disabilities to work under the charge of the testator) he could dispose his property to any other person, as per article 32 of the Decree.<sup>14</sup> Property could pass to a social or state organization. Furthermore, such decree did not allow disposing property in favor of religious institutions. The Legislative has forbidden to dispose through testament the belonging part of minor children or minor children of their children, as well as the part of other heirs with disabilities to work in case that according to legal inheritance they have the right to be called in an inheritance. Counter dispositions are invalid and in case with this disposition inheritance is changed its form of ownership, i. e., it is allowed to pass in favor of the state<sup>15</sup>. A particularity of the Decree on Inheritance is that it also envisaged inheritance in agricultural economy, where inheritance over the joint estate of the agricultural family started only when the last member of the agricultural family died, and disposition through testament of land was forbidden (article 58). The agricultural family was composed by all the persons, without discrimination of sex, age, related among them due to gender, marriage, adoption or persons who do not have any gender relation, but who are accepted as members in the agricultural family and who together with their work or with their means earn the living of such family<sup>16</sup>.

The Civil Code of 1981 regulated the inheritance institution with only 25 provisions in contrast with the Civil Code of 1929 which regulated it with 319 provisions, and more concretely in heritage through testament was regulated by articles 110-118. In contrast with the Decree on Inheritance, such Code did not recognize the capacity to dispose through testament the wealth gained with their work to minor children from 14-18 years old. Referring to article 112 of this Code, the testator could leave through testament his entire property or a part of it to a heir or more heirs envisaged by articles 104, 105 and 106 (i.e., children, offspring's of children, able and disable spouse, able and disable parents, grandfather and grandmother, sisters and brothers, children of brothers and sisters that had died, persons with disabilities to work under the charge of the testator), state or enterprises, institutions, agricultural cooperatives or social organizations. The

<sup>10</sup> Nazmi Biçoku "E drejta e trashëgimisë së Republikës së Shqipërisë" shtëpia botuese "albPaper", Tiranë 2011, fq.37.

<sup>11</sup> Article 30 of Decree No 1892, dated 05.07.1954.

<sup>12</sup> Andrea Nathanaili, Nonda Papuli "Disa çështje mbi pronësinë dhe trashëgiminë", Botim i Ministrisë së Drejtësisë, Tiranë 1961, fq.100.

<sup>13</sup> Articles 41,42 and 43 of Decree No 1892, dated 05.07.1954.

<sup>14</sup> Hilmi Dakli "Trashëgimia me testament", Drejtësia Popullore, Janar 1955, fq.44

<sup>15</sup> Kleantih Koçi "Disa çështje kryesore lidhur me institutin e trashëgimisë në shoqërinë tonë" Drejtësia Popullore, Korrik-Gusht 1972, fq.13

<sup>16</sup> Article 90 of Decree No 1892, dated 05.07.1954.

144 testamentary testator could expel from inheritance one or more of his legal heirs, but he could not touch the part  
145 belonging to minor children or other minor heirs who inherited via representation, as well as to other disabled heirs. Such  
146 code also expelled the possibility of disposing property to religious institutions or to the church. With regards to the  
147 testament, it was made through a notary act or written by the testator himself<sup>17</sup>. The testament through notary act was  
148 made with an edited act or certified by the notary and signed by the testator. The testament written by the testator was  
149 written entirely by the testator himself, bears the date when written and signed in the bottom by him. According to this

150 Code, the testament was invalid in one of the following cases:

- 151 a) when is made by a person who did not have capacity to act;
- 152 b) when it was not made in the form required by law;
- 153 c) when it was made in favor of persons who could not inherit;
- 154 d) when it was made by violating the legal reserve for minor children, of other minor descendants without limitation  
155 or disabled persons under the charge of the testator<sup>18</sup>.

#### 156 4. The Testament Institution Pursuant to the Civil Code of 1994

157 According to the Civil Code in force the testament is a one-sided juridical action conducted by the testator himself through  
158 which he disposes his property after death<sup>19</sup>. The testament is a juridical action arising due to death or *mortis causa*. It is  
159 a highly personal action, which may be conducted by the testator himself and not anyone else.

160 It is an action which can be revoked at any time and the testator is not obliged to indicate the reasons of such  
161 revocation and with a solemn formal juridical action which should be in the form required by the law, otherwise it is  
162 invalid. The testator disposes inheritable property to the testamentary heir through a testament. In such cases when the  
163 testator disposes only a part of his property, for the property which is not disposed by testament, legal inheritance shall  
164 apply. Inheritable property is composed by movable, immovable property, as well as rights related to such property.  
165 Based on article 332 of the Civil Code, the testator may win all the property of the testator or a part of it, only a certain  
166 item or a part of it, or a certain item or property right. Referring to the unifying decision of the High Court No 1, dated  
167 24.03.2005: (...) *In the case of testamentary inheritance, given the fact that the source of call in inheritance is the will of*  
168 *the testator himself, the extension to inheritance rights is exclusively related to determined relations by the testator, who*  
169 *formulates his will through an one-sided juridical action, the testament. As a result, the call for inheritance in the case of*  
170 *testamentary inheritance could be not only over the entire inheritable property or a part of it – with universal title, but also*  
171 *on one or special items – with special title. Only universal heirs or those who have the universal title have the judicial*  
172 *capacity to benefit even property elements, which de cuius are not envisaged expressly in the testament. The special*  
173 *title heir has a limited right related to the items or the rights determined expressly in the testament, and as a result, the*  
174 *changes of inheritable property found at the moment of starting the inheritance process, shall not be reflected in their*  
175 *title*<sup>20</sup>. As an one-sided judicial action, the testament brings consequences only with the willful declaration of the testator  
176 and the persons called heir in it are not required to give their consent at the onset of this action in order to be called as  
177 heirs<sup>21</sup>. The testator is not completely free to dispose his wealth in favor of a person, but he is obliged to respect the legal  
178 reserve of minor children and/or other minor descendants without limitation, of disabled persons in case they are called in  
179 inheritance, as well as dispose his property within the three first rows of legal heirs when there are such. According to the  
180 Italian law on legal children, legitimated or adopted, there exists a legal reserve according to which they benefit wealth  
181 equal to the half of inheritable property, in case there is only one child or equal to 2/3 in case there are two children or  
182 more. (Article 537 of the Italian Civil Code). Pursuant to the Common Law system, the spouse cherishes the right of  
183 selection, according to which he has the right either to accept the conditions of the testament or choose against it, thus,  
184 taking the part that would belong to him legally in full ownership<sup>22</sup>.

185 The capacity to make a testament is the capacity of the physical person who willfully and in accordance with the  
186 law may dispose his entire or partial property, after death, in favor of one or some other persons. Such capacity is found  
187 in any person who has reached the age of 18 years old, as well as women under this age when they are married. A minor  
188 child ranging from 14-18 years old may make a testament only for the property he has gained through his work.<sup>23</sup> The

17 Article 115 of the Civil Code of 1981.

18 Article 118 of the Civil Code of 1981.

19 Article 372 of the Civil Code.

20 High Court Decision, No 1, dated 24.03.2005, date of approval 24.03.2005, Official Journal No 74,2005.

21 Valentina Kondili "E drejta civile II Pjesa e posaçme, Pronësia, të drejtat reale të përkohshme dhe trashëgimia" Geer 2008, fq.222.

22 Rezana Konomi dhe Merita Prifti "Trashëgimia testamentare", Jeta juridike Numri 4 Viti XII, Tiranë Dhjetor 2012, fq.85.

23 Article 373 of the Civil Code.

191 married woman under 18 years old does not lose such capacity even when the marriage is declared invalid or dissolved.  
192 However, there is a loophole in this law because it does not include the capacity of persons under 18 years old.  
193 Therefore, full capacity to make a testament should not only have divorced spouses or spouses dissolved by stating their  
194 marriage as invalid, but also those under 18 years old who have remained widowed due to the death of their spouse<sup>24</sup>.  
195 Persons whose capacity to act is removed by court decision as well as persons who at the time of making a testament  
196 are not able to understand the importance of their action thereof, may not make a valid testament. In addition, persons  
197 under 14 years old do not have capacity to dispose at all, since they have no capacity to act in general. In contrast with  
198 the Albanian legislation, the Italian Civil Code (articles 591, 592), as well as the French Civil Code (articles 901 and  
199 further and 1035 and further), both consider as unable to make a testament even persons sentenced with life  
200 imprisonment or for a long period of time. With regards to the capacity to win through testament, this capacity is owned by  
201 such persons who can inherit by law and who are alive at the moment the inheritance process is opened or who are  
202 conceived prior to the death of the testator and were born alive. Unable to win through testament are those persons who  
203 are unable to inherit by law, apart from direct children of a certain person and alive at the time of death of the testator,  
204 even though such children were not conceived yet<sup>25</sup>.

205 The following do not have capacity to inherit: any heir who has died prior to the testator, any heir who has become  
206 indecent to inherit and has been expelled from inheritance or has waived. Children who enter by representation in this  
207 case should be alive at the time the testator dies or be conceived prior to his death and born alive. The Civil Code forbids  
208 the custodian to benefit property through testament by disposition of the person under his custody prior to the final  
209 approval of accounts even though the testator had died after the final approval of accounts<sup>26</sup>. The Civil Code envisaged  
210 two types of testaments, the ordinary testaments and testaments made under special circumstances. The ordinary  
211 testaments are the holographic testament and the notary act testament. The holographic testament, to be valid, should  
212 bear a clear and readable handwriting of the testator, bear the date when it was written, indicating the day, month, and  
213 year.<sup>27</sup>

214 Referring to article 602 of the Italian Civil Code, the conflict on the authenticity of the holographic testament date is  
215 allowed only when the capacity to make a testament is being judged or in the case when a priority of giving a date is  
216 confirmed among many testaments or to determine it by taking into consideration the time it was written. According to the  
217 French legislation and jurisprudence in general, the lack of a date may be regulated in accordance with the evidence of  
218 the testament itself or through external proof. However, according to the Albanian legislation, an holographic testament  
219 without a date, even though the date can be inferred by its content, makes it invalid, since it lacks one of the indispensable  
220 elements of form. The holographic testament shall be considered invalid if the testament is written in a typewriter,  
221 computer or other devices. The holographic testament is allowed only to those persons who are literate, who can read  
222 and write, otherwise they cannot make a holographic testament. According to the law "On Notary", the holographic  
223 testament may be deposited at the notary to be kept in a sealed envelope at the notary office. In this case, the notary is  
224 obliged to keep a written record, which bears the date of acceptance, the full identity of the person, and the description of  
225 the deposited document<sup>28</sup>. With regards to the notary act testament it is prepared by the notary after the testator has  
226 expressed to the latter his will and is signed by the testator in the presence of the notary. The notary act testament  
227 presents more security both for the content and for the will expressed by the testator himself. While the notary is  
228 preparing the testament, the notary is obliged to verify the identity of the disposing person, whether such person has  
229 juridical capacity to act, whether he is able to understand the importance of his action or whether he is making this  
230 testament without his free will. Otherwise, the notary should refuse the preparation of such testament. The notary is  
231 obliged to know the testator with regards to all law requirements and limitations and only after this he can start to prepare  
232 the testament<sup>29</sup>. The notary should respect the expression of the testator's free will and never intervene in the testator's  
233 will. While preparing the testament, the notary, based on article 52 of the law mentioned above, may not refuse to  
234 prepare the testament claiming that the testator is not the owner of the property he is disposing through testament, or that  
235 the testament violates the legal reserve or that the disposition through testament is made beyond the row of legal heirs.  
236 However, the notary is obliged to refuse the preparation of the testament when its content is in contradiction with public  
237 order. In such cases, the notary, within five days notifies the concerned person about the refusal for the preparation of

<sup>24</sup> Arben Hakani "Trashëgimia testamentare" Legjislacioni dhe praktika gjyqësore, Botimet Dudaj 2010, fq.62.

<sup>25</sup> Indirect child means a person who does not come directly from the testator, but is the nephew or great nephew with whom he is indirectly related.

<sup>26</sup> Article 375 of the Civil Code.

<sup>27</sup> Article 393/2 of the Civil Code.

<sup>28</sup> Juliana Latifi "E drejta civile, Trashëgimia" Geer 2007, fq.85.

<sup>29</sup> Article 40 of the law "Për Noterinë".



238 such testament, and the testator has the right to address a complaint at the district court in whose territory the notary  
239 office is situated. The notary should be careful in particular when making testaments of old and diseased people. In such  
240 cases the notary should be sure about their mental state, as well as for the expression of their free will. The notary where  
241 such act is deposited starts the notary statement after receiving a request from the persons concerned. The notary should  
242 keep a written record where to write the act of death and make the transfer of testament to the general register of notary  
243 acts.

244 In case there is no request from the persons concerned to open the testament deposited at the notary office, the  
245 notary is obliged to inform them. The Civil Code envisages special testaments also. Such a testament is the one prepared  
246 by the testator himself in a country belonging to the administrative unit which does not have a notary. In such a case, the  
247 testament is certified by the mayor or head of commune<sup>30</sup>. This kind of testament in practice is seldom found due to the  
248 fact that the testator either chooses the notary form, or the holographic testament form, and in the case when in his  
249 commune or municipality there is no notary, the testator goes to the closest commune or municipality that has a notary to  
250 prepare the testament.<sup>31</sup> Another kind of testament is the one that the person does when he is under military service or  
251 hospitalized. In the case of the person who disposes his property via testament under military service, this act may be  
252 certified by the commander of the military unit where is part of.<sup>32</sup> This kind of testament can be prepared by military men,  
253 both permanent officials and temporary ones who serve their mandatory military service. This kind of testament could be  
254 made in special circumstances that hinder the person to make a testament in the ordinary forms envisaged by the law.  
255 Another case is that of the person who makes a testament when hospitalized for treatment. In this case the testament  
256 made by him could be certified by the hospital director<sup>33</sup>. A person may make such a testament when found under serious  
257 health conditions, so serious that his life might be at risk and it is impossible for him to go to the notary.

258 Another type of testament is when the person who disposes his property via testament is in an Albanian ship which  
259 is sailing or has stopped in a foreign port. In this case the testament may be certified by the ship captain<sup>34</sup>. In this case  
260 the person does not have any possibility because of any disease or any other circumstances to wait for the ship to come  
261 back and make a testament at the notary. A weakness of the Civil Code in force is that in contrast with article 42 as  
262 amended of the Decree "On Inheritance" and the Civil Code of 1929 (article 523 up to 531), which envisaged detailed  
263 rules in relation to the validity term of such testaments and the method of their replacement with ordinary testaments, the  
264 Civil Code in force does not envisage any validity term and does not envisage the method of their replacement with  
265 ordinary testaments. This way, being that there is no term, we can say that such special testaments are valid as any other  
266 testament. Analyzing the content of the Civil Code of 1929, it is important to mention that there are many similarities with  
267 the Italian Civil Code for many institutions, including testament forms. The Italian legislation classifies testaments as  
268 ordinary (article 601) and special (article 609). With regards to the ordinary form, it is envisaged the holographic and the  
269 notary act testament. The notary act testament may be a public or secret act.

270 The French Civil Code, in contrast with the Albanian legislation and the Italian one, in article 969 envisages three  
271 usual forms of the testament: the holographic testament, the public act and the secret act. Such legislation also  
272 envisages the international testament if it does not contradict the forms of French law. Article 976-980 of the French Civil  
273 Code envisages the mystic testament which is closed and sealed at the notary, in the presence of two witnesses. After its  
274 deposition at the notary, the latter prepares a signature act for the present persons – testator and witnesses, which bears  
275 the date of such testament. The mystic testament has advantages in contrast with the holographic testament, because it  
276 makes possible its secret maintenance. The various international legislations also recognize joint testaments in which are  
277 included reciprocal testaments when through the same act, two persons dispose in favor of each other, as well as  
278 collective testaments when some testators through the same act dispose in favor of a beneficiary<sup>35</sup>. Such testaments are  
279 forbidden by the French legislation (article 963 of the Civil Code) and by the Italian one (Article 589), whereas according  
280 to the Albanian legislation, the testament cannot be made by two or more persons in the same act, neither in favor of a  
281 third party nor with reciprocal dispositions<sup>36</sup>. Thus, based on such provision, joint and reciprocal testaments are invalid.

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<sup>30</sup> Article 398 of the Civil Code.

<sup>31</sup> Ardian Nuni, Luan Hasneziri *E drejta civile III (Trashëgimia)*, Tiranë 2010, fq.122.

<sup>32</sup> See the first par. of article 399 of the Civil Code.

<sup>33</sup> See the last paragraph of article 399 of the Civil Code.

<sup>34</sup> Article 400 of the Civil Code.

<sup>35</sup> Agim Tartari "Trashëgimia në të drejtën ndërkombëtare private shqiptare" *Botim* 2010, fq.160.

<sup>36</sup> Article 372 of the Civil Code.

## 5. Issues Arising from Testament Application and Suggestions Improving Relevant Provisions

Article 373 of the Civil Code envisages the capacity to dispose via testament that belongs to any person who has reached the age of 18 years old, as well as women under this age when married. The married woman under 18 years old does not lose such capacity even when the marriage may be declared invalid or dissolved. We suggest an improvement of such provision by including in it the capacity of widowed persons under 18 years old. Therefore, full capacity to make a testament should have not only spouses who are divorced or separated through declaration of their marriage as invalid, but also those less than 18 years old who have remained widows due to the death of their spouse.

Based on practice it results that in all cases, it is the testament preparation time which is verified and not the moment it is opened. In the case of testament preparation, for the testator it results that there are no heirs from those the law envisages, namely article 379 and 361/2 of the Civil Code. Later it results that after opening the testament there are some such heirs. It may happen even the contrary that during the preparation time there are heirs and during the opening moment there are not anymore. In this case we can say that many persons are obliged to alienate their property while alive by violating therefore their will and making the testament a formal and inapplicable juridical action.

Articles 398-400 of the Civil Code in force envisage special testaments which may be applied in exceptional or unforeseen circumstances, in which the concrete person may find himself. A weakness of the Civil Code in force is that it does not envisage any term for the validity of such testaments and nor the method of their replacement with ordinary testaments. For this reason, we suggest to include in such provision a certain term related to the validity of such special testaments.

The Civil Code envisages two forms of testaments: ordinary and special testaments. Due to the development of relations between different countries and continuous efforts for collaboration and creation of a common legislation it is preferable to include in the Civil Code in force, more various forms of testaments which are envisaged by the legislations of other countries, such as the international testament, etc.

## 6. Conclusions

The Testament is a juridical action which is born due to death or *mortis causa*, a highly personal action and which is revocable at any time. During the years 1912-1929 testamentary inheritance was regulated by religion norms to which the testator belonged. The Civil Code of 1929 defines testament as a revocable act through which the testator disposes entire or part of his property, referring to the time after his death, in favor of one or some persons. During the communist dictatorship testamentary heirs could be legal heirs, state organs and social organizations, but in no case it was allowed to dispose via testament property to the church or other religious institutions. According to Decree No 1892, dated 05.07.1954 "On Inheritance" the testament is defined as an one-sided juridical action, conducted by the testator himself, through which he disposed his property after death. Any person who had reached the age of 18 and any person under this age when married had the capacity to make a testament. A peculiarity of the Decree on Inheritance was that it envisaged inheritance in the agricultural economy, where inheritance over the common wealth of the agricultural family was started only when the last member of the agricultural family died and land was forbidden to be left via testament. A characteristic of the Civil Code of 1981 is the existence of a limited number of provisions which regulated inheritance and the failure to regulate a series of important institutions which regulated inheritance. The Civil Code of 1981 defines testament as an onside juridical action conducted by the testator himself through which he disposed his property after death by determining that the testator in any case would not violate the legal reserve of his heirs. The Civil Code in force envisages two kinds to testaments, the ordinary and the special one.

Testament cannot be made by two or more persons in the same act, neither in favor of a third party nor through reciprocal dispositions.

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# The Reasoning for Methodical Instruments of Evaluation of Organization Readiness, Possibility and Necessity to Implement the Organizational Changes

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## Abstract

Organizational change implementation at the industrial enterprise is a complex task with multiple choice of decisions and with the demand to do a lot of preliminary work before starting the changes. On the basis of the empirical research about the specific characteristics of change implementation process and the existing approaches of assessment of enterprise readiness to changes the authors developed methodological instruments of integral assessment of organization readiness, possibility and necessity to implement the changes. The basic parameters of this assessment method were formed by the parameters of external environment comfort assessment, ability to implement the changes (staff resistance level), development potential level, level of changes implementation necessity. The object of the research is organizational and economic relationship appearing during change management process. The goal of the article is to offer the new assessment instrument for decision making process in change management.

**Keywords:** organization changes; change necessity; change implementation potential; development potential subsystems.

## 1. Introduction

### 1.1 Background

The basic principles of the external environment assessment were set out in the research works where the whole environment was divided into macro level environment systems and the micro level which can be influenced by the enterprise. (Porter M., 2004 ; Harrington H.J., 2006) The groups of organization stakeholders are usually formed from the system of microenvironment and they define the enterprise policy according to their own interests, so the matters of relationship of the enterprise and its stakeholders are also thoroughly studied. (Sokolova Y., 2013; Abrosimova E., Sedelnikov I., 2011)

To implement the organizational changes effectively it is necessary to do some preliminary work. The question of preliminary assessment of the possibility to implement the changes was recently studied and the suggested models are analyzing the possibility to implement the changes mostly from the point of view of staff readiness to them before starting the process of changes itself. (Weiner B.J., 2009; Khalitova I., 2013; Liden F., 2011; Lindgren M., 2012)

### 1.2 Status of the problem

The process of change management is rather complex and its fragmentary study, from the point of methods or main approaches does not allow to take into account system dynamics and synergy factors. This stipulated the objective need for concept approach to change management strategy in the organization. Authors' approach to the problem is more complex. As the basic criteria for substantiation of managerial decisions concerning change implementation we suggest: comfort level of external environment, ability of economic entities to implement the changes (the level of staff resistance), the potential of development of enterprise, the necessity to implement the changes. Rather important parameter should be the assessment of the enterprise potential for development which actually reflects the enterprise readiness for changes. But the greater role in our assessment methods is given to the change necessity assessment because rather often the reason for starting the changes is the groundless impression of company management about the urgency of changes.

## 2. Research Methodology

Suggested authentic methodical instruments to assess the possibility, necessity and readiness of industrial enterprises to implement the changes is the result of the authors' research aimed to study specific factors that influence change implementation process. The assessment of any economic entity should be performed complexly and according to the system approach. It is sensible to evaluate the external environment and the enterprise itself as two interconnected systems. And the enterprise is only the part of more complex and multilevel external subsystem. The social system can be determined by complexity of interconnected social processes and events which are formed with the given target vector directed at the creation of the united unit.

So the suggested methodical instruments of assessment should be developed on the following principles:

1. Being based on the principle of system analysis of complex and multidimensional economic phenomena;
2. Contain the set of quantitative parameters of assessment in order to decrease the subjectivity;
3. Being defined by the set of unidirectional indicators which allow to have single-valued assessment;

The methods for the research are systems analysis, methods of expert judgments, economic and mathematical modeling.

## 3. Findings

### 3.1 External environment comfort assessment

External environment comfort determines the level of environment aptitude for effective functioning of the industrial enterprise. The environment can be comfortable when the activity of the enterprise is not restricted by the negative factors or limits and the uncomfortable environment is characterized by the great influence of the limits on the enterprise activity.

The research work has shown that the greatest influence on the level of organization readiness to changes was displayed by the following external systems: economic, political, social, ecological, technological, regional, sectoral and stakeholders' system.

In order to implement complex study of the environment influence level it was offered to use expert assessment. Each factor of external environment was assessed by the index which characterizes the quantity influence level. The best value of index was assessed by point "five", the worst – by point "one". The studied factors indexes should be differentiated according to the experts opinion to define their importance weight from "zero" to "one". Final assessment of each factor is a sum of the point of the factor multiplied to its weight. So we define the factors with the highest and the lowest indexes. The higher the influence index of the factor, the higher is the comfort level of the environment and the more effective will be change implementation.

The main factors influencing the enterprise readiness to implement the changes were studied and the most influential are the following:

- economic system – inflation speed; GDP per citizen; economy structure; quality of living and the living standards; tax system; investment attractiveness; innovation activity; the level of labour productivity; integration into global economy and others.
- political system – the level of political stability; legislation loyalty to entrepreneurial activity; existence of special economy development programs; legislative limits; the level of state support of business structures.
- social system – the level of demography; unemployment level; average level of wages; the level of retirement payments; life duration; education level; the level of medical services.
- regional system – GDP per citizen; the level of industrial production; demographic situation; regional attractiveness for investments; the level of population labour activity; financial stability of the region; the level of small-scale business development; the level of consumption.
- sectoral system – the volume and the structure of market demand; scientific and technology progress development; production intensification; development of progressive forms of social organization of production process; development of international links; the number of sectoral producers and others.
- stakeholders system – the number of stakeholders; their main characteristics; the level of their influence on the enterprise; the degree of personal interest of the enterprise in some stakeholders; the branching of stakeholders net.

3.2 Assessment of the enterprise ability to implement the changes.

The greatest parameter that influences enterprise ability to implement the changes is staff resistance and the matter of this problem was thoroughly studied in the research works of Ansoff (1990) who made a hypothesis about the possibility of staff resistance management with the help of various methods depending on the resistance degree and the time limits of change implementation. Also some methods of staff resistance assessment were suggested by Hiatt (2006). The main shortcomings of these research works are in absence of any practical ways or methods of assessment of staff resistance.

We define the main factors that influence staff resistance and divide them into three groups: technical, political, cultural. Technical factors are connected with influence of technical conditions at the enterprise. These conditions are mainly the ways of human and technical resources combination. The most important among them are: the level of communication infrastructure development (the factor influences information support of change implementation process); the isolation level in the enterprise; the level of purpose definiteness (the indefiniteness of future activities, the absence of its structuring into some stages according to the purposes may finally cause the appearance of the idea of unrealizable plans and unnecessary changes among the staff); the professional level of the leaders; the level of enterprise sustainability; the level of development of staff consulting and tutorial system.

Political factors are connected with redistribution of authority in case of structural and cultural changes in the enterprise. We suggest evaluating of the following ones: the level of authorities readiness to delegate responsibility; the level of management system flexibility; the level of management participation in making strategy decisions; the level of management system sensitivity to changes (influences the scale of changes possibilities and the managers readiness to implement the changes)

Cultural factors of change resistance are connected with values and social norms transformation: the level of former values influence; the norms control sustainability (as a rule the norms set for organizing enterprise activity may become a kind of dogmatic principles in organization development and any declination of them may cause the greater level of resistance); organization culture flexibility.

We have defined indexes for each group of factors, they give the complex assessment of highlighted research trends.

3.3 Assessment of the enterprise potential to implement the changes and changes necessity.

The importance of such assessment is defined by the necessity to set up some correspondence between the tasks which the planned changes are aimed at and possibility to solve some current or even strategy tasks of the enterprise. If the development potential of the enterprise does not meet the demands of its strategy tasks implementation, there will be the possibility that the tasks of change implementation process cannot be solved.

The systematization of the results of scientific researches allows to distinguish the following basic subsystems of the enterprise potential: financial, production, innovative, marketing, informational, management. We have defined some indexes inside each subsystem and the indexes show the specific character of each subsystem and the possibility of sustainable development strategy implementation.

The complex system of indexes reflecting enterprise potential for development is represented in Table 1.

**Table 1.** The enterprise potential subsystems and their indexes

Subsystems of the potential	Indexes	The degree of each index correspondence to strategy development tasks	The importance weigh of each index
Finance	The level of financial sustainability Return on equity Investing activity Profitability Sales volume		
Production system	The level of technical development The level of technological development Production infrastructure balance The level of production assets modernization The level of production assets capacity		
Management system	Management system flexibility The number of programs for staff development The level of managerial processes organization		

Marketing system	The level of balance inside the suppliers network Interaction with the key customers The level of development of marketing informational and analytical system Marketing budget The volume of the market		
Information system	The level of development of the united corporate area The level of standardization and unification of the united computer-aided system. The speed of information flows Information safety IT-department budget		
Innovations system	The level of development of innovation support infrastructure The number of innovations implemented in technical and technological areas R&D costs Innovative management technology		

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There is some difference between the indexes showing enterprise current state and the indexes of its development potential. Current state is assessed according to the current development data. Potential indexes show resources of the enterprise to achieve change strategy aims conveyed through the indexes. These indexes are also defined with the help of experts assessment method. Thus, potential assessment should be done in two stages with absolute indexes at the first stage and relative indexes at the second one. The authors of this research raised the problem of change necessity for the first time. We think that assessment of necessity of changes implementation is also one of the most important criterion. We are giving the following definition of necessity – a gap between the existing development potential level and its correspondence to the aims of change implementation. The more is the disparity the higher is the necessity to implement the changes. The assessment of change necessity is offered to be made on the basis of the indexes in Table 1. The value of the index from 'one' to 'five' will mean its correspondence to the aims of change implementation and its weigh will show its importance in the system of indexes showing the success of changes, so the higher will be the index the less necessary are the changes in this area.

### 3.4 The enterprise assessment matrix

The final stage of the complex substantiation of managerial decisions about changes implementation is the design of enterprise assessment matrix. The axes of the matrix are formed by the parameters of external environment comfort assessment, ability to implement the changes (staff resistance level), development potential level, level of changes implementation necessity. The matrix field is divided into nine squares characterizing possible differences in enterprise position. Rough management recommendations were given for strategy decisions elaboration concerning change implementation for each position of the enterprise on the matrix. The example of the matrix itself has been already given in some of our previous publications, so further we are going to give just the description of its fields.

The first zone "Essential Success" is characterized by the low level of staff resistance, the high level of external environment comfort, the high level of enterprise readiness to implement the changes and the high level of change necessity. This means that the enterprise has a great chance to implement the changes successfully. The most important here is to implement the changes quickly because the level of their necessity is high.

The second zone "Worthwhile but with preparations" has the high level of external environment comfort, average level of resistance and enterprise readiness, the necessity is high. When the enterprise is in this field it means that the possibility and urgency of changes is rather high but to implement them successfully the management should do some preliminary work to raise the enterprise potential and decrease the staff resistance.

The third zone "Low readiness" with high resistance level, low potential level, high environment comfort level and high change necessity means that any attempts to start the changes will fail. It is necessary to raise the readiness and decrease the staff resistance level.

The fourth zone "Success" has low level of staff resistance, high level of enterprise readiness to changes, average level of environment comfort, average level of change necessity.

The fifth zone "The Golden Mean" means that the company is practically ready to implement the changes which necessity degree is rather high. But the management should do great preliminary work with their staff as its resistance is not so low.

The sixth zone "Not worthwhile in the nearest future" is characterized by high staff resistance level, low level of enterprise readiness, comfortable environment and average change necessity. Although there is some necessity in changes it is not sensible to implement them in the nearest period because they may be accompanied by significant staff resistance and low readiness level of the enterprise itself.

The seventh zone "Absence of necessity" has the low level of change necessity. Although staff resistance here is rather low and the enterprise readiness to changes is rather high the changes at this stage are not worthwhile because they are not necessary.

The eighth zone "Depression period" means that the changes are unnecessary but the high level of resistance in this zone and average level of company readiness to changes should force company management to make some decisions about company potential development and staff incentive programs.

The ninth zone "Crisis" is characterized by risky period in the enterprise to start the changes because of absence of necessity to implement major changes and crisis situation at the enterprise concerning its development potential and staff attitude.

#### 4. Discussions

The assessment methodology of organization readiness, changes possibility and necessity was elaborated. This system is the basis of decision-making support while implementing organization changes in the industrial enterprise. Thus, suggested organizational instruments allow organizations to improve their readiness to changes, increase the degree of validity of managerial decisions at the stage of initial choice of further change implementation trends

Each group of factors influencing the successful implementation of organizational changes was analyzed from the point of view of the main procedures of changes implementation. Also the reasonability of practical use of the instruments of theoretical management schools indicated in the research work was grounded.

#### 5. Conclusion

Nowadays the problem of development of strategic planning instruments is becoming more and more actual. The most usual decision which is made by management now is to rise efficiency in financial sphere and it has some effect but only for a short-term period. Long-term planning forces managers to work out more flexible aims and to formulate the tasks taking into account changeable external and internal conditions of environment. At the same time strong competition at the market forces the enterprises to optimize their strategy work by organizational changes introduction. The authors suggest using the elaborated assessment instruments to support the decision-making process in the situations of changes implementation to raise the validity of managerial decision-making.

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# Effective Work Place Training: A Jump Starter to Organizational Competitive Advantage through Employee Development

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## Abstract

Workplace training programs are usually considered to be an important element of the competitive organization's corporate strategy. It presents a key avenue to expand the knowledge base of all employees and provides both the company as a whole and the individual employees with benefits that make the cost and time a valuable investment. Most employees have some weak spots in their workplace skills providing them continuous workplace training creates an overall employee development. Further employees who are competent and on top of dynamic industry standards help in overall organizational growth and aids in company to hold a position as a leader and strong competitor within the industry. This paper is broadly categorized in two parts. The first part tries to explore the meaning of workplace Training, Its impact on Organizational Competitive advantage. It also emphasizes how employee development in turn impacts organizational Competitive advantage. This paper suggests model framework in which its main aim is to show how Workplace Training has impact on organizational competitive advantage through Employee development.

## 1. Introduction

In a today's challenging global scenario, both behavioral and technical skills of employees are the most important assets for organizations to determine their competitiveness and competence to adapt and be hands-on when faced with an uncertain environment. An employee who possesses the necessary skills, knowledge and expertise is crucial for any organization who wants to achieve high levels of business success. In our current challenging and competitive business environment, workplace Training and development has been more important as an aid to keep employees engaged and maintain that competitive advantage. Training has the distinctive role in the achievement of an organizational goal by integrating the interests of organization and the workforce.

Now a day's training is the most crucial factor in the business world because training increases the efficiency and the effectiveness of both employees and the organization. The employee performance depends on various factors but the most significant factor of employee performance is training. Training is important to boost the capabilities of employees. The employees who have more on the job experience have better performance because there is an increase in the both skills & competencies. The organizational performance depends on the employee performance because human capital of organization plays a vital role in the growth and the organizational performance. So to improve the organizational performance and the employee development, training is given to the employee of the organization. Training is a key tactic for developing skills in people, since it aids them to both learn and unlearn skills – in other words, to acquire new skills and change inappropriate skills.

Training may be defined as the organized acquisition of skills, concepts, or attitudes that shall further result in superior performance of the trainee. Workplace training is important in today's knowledge-based economy. Workplace training is necessary to help employees widen and use the skills they need to acclimatize to changing workplace needs, to endorse innovation and to help employers remain competitive in the global marketplace. Finding and keeping employees with the knowledge and skills to get the job done is critical in today's workplace. A skilled workforce is often the asset to a company's growth and stability, and it could be the influential factor in the success of organization.

57 Improving the essential skills of workers has remarkable impact for both the employee and employer, including higher  
58 retention rates, improved performance and Employee productivity.

59 Employees who participate in workplace training programs increase their level of self-confidence, acquire new  
60 skills, are better prepared to seek promotion opportunities, and believe that they are valued by their organization. A  
61 training program aids in strengthening those skills that each employee needs to perk up. This brings development of  
62 employees to a higher level so they all have similar skills and knowledge. This helps reduce any weak links within the  
63 company who rely heavily on others to complete basic work tasks. Providing the necessary training creates an overall  
64 knowledgeable staff with employees who can take over for one another as needed, work on teams or work independently  
65 without constant help and supervision from others.

66 An employee who undergoes the necessary training is better able to perform her job. The training may also build  
67 the employee's confidence because they have a stronger understanding of the industry and the responsibilities of their  
68 job. This confidence may push them to perform even better and generate new ideas that help them to excel. A planned  
69 training and development program ensures that employees have a consistent experience and background knowledge.  
70 Employees with access to training and development programs have the advantage over employees in other companies  
71 who are left to seek out training opportunities on their own. The investment in training that a company puts projects the  
72 employees they are valued. Employees who feel valued and challenged through training opportunities may feel more  
73 satisfied towards their job. Therefore workplace training is considered as profitable for both employees and the  
74 organizations in which they work and it Connects employee to opportunities to develop skills and abilities on an ongoing  
75 basis means that organization will be prepared to respond to changing circumstances. However, if training and  
76 development is to make a significant impact on organizational performance, employees must see the benefits to  
77 themselves of undertaking training activities.

## 78 79 **2. Review of Literature**

81 In the existing scenarios, employee training and their development have utmost importance for the sake of enhancing  
82 the productivity, which leads towards gaining competitive advantage. However, employee training is considered as the  
83 planned step towards facilitating employees to seek job- related knowledge including behaviors and skills by Dennis and  
84 Griffin (2005). Training is a type of activity which is planned, systematic and it results in enhanced level of skill, knowledge  
85 and competency that are necessary to perform work effectively (Gordon, 1992).

86 Oatey (1970), states training perks up a person's skill at a task. Training helps in socially, intellectually and  
87 mentally developing an employee which is very vital in facilitating not only the level of productivity but also the  
88 development of personnel in any organization. The training and development of the employees has direct offerings in the  
89 high achievements of organization which shows better performance. Training increased the organizational performance  
90 which predicted by many researches Niazi, (2011). Adeniyi (1995) states staff training and development is a work activity  
91 that can make a very important contribution to the overall effectiveness and profitability of an organization. Performance  
92 can be defined as the achievement of specified task measured against predetermined or identified standards of accuracy,  
93 completeness, cost and speed. In an employment performance is considered to be the accomplishment of a commitment  
94 in such a way that liberates the performer from all responsibilities framed down. Efficiency and effectiveness are  
95 ingredients of performance apart from competitiveness and productivity and training is a way of increasing individual's  
96 performance (Cooke, 2000). Kenney et al., (1992) stated that employee's performance is measured against the  
97 performance standards set by the organization. Good performance means how well employees performed on the  
98 assigned tasks. In every organization there are some expectations from the employees with respect to their performance.  
99 And when they perform up to the set standards and meet organizational expectations they are believed good performers.

100 There is a positive relationship between training and employee performance. Training creates benefits for the  
101 employee as well as the organization by positively influencing employee performance through the development of  
102 employee knowledge, skills, ability, competencies and behavior (Benedicta and Appiah, 2010). It is obvious that training  
103 plays a vital role in the development of organization, improving performance as well as increasing productivity, and  
104 ultimately putting companies in the best position to face competition and stay at the top.

105 Chris (1996) Training and development aim at developing competences such as technical, human, conceptual and  
106 managerial for individual and organization growth. Seyler et al. (1998) states in this continuous changing scenario of  
107 business world, training is an effective measure used by employers to complement employees' knowledge, skills and  
108 behavior. Akinpeju (1999) the process of training and development is a continuous one. The need to perform one's job  
109 efficiently and the need to know how to lead others are adequate reasons for training and development and the desire to  
110 meet organizations objectives of higher productivity. Isyaku (2000) states the process of training and development is a

111 continuous one. It is an opportunity to acquire more and fresh knowledge and develop the further skills and techniques to  
112 function successfully. Tan et al. (2003) states companies are making enormous investments on training programs to  
113 prepare them for future needs. The researchers and practitioners have constantly emphasized on the importance of  
114 training due to its role and investment. Stavrou *et al.*, (2004) focuses on the main goal of training is to provide, attain and  
115 develop the necessary skills in order to help organizations achieve their goals and create competitive advantage by  
116 adding value. Glance et al. (1997) stressed that workforce trainings helps the employee commit with the organizations  
117 and motivate the employees to perk up their work performance. Stephen & Bowley (2007) focus on the outcome of capital  
118 invested on training processes that further raise the efficiency of the employees and the organization.

119 According to Pitfield (1982) the objectives of training are to: provide the skills, knowledge and aptitudes necessary  
120 to undertake required job efficiently and develop the employees so that if they have the caliber they may progress,  
121 increase efficiency by reducing errors and risks.

122 Nadler has shown specific benefits that an organization receives from training and developing its workers,  
123 including: Increased performance, reduced employee turnover, increased efficiency resulting in financial gains,  
124 Decreased need for supervision.

125 Training is an best way to learn a job and it helps employees to improve their skills to do their duties better than  
126 before, and employee development (Noe, 1999). Training and development programs can advance employee's skills and  
127 attitudes at all levels to maximize enterprise effectiveness. (Holton et al 1996). The aim behind training employees is  
128 achieving cost effective high performance and good performance brings quality, as according to Deming, (1982), higher  
129 quality of employee services implies lower costs and increase their productivity, which in turn provides the firm with a  
130 greater market share and enhanced competitiveness levels.

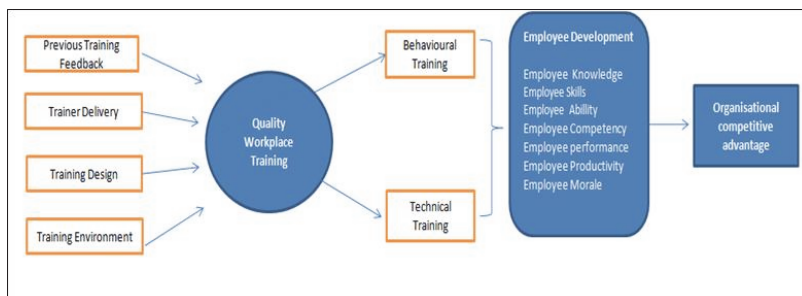
131 There are several methods of training used in the workforce: learning principles and instructional techniques  
132 (Alvarez et al., 2004); goal setting (Holton, 2005) and self-management and decline anticipation strategy or policy  
133 (Thinner et al., 1991). Therefore, organizations should prepare their training programs much in advance Rautalinko &  
134 Lisper (2004) claim that certain programs are designed to prompt specific reasons while others apply to improve  
135 strengths and overcome weaknesses of employees before training. The two types of trainings are Behavioral Training  
136 which is conducted to improve the work place behavior of employees; and the technical training which is conducted to  
137 enhance specific skill or techniques that are used in their day to day functioning.

138 Successful and effective job trainings largely impact the productivity of employees during their present job. If an  
139 employee feels well-trained, they automatically commit to the organization.

140 Coho & Bowleg (2007) mentioned some of the most noticeable independent variables affecting training and  
141 development. These factors include: training design, trainers quality, and learner's experience from the training session.  
142 The quality of training is generally influenced by the trainer's experience, knowledge and motivation. Course design of  
143 training specifies whether the training is designed for on-the-job, off-the-job, or whether the course is rather specific or  
144 general in nature. An employee's level of confidence reflects the efficiency and effectiveness of the training which further  
145 increases the competitive advantage of organization.

146 Many researchers and practitioners have harassed the significance of the learning organization as a plan to  
147 improve performance, and as the only sustainable competitive benefit for organizations. Responding to an increasingly  
148 unpredictable and turbulent business environment emphasis has also been placed on effective training and specifically  
149 on transfer of training as a strategy for competitive advantage. The confused environment has increased stress on  
150 transfer of training because organizations are forced to restrain performance in competitive environment.

### 152 3. Proposed Framework



In the literature review, it has been observed that training has an impact on different variables like Employee KSA development, Employee productivity and Employee Performance. Organizational competitive advantage ultimately depends upon employee development and training is a tool to improve employee performance and their overall development in workplace.

The above theoretical framework has been formulated to depict a relationship between workplace training and organizational competitive advantage, in the presence of moderating variable Employee development.

This research has resulted in developments of training model that depicts the influence of workplace training elements on employee development and in turn its impact on organizational competitive advantage. This model was created with the review of Prior studies and theoretical models on training,

Independent variable of the study is Quality Workplace training while the dependent variable is Organizational Competitive advantage with Employee development as moderating variable.

#### 4. Workplace Training Consisted of Four Dimensions Namely

- 1) Previous Training Feedback
- 2) Trainer Delivery
- 3) Training Design
- 4) Training Environment

Further the workplace training has been subdivided into two types of trainings

- a) **Behavioral Training:** This training program helps in nurturing the corporate behavioral aspects of employee like Team management skills, Conflict management, and positive outlook towards challenging works.
- b) **Technical Training:** Contrary to above training this aids in developing the specific techniques or skills that are required for better understanding and execution of day to day works and also specific technology related tasks.

Further as a planned attempt by an organization to facilitate employee learning, training enhances employee development by increasing employee KSA's,improving performance and productivity Furthermore, organizational training activities are recognized as being able to become sources of competitive advantage (Barney, 1995) through their impact on employee overall development (Ng & Siu, 2004).

#### 5. Limitations

This model is not yet tested in industry however author believe that this research has lead to the development of model that addressed the barriers of previous models. Further research needs to be carried out to test the model.

#### 6. Conclusion

We consider the point of view that training leads to important benefits to employees and organizations .The present review suggests that these benefits range from employee development to organizational competitive advantage. Certain factors like training design, delivery, environment and evaluation were used in the current research to represent their importance in training.

Further in the current competition and market related pressures, organizations need to recognize the benefits of training quicker and faster. Research on this issue is lacking in the scholarly literature; work is desired regarding the factors that can speed up the realization of the benefits of training at various levels of analysis. Prior research has focused on the relationship between linking a training program and employee learning or performance but has paid less attention to relationships between training and competitive advantage to organization. Training is a key element for improved performance it can increase the level of individual and organizational competency. Training need is any deficit in employee performance, or potential performance which can be remedied by appropriate training. There are many ways of overcoming weaknesses in human performance at work, and training is one of them. Training enhances skills, competency, and ability and ultimately worker performance .It is followed that organizational success relied on the skills and abilities of their employees, and this means that organizational success depends to an extent on considerable and continuous investment in training. This would ensure an adequate supply of employee that is technically and socially skilled and capable of being developed into expert for the departments or management positions.

Training and development eventually upgrade not only the performance of employees but also of the organization. It has been rightly said, employee development is the key to sustain organizational development and its competitive

209 advantage. The 21st century will belong to those organizations which are able to learn faster than their competitors.  
210 Training improves the drive, initiative and quality of work of the employees thus assist them to be more committed to  
211 achieving the goals and objectives of the organization and this has the tendency of enhancing effectiveness among  
212 employees within the organization.  
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# The Implementation of Peace and Security Programme initiative in Nigeria: The Role of NEPAD

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## Abstract

The New Partnership for Africa's Development (NEPAD) as an Agency of the African Union was established in 2001 by the African leaders with the view of eradicating poverty in Africa. The NEPAD programme initiatives encompasses the political, economic and social-cultural development of the African states through partnership with the private and public sectors, the international community and countries in and outside Africa. Through thematic areas of NEPAD such as, democracy and political governance has encompassed the peace and security programme initiative of NEPAD as a priority to be achieved. This then forms the objective of this paper to be studied considering the insecurity challenges that faced the Nigerian state as a member of the African Union and co-initiator of the NEPAD programme initiative. Since 2009, the Nigerian state is faced with the activities of the Boko Haram militant group whose engagement has led to activities such as burning and bombing of people's houses, churches, Mosques and public buildings, killing of innocent lives including but not limited to both Christians and Muslims, attack on security operatives and schools which include bombing of structures. This paper therefore, is to study the strategic plan of NEPAD in implementing the peace and security objective for the purpose of promoting peace and political stability in Nigeria. The methodology adopted in this research is the review of previous literature, the use of descriptive, historical, and interpretative methods of analysis, with the available research materials. The findings thus reveal that, issues such as zoning of political and elective positions should be addressed in the Nigerian constitution in order to accommodate the six geopolitical zones so as to promote unity, political stability, peace and security within the Nigerian state.

**Keywords:** NEPAD, Implementation, Nigeria, Peace and Security

## 1. Introduction

Africa like other continents of the world was colonized by the Europeans, and the colonization process took place in stages. In the Asian continent as well, many countries were colonized by the Europeans just as there was the presence of the British government in some of the countries such as Malaysia, India, and Singapore. Also, they were present in Australia and the New Zealand, as well as in North American countries like the United States of America and Canada. This is to establish that these continents also experienced colonization but today, they are far ahead of the African countries. This became a great concern for the African Union through her leadership to establish an agency charged with the functions and responsibility of repositioning Africa to the path of sustainable development through eradication of poverty. The African people who serve as great human resources are endowed with many natural resources in the said continent, but ironically, they still suffer from poverty.

This posed a major issue among others that brought the establishment of the New Partnership for Africa's Development (NEPAD) in 2001, by the leaders of the African Union (AU). NEPAD's establishment sought to reposition

Africa looking at the issues that surrounds the continent from the political, economic, social and cultural points of view. As such, this programme stretches through Peace and Security, Education, Democracy, Good Political Governance, Economic and Corporate Governance, Agriculture, Environment, Energy, Water, Infrastructure, Transport, and Information and Communication Technology. In view of the fact that poverty is to be eradicated in Africa, there are certain issues that would be considered as well, which then forms the objectives of NEPAD programme as a policy document and framework. NEPAD therefore, seeks to integrate with the public sector, the private sector, civil society, the countries within and outside Africa, international organizations as well as the multinational companies in achieving her set goals and objectives (NEPAD, 2005).

However, can these objectives be achieved in the absence of Peace and Security? What then is the role of NEPAD in sustaining Peace and Security in African countries? In what ways can Peace and Security be sustained? These are the questions this research paper intends to focus on in proffering solutions and giving answers to the said questions. Many African countries in the past had gone through series of conflicts, insecurity challenges and wars. In the recent years in 2010 to 2014, we have issues such as the Arab spring in countries such as Tunisia, Egypt and Libya where the people wanted a change in government and the leadership of their countries. However, the focus of this paper is on Nigeria.

Terwase, Abdul-Talib and Zengeni (2014) observed in their work, the endowed resources in Nigeria as Africa's largest economy where there are natural and agricultural resources as well as human resources. Yet, with all the resources, the country is still faced with issues such as poverty and unemployment. Many of the Nigerian graduates are still searching for job opportunities, while in the rural areas the people are living in abject poverty especially in the villages, yet some of these villages have untapped resources. NEPAD therefore, seeks to partner with the developed countries, the emerging countries, private and public sectors in engineering production of raw materials into finished goods/products for the purpose of economic growth and development of the Nigerian state. According to some authors; poverty, unemployment, illiteracy and bad governance are the reasons that makes the youths to join groups that influenced them to engage in insurgency and to partake in militancy against the government such as the case of Boko Haram militant group in Nigeria (Dike, 2014; Olaiya, 2014; Yusuf, 2013; Aghedo, 2012; Salaam, 2012; Jackson, 2007).

How then can the NEPAD programmes be implemented in the face of insecurity and absence of peace and security in Nigeria, especially in the Northern part of the country where there are a lot of activities of the insurgents group known as the Boko Haram, who started their attacks on the Nigerian State since 2009 during the administration of the Late President Umaru Musa Yar'Adua (Ekereke, 2013). The objective of this paper therefore, is to examine the role of NEPAD in implementing peace and security strategy in Nigeria. This will help us to understand the ways that NEPAD can get involved in restoring Peace and Security, as well as in conflict resolution. As a country, Nigeria has gone through series of insecurity challenges not only during the civil war, but also during the military administration, and the Niger Delta crisis during the civilian administration otherwise known as the period of democratic dispensation.

## 2. Literature Review

Gillies (2007) notes that, the Nigerian State known as the West African giant, has contributed in notable dimensions to the development of peace and security in the sub-region as well as to the African continent. In the past, the country through her leadership role in West Africa and indeed Africa, was able to deploy military forces to engage in the sustenance and maintenance of peace keeping operations in countries such as The Gambia, Guinea Bissau, Togo, Liberia, Cote d'Ivoire, Darfur as well as Sao Tome and Principe.

In the work of Johnson (2007), it also discusses the role of Nigeria in contributing to the development of ECOWAS Monitoring Group (ECOMOG) through various roles in peace keeping especially in the conflict states in both sub-region and indeed African states. However, the work also associated insecurity challenges in Nigeria to poor leadership on the part of the government, issues surrounding unemployment of the youths, corruption, poverty, as well as religious conflicts. Such issues confront the country thereby leading to sources of insecurity in the country. Notwithstanding, the work is limited to knowledge in the area of NEPAD's role in resolving such conflicting issues that gives rise to insecurity challenges in Nigeria as a result of the Boko Haram activities which this paper intends to fill the gap.

Mangu (2014) reveals the achievements of the African Peer Review Mechanism (APRM) as well as that of the African Union in relation to political and legal perspective of NEPAD programme initiative on good political governance, and democracy in Africa. However, in the work of Bach (2013), it focuses on Africa with a broad view of understanding her relations with the states outside the African continent while presenting NEPAD to the global economy. Ndlovu-Gatsheni (2012) concentrates on issues that affect the continent of Africa such as violence while revealing such issues in relation to pre-colonial, colonial, and post-colonial periods. The paper then establishes issues that affect the African

111 countries, while same applies to Nigeria.

112 Mayaki (2010) then observes important issues that can lead to the development of African countries. He considers  
113 the opportunities that are in the continent which can be shared between the South-South countries through their  
114 experiences where the African continent can be developed rather than developing and establishing violence, crises,  
115 conflicts and war. This can be done through good leadership, good political governance with exchange of knowledge to  
116 push Africa forward. More has been written on Africa in relation to NEPAD's implementation of her programme initiative in  
117 areas such as political economy, democracy and political governance, but limited contribution to its programme  
118 implementation in the area of peace and security. This is the focus of this work, to give more understanding on the role of  
119 NEPAD in implementing peace and security, where political stability can be restored in the affected areas in Nigeria,  
120 especially in the Northern part of the country.

### 121 122 **3. The Role of NEPAD in Implementing Peace and Security Initiative**

123  
124 The need for peace and security sustainability remains the backbone of human and societal existence, be it developed  
125 countries, developing countries or even underdeveloped countries, a harmonious environment is needed, where there is  
126 peace, security and political stability. For African countries to succeed or move forward an environment free of insecurity  
127 remains the first goal and that is the reason NEPAD has outlined her set goals where the said subject is listed first among  
128 other priorities (NEPAD, 2005).

129 Therefore, there are procedures that are followed in implementing the peace and security objective of NEPAD. The  
130 various bodies of NEPAD operate at country level where they are responsible for the implementation of the NEPAD  
131 programme initiatives. However, they report to the NEPAD Agency at their Headquarters in South Africa. NEPAD  
132 therefore serves as an Agency of the African Union who's Headquarters is located in Addis Ababa, Ethiopia. Issues  
133 relating to peace and security that could not be resolved at country level are therefore sent through the Head of the  
134 NEPAD Heads of State and Government Orientation Committee (HSGOC), who then sends such issues as  
135 recommendation to the African Union General Assembly for action and consideration (NEPAD HSGOC, 2014).

136 Indeed, African countries over the years wasted resources during the periods of war, political instability as a result  
137 of conflicts within some of the countries, while to some countries such resources are used for the development of people  
138 and government. AU/NEPAD (2009) reveals that, an estimated US\$18bn per year is what the continent spends on  
139 conflicts while her people are dying of poverty. Such resources can therefore be injected into the African economy to give  
140 hope to the poor, therefore fulfilling the very first primary objective of NEPAD as an Agency of the African Union, which is  
141 to eradicate poverty. NEPAD therefore, seeks to address peace and security initiative through the following areas:

- 142 A) Conflict prevention;
- 143 B) Conflict management;
- 144 C) Conflict resolution; and
- 145 D) Post-Conflict reconstruction.

146 In achieving this goal, NEPAD partners with the Federal Ministries, Departments and Agencies at the national level  
147 on how best issues relating to insecurity challenges can be resolved, other stakeholders of NEPAD includes the  
148 integration of the State and Local Governments, the Civil Society Organizations, the Private Sector, and as well as the  
149 international community to engage in strategies that would lead to conflict prevention, conflict management and resolution  
150 (NEPAD, 2001; NEPAD Nigeria, 2010 and NEPAD Nigeria, 2015). It is very important then to understand that without  
151 peace and security, the NEPAD objectives of partnering with other countries within and outside Africa becomes very  
152 difficult, and that is the major focus of this paper which is to proffer solutions to the issues that are presently facing  
153 Nigeria as a State in Africa, considering the insecurity challenges posed by the Boko Haram militants since 2009.

154 Many people have been killed during this period from 2009 to date (2015), issues such as suicide bombing have  
155 occurred in many states especially in the Northern part of the country such as Borno, Yobe, Adamawa, Kaduna, Kano,  
156 Plateau, Gombe, Bauchi, and Abuja which is the Federal Capital of Nigeria. Many innocent people have been killed  
157 during the attacks both on the people and government officials as well as the military officers. On the 14<sup>th</sup> of April, 2014,  
158 many lives were killed in the Abuja bomb blast, some of whom were going to work that morning when the attack was  
159 launched on them. The mastermind of the said attack was later arrested in the Republic of Sudan by the International  
160 Police Organization (Interpol). Aminu Sadiq Ogwuche was brought back to Nigeria from Sudan after his arrest (Ajayi and  
161 Suberu, 2014). In a shocking revelation, Mr. Ogwuche confessed to have masterminded the Nyanya, Abuja bomb blast  
162 attack that killed over 70 people while answering questions posed by the Nigerian Security forces in Abuja. Ogwuche  
163 lamented more on their planned activities, of which some of it were in the past including that of Abuja attack. He also  
164 promised that they (Boko Haram militant group), are well prepared and well-funded to fight the Federal Government of



165 Nigeria including the infidels.

166 Following the attack, the African Union condemned the attack on the people and government of Nigeria by the  
167 Boko Haram militants. The condemnation came through the AU Commission Chairperson in Addis Ababa, Ethiopia  
168 (Sotunde, 2014). According to the Premium Times (2014, May 17), the summit which was held in France hosted by the  
169 French President on the 17<sup>th</sup> of May, 2014, it was revealed that over 12,000 people have been killed by Boko Haram from  
170 their series of attacks on the people as it was made known by the President of Nigeria, Goodluck Jonathan during the  
171 summit in France.

172 Having seen some of the insecurity challenges as discussed above, it is then a serious issue which should be  
173 taken into account in order to put an end to the looming conflict as it is spreading through other African countries such  
174 as Chad, Niger and Cameroon, as the group finds places of hideouts and collaborations. According to AU/NEPAD (2009)  
175 for the purpose of engaging in issues related to conflict in Africa countries and for such to be resolved, the highest body  
176 of the African Union known as the Assembly of Heads of State and Government established African Peace and Security  
177 Architecture (APSA) of the African Union on the 9<sup>th</sup> July, 2002 Ordinary Session in Durban, South Africa. The APSA  
178 collaborates with the Regional Economic Communities such as Economic Community of West African State (ECOWAS),  
179 Southern African Development Community (SADC) in working relations to prevent conflict, engage in conflict resolution,  
180 and conflict management. The APSA therefore engages in peace monitoring, peace building as well as that of post-  
181 conflict reconstruction.

#### 182 183 4. Recommendations

184  
185 The country Nigeria which is the largest economy in Africa is faced with insecurity challenges and is in a state of crisis  
186 especially in the Northern part, where some places are described as war zones. Such areas include Borno, Yobe and  
187 Adamawa states. These issues need to be resolved for the country to move forward. This paper therefore, recommends  
188 the following as suggestion to NEPAD, the government and people of Nigeria in resolving the crisis:

189 A) The Federal Government in collaboration with the National Assembly should amend the Nigerian constitution  
190 in order to accommodate the six geopolitical zones into the Nigerian constitution to create room for rotation of  
191 power sharing. This stands as the greatest problem the country is facing when it comes to the time and  
192 position of "who to rule" Nigeria, considering the diverse ethnic groups with over 300 languages in Nigeria and  
193 the issues of North and South divides as well as the religious backgrounds between the Christians and  
194 Muslims leadership of the country. The six geopolitical zones are recognized by the government but not  
195 recognized by the Nigerian constitution. What are the six geopolitical zones?

196 Below is an understanding of the said zones which includes the thirty-six states of the country Nigeria:

197 **North-West zone** constitutes of the following States namely Sokoto, Kano, Katsina, Zamfara, Kebbi, Kaduna and  
198 Jigawa.

199 **North-East zone** constitutes of Borno, Adamawa, Yobe, Taraba, Gombe and Bauchi States.

200 **North-Central zone** constitutes of Benue, Kogi, Nasarawa, Plateau, Niger and Kwara States.

201 **South-West zone** constitutes of Lagos, Ogun, Oyo, Osun, Ondo and Ekiti States.

202 **South-East zone** constitutes of Enugu, Anambra, Ebonyi, Abia and Imo States.

203 **South-South zone** constitutes of Rivers, Cross River, Akwa Ibom, Delta, Bayelsa and Edo States.

204 When the constitution of Nigeria makes provision for power rotation otherwise known as the Zoning Formula into  
205 the constitution, it will then give the opportunity for all the six geopolitical regions to participate fully in building peace,  
206 national unity, economic growth and development of the nation shall become the desire of all the regions. An example of  
207 this is sharing of power between the North and South rotationally within the zones respectively from term to term. Also,  
208 when a Muslim is the President from any of the zones in the North, then the Vice-President should be a Christian from  
209 any of the zones from the Southern part of the country. The seat of the President should rotate in all the zones before  
210 getting back to the zone that started out of the six zones. This would therefore resolve the problem of North and South  
211 power tussle, where the Christians and the Muslims fight over power as it is currently witnessed since the administration  
212 of President Goodluck Jonathan, which started from 2011 to 2015 as his first term after winning the 2011 presidential  
213 elections. Joseph (2014) notes that, a founding member of the People's Democratic Party (PDP), Mallam Adamu Ciroma  
214 lamented over the zoning issue as it was truncated by the PDP after the death of President Yar'Adua in 2010. It was no  
215 longer recognized by the PDP and as well as the Nigerian constitution and that became the source of political conflict  
216 therein.

217 It will also break the idea of using religion as a tool in fighting political issues and interests in the name of fight  
218 between the Muslims and Christians just like what is happening since Jonathan took over as the president. The Boko

Haram in one of their videos lamented the reasons why they are fighting the Nigerian government is that they are against the Nigerian constitution and Democracy. It will also resolve the problem of neglecting other sections of the country in occupying the seat of the President like the South-East zone, where the Igbos have not been allowed to be President since the end of the Nigeria civil war in 1970. This led to the intention of the Igbos to disintegrate from Nigeria to establish her own country. Also, the neglect of the North-Central where it seems as if a Northern Christian cannot be the President of Nigeria in a democratic dispensation, since the major ethnic group in the Northern part of the country amongst other groups is that of the Hausa-Fulanis from the North-West and North-East zones and majority of them are Muslims in the North. The truncated zoning arrangement by the PDP in 2010 after the President Yar'Adua's death has amounted to Christian/Southern leadership of the country from 1999-2007 and 2010-2015 under study. Thus, zoning is not recognized by the Nigerian constitution and it connotes the idea of why the Boko Haram insurgents are fighting against the Nigerian state, the Nigerian constitution and democracy. When this issue is resolved within the Nigerian constitution, it will then provide an environment for equity, peace, political stability and unity in diversity.

- B) The government of Nigeria should fight corruption to a zero level and should provide autonomy to the anti-corruption agencies, like the Economic and Financial Crime Commission (EFCC) to do their work without any interference from the Federal Government especially the Presidency. Public money that has been made away by public officers in office should be brought back into the Federal Government treasury for the purpose of developing the country.
- C) Provision of job opportunities for the youths who have graduated from higher institutions of learning. This will enable them to be productive as well as to be engaging in doing something meaningful to contribute to the growth and development of the country. Most of the Boko Haram members are jobless youths who become tools in the hands of the militants where they serve as members of the militant group.
- D) Provision and enhancement of education facilities from primary to higher levels of education in Nigeria. Sponsorships should be provided to excellent and deprived students to encourage scholarship. More so, the teachers and lecturers should be paid promptly when due rather than allowing them to embark on incessant strikes which cripple the educational system.
- E) NEPAD should embark on serious sensitization in collaboration with the civil society organizations, governments at all levels, non-governmental organizations, as well as the private sector in launching Peace and security awareness campaigns, the need for peace and conflict resolution between the government and the people. NEPAD should therefore, strategize in resolving the conflict using the above suggestions as recommendations to the federal government as well as the African Union, as one of the means to ending the conflict.
- F) The people of Nigeria also have a role to play. They must accord high regard to Nigeria before attending to personal interests. No country can stand when it is divided against her-self. United we stand as a country, but divided we fall as a people and country. Nigerians as a people must understand that, there is strength and unity in diversity, therefore, the differences arising from ethnic and cultural backgrounds should be rather translated into a source of strength, where nation building can be sustained, then peace and political stability can be restored.

## 5. Conclusion

Nigeria is an endowed country with diverse natural resources, and the highest population in Africa. The country's population therefore serves as a huge market and resource base both locally and internationally. As a backbone of the West African sub-region, the country has contributed to the development of many countries in Africa especially countries that passed through crisis at some point. Also in the past, her military power was used in restoring peace and security in such countries as Liberia, The Gambia, Guinea Bissau, Togo, Cote d'Ivoire, Darfur and Sao Tome and Principe. Nigeria serves as the Headquarters of the ECOWAS, a major power and contributor to ECOWAS Monitoring Group (ECOMOG) during the peace keeping operations in many African countries. This provides a basis for the need for peace and security to be restored in Nigeria, and for the people to be united. NEPAD, therefore in collaboration with the African Union and other relevant bodies should engage in conflict resolution processes using the mediation tool between the Boko Haram and the Nigerian government in order to resolve the issues therein for the purpose of enhancing political stability.

The zoning formula should be applied for the purpose of creating an environment where all the zones will be recognized in the Nigerian constitution so as to ensure power rotation among the six geopolitical regions of the country Nigeria. This would help bring the people together where unity shall be restored between the Christians and the Muslims, the North and the South. The government should provide more jobs for the youths and the educational system should be

improved and monitored. All these if effectively done, would enhance nation building, economic growth and development of the people and the country.

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## Methods of Management of Public Financial Resources

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### Abstract

December 2012 marked 20 years since the formation of the Federal Treasury and throughout this period the Treasury of Russia has always been at the forefront of innovation processes. In this article the use of tools aimed to improve the Federal budget execution in terms of management of liquidity of Unified account of the federal budget (Treasury Single account) are studied. The existing mechanism of liquidity management proves its effectiveness and, consequently, the ways of its development and improvement are in existence. The liquidity of the Single Treasury account is the ability of the relevant Treasury single account in a certain period of time to make timely payments of public administration sector. Ensuring the liquidity of the Single Treasury account are developing in the following areas: the functioning of the Single Treasury account, forecasting and cash planning funds from the Federal budget, management of funds of the Federal budget. The implementation of these directions will set a new standard in the process of formation of system of liquidity management of Single Treasury account, will allow in time to assess the liquidity of the Treasury and to make informed decisions on its regulation, will simplify many business processes in the management of public financial resources.

**Keywords:** Single treasury account, outturn of the budget, liquidity of Single account, Cash Management, cash planning.

### 1. Introduction

The public authorities in the process of implementation of various government functions provide the necessary regulation in the sectors of the national economy and the social sphere through funding and reallocation of funds provided for these purposes in the budget, the relevant provisions of the Budget message of the President of the Russian Federation to the Federal Assembly of the Russian Federation on budget policy for the corresponding three-year period, the main indicators of socio-economic development of the Russian Federation and the main directions of the budget policy. In the field of public Finance management new instruments of budget planning and financing, should be actively introduced, which causes the improvement of individual stages of the budget process, including the execution phase of the budget, which will result in the efficient use of public financial resources. The efficient use of public resources is one of the most important problems which are solved by authorities of the state at the present time. The effectiveness can be achieved by the continuous increase of budget expenditures, i.e. to have "economies of scale", and with the same quality of public services or (in some cases) of its decrease. (Peacock S., 2008). The key point of the anti-crisis plan of the state is the optimization of budget expenditures at the expense of inefficient spending, the performance of public obligations of all levels of government and the concentration of resources on priority areas. Because of this investigation in search of tools for improving the management of public financial resources and liquidity management Single Treasury account in the framework of the implementation of anti-crisis route support of the Russian economy in 2015-2016 is well-timed.

The purpose of a scientific article is to provide a method of creating sovremnyh treasury single account that can

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solve such problems as:

1. Promptly evaluate the liquidity of the Treasury and to make informed decisions on its regulation.
  2. simplify many business processes in the area of public financial management.
- The objectives of this research is to discuss and propose ways of making higher these problems.

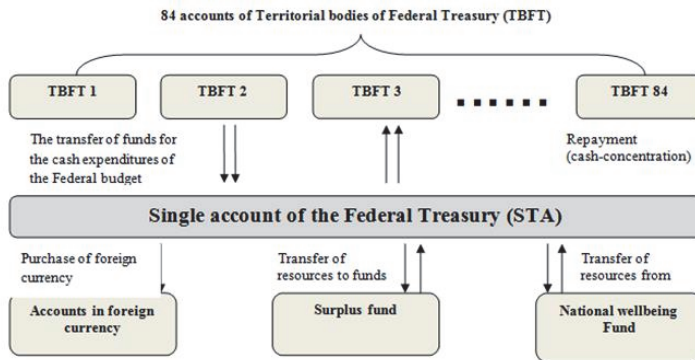
**2. Literature review**

State payments take the main role of the national payment system that have a huge impact on economic growth and monetary policy.

**Table 1.** Single Treasury account (STA)

Account	Name
401 01	Income distributed by the Federal Treasury bodies between the levels of the budgetary system of the Russian Federation
401 05	Federal funds
401 16	The funds for the payment of cash to the recipients
402 01	The funds of budgets of the territorial entities of the Russian Federation
402 04	Funds of local budgets
403 02	Funds temporary used by budgetary organizations
408 16	Budget of the Common state
405 01	Funds of enterprises in Federal ownership. Financial institutions
406 01	Organizations account located in the state (except Federal) ownership.
407 01	Accounts of non-governmental organizations. Financial institutions

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**Figure 1.** Single Treasury account (STA)

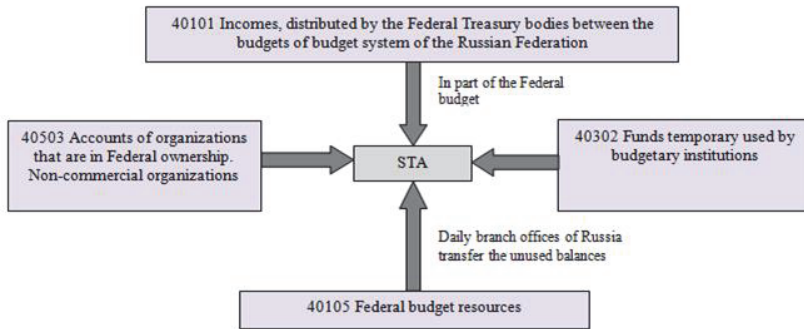
The functioning of the system of budget execution is carried out taking into account a number of fundamental principles, which traditionally include General principles of the organization and build of a budget system, namely: the principle of independence of the budget, the principle of budget transparency, the principle of separation of revenues, expenditures and sources of financing the budget deficit and other principles. The basic principles are reflected in the legislation of the majority of both Federal and unitary states. (Premchand, A., 1994).

The efficiency of government payments depends on the functioning of the Single Treasury account (STA).

STA is treasury account at the Central Bank of the country, which consolidates the cash position of the state (Treasury Single Account, 2010).

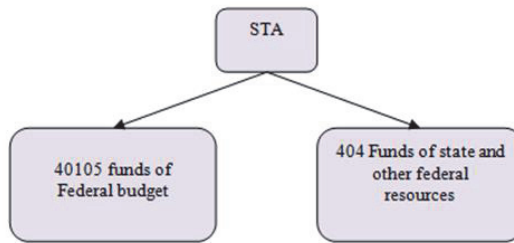
STA of the budget represents an actual and, as noted, constantly improving structure, ensuring the transparency of the movement of public finances. The operation of the STA of the Federal Treasury is presented in the following figures (2, 3, 4).

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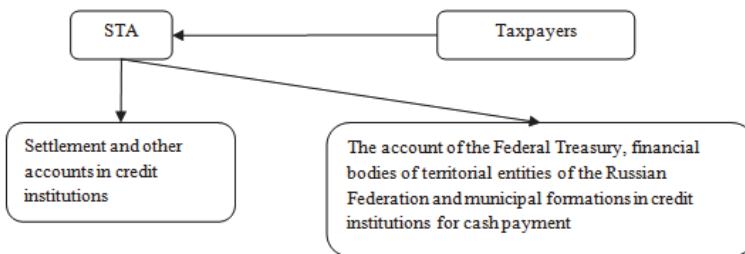
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**Figure 2.** Transfer of funds of department of the Federal Treasury to the STA from its open accounts



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**Figure 3.** Writing off of amounts from the account of STA to accounts of departments of Federal Treasury

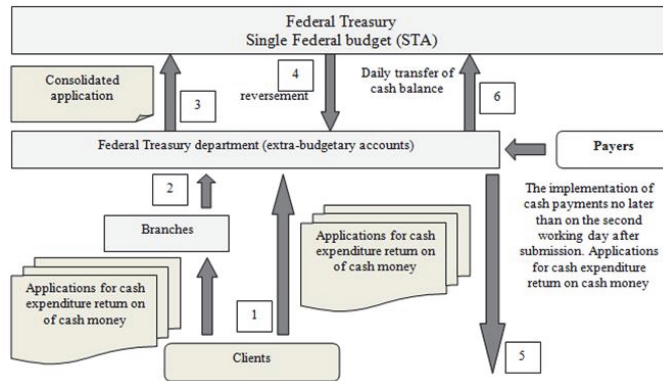


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**Figure 4.** Intended functioning of the STA in 2017

The performance of the Single-account budget contributes to the implementation of effective fiscal policy, allows administrate the free budget Finance of him. Call for funds is a mechanism of reinforcement of a Unified account of the Federal budget for the implementation of performance of previously scheduled commitments. Under this mechanism the funds that are in the account of № 40302 «Funds temporary used by budgetary institutions», № 40501 «Accounts of organizations that are in federal ownership are used. Financial organizations» with their subsequent return to the specified account (figure 5).

105



**Figure 5.** The scheme to attract temporarily available extra budgetary funds

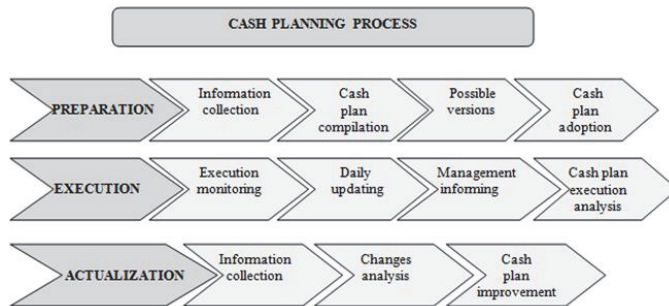
In case of costs implementations and cash payments providing necessity Federal Treasury transfers all necessary money from the Federal Treasury Single Account to accounts, there temporary spare money was involved.

This mechanism realization would be impossible without the Budget Single Account, which provides the accumulation of federal budget money, which allows to get actual information about budget money state and hence to realize rational planning of its usage. That provides the timely payments on the expenditure obligations of public and legal institution. In addition, the attraction of free funds from the budget accounts to the single account of the federal budget enables the State to cover cash gaps formed in the course of the year.

Mobilization of domestic resources of the State is necessary for the timely implementation of financial operations, rapid response to economically adverse events and constant movement of budget funds for their use insurance.

### 3. Methods and Medium

One of the main liquidity management mechanisms of Federal Budget Single Account is the usage of cash planning and financial forecasting procedures during the execution of the federal budget.



**Pic 6.** Cash planning process scheme

Cash planning – is a unique planning tool of monetary circulation in the country, allowing to implement a system of efficient operations management of state financial resources that will ensure the transition to the centralized management of STA liquidity.

Financial forecasting provides the calculation of the possible volumes of all cash receipts and payments from the budget in a certain time period in the future, as well as the comparison of actual results obtained with the forward-looking indicators.

The main result of cash planning is a cash plan, serving as cash receipts and cash payments from the budget in

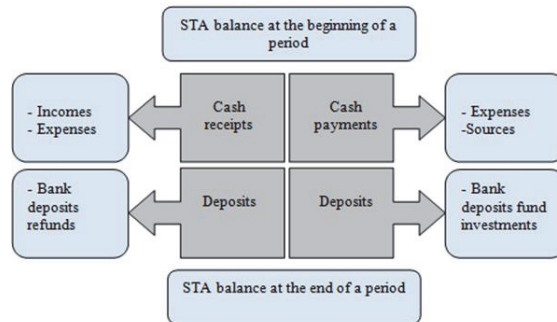
136 the current fiscal year prediction. (Emelianenko A.V., 2011).

137 In performing functions for the cash plan development, refinement and maintenance Federal Treasury designs a  
138 cash plan for the current fiscal year with monthly detail; cash plan for the current calendar month with weekdays detailing;  
139 makes cash plan improvements for the current fiscal year with monthly detail; receives and processes the information  
140 provided for the formation and refinement of the cash plan of the federal budget for the current fiscal year.

141 The cash plan index system allows to analyze this year state of the STA to ensure the effective implementation of  
142 the budget by budget process participants.

143 Thus the ratio of federal budget cash receipts and cash payments allows to define the minimum acceptable level of  
144 budgetary funds for STA as well as the amount of federal budget temporarily spare funds at a time (pic. 4).

145



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147

148 **Pic 7.** Federal budget execution cash plan structure

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150 Summing up, it should be noted that the result of the effectiveness of the use of the described mechanism cash planning  
151 are affected by the executive discipline of the budget process participants, namely the timely submission of accurate and  
152 complete information, as well as the introduction of new technological approaches to cash planning.

153 So, despite the positive examples of evaluation practices in different countries, it should be noted that today the  
154 problem of existing programs effectiveness estimation is not fully resolved and there is no country in the world that would  
155 have been completely satisfied with their efficiency indices. (Bartle, J.R., 2001). Therefore, the issues of reliability and  
156 relevance of the indicators continue to be among the most important.

157 It is clear that the phased planning performance evaluation indices should include not only quantitative but also  
158 qualitative aspects.

159 Effective functioning of the cash planning model contributes to the rational and operational financial management  
160 in the public administration sector, which in its turn helps to minimize the Sovereign Wealth Funds involvements for the  
161 federal budget balancing, acquire additional interest earnings from bank deposits spare federal budget funds and use  
162 new technologies for additional reserves involvement.

163 The System of budget payments reforming by 2017 and the transition to a Single treasury (bank) account would  
164 require targeting of STA cash balances for the effective management of excess liquidity to generate additional income.

165 Cash planning and forecasting for STA policymaking in the new environment and the necessity of strict execution  
166 of all activities planned by the Treasury Russia strategy map in 2015 are of priority importance. (Artyuhin R.E., 2014).

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## 168 **4. Results and Discussions**

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### 170 **4.1 Federal budget cash management**

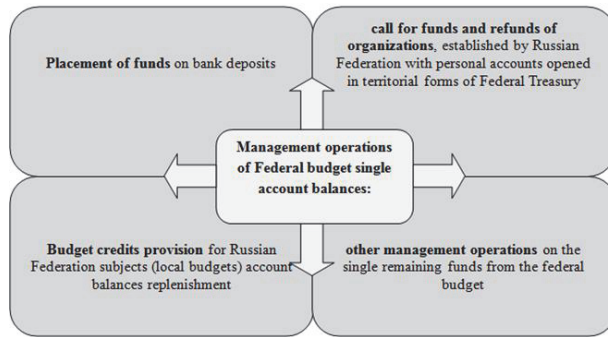
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172 Even today the Treasury of Russia provides the required minimum level of funds in the Single account of the federal  
173 budget (STA) and receives additional federal revenues due to the management operations of spare cash balances of  
174 STA.

175 STA liquidity management is carried out in various directions (Pic 8).

176 Budget accounts liquidity Management (L.V. Shubina, 2013) is carried out in a strict accordance with the budget  
177 legislation, which provides that a relative lack of funds authorized federal authorities are to mobilize borrowed funds in the  
178 credit market to cover all the necessary budgetary expenditure.





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181 **Pic. 8. Federal budget funds management**  
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183 In 2014 in the conditions of unstable situation on the financial markets one has been managed to clearly organize the  
184 federal budget placement on bank deposits. Altogether there was 80 credit institutions applications selections, which is of  
185 1.2 times more than the same period of 2013.

186 Estimated income from the placement of the federal budget on bank deposits will amount to about 35.2 billion  
187 rubles and 2.9 billion rubles will come in 2015 from the federal budget placed in 2014.

188 As part of anti-crisis measures aimed at providing liquidity to the banking sector in terms of sanctions imposed on  
189 the large state-owned banks, for Russian Ministry of Finance individual solution there has been 170 billion rubles placed  
190 on bank deposits. From these transactions on the federal budget additional 4.8 billion rubles will go in 2014.

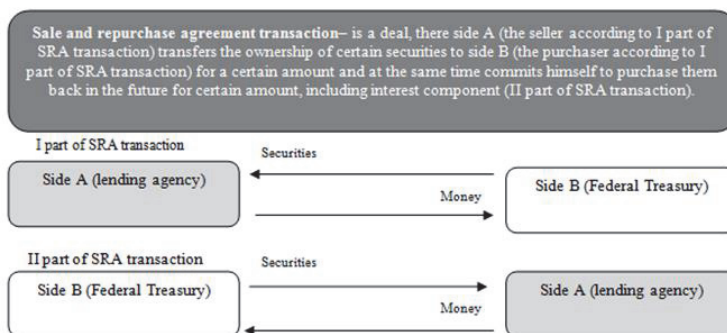
191 The STA federal budget spare balance, including achieved by carrying out operations for unrestricted STA  
192 balances of public administration sector targeting, creates the conditions for the provision of short-term loans of the  
193 federal budget to the budgets of subjects of the Russian Federation and local budgets to cover temporary cash shortages  
194 at a rate below the refinancing rate.

195 Since the beginning of 2014 I a new mechanism of territorial bodies of the Federal Treasury budget credits  
196 extension for the regional budgets account balances replenish (budget loans) was started. As of September 26, 2014 56  
197 agreements with the authorized organs of the Russian Federation subjects were signed, 173 budget loans totaling 376.6  
198 billion rubles were provided. Sum total the federal budget received 259.6 million rubles by providing budget loans.

199 Given innovation implementation on the one hand allowed the subjects of the Russian Federation to replenish cash  
200 gaps arising from short-term budgetary credits with a new mechanism of subsidies and subventions providing from the  
201 federal budget. On the other hand, it has contributed to reducing the debt ratio on regional budgets in terms of  
202 substitution of the Russian Federation subjects commercial credits with budget ones.

203 In 2015 it is planned to test the mechanism of budget loans to municipalities.

204 This will start the mechanism of the Federal budget single account balance management operations in terms of  
205 purchase (sale) of securities under sale and repurchase agreements with credit institutions.  
206



207  
208 **Picture 9. Securities operations according to SRA transactions**  
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210 The effect of the placement of the federal budget on bank deposits on the basis of the exchange:

- 211 - regular and frequent funds placement is provided;
- 212 - supply to demand taking into account the data about the state of the financial markets is approximated;
- 213 - limpid mechanism of competitive selection of credit institutions applications is proposed;
- 214 - a certain minimum size of the offering funds for placement is guaranteed;
- 215 - different maturity range of deposits placed in a calendar month is offered;
- 216 - modern efficient trading platform (exchange) is used;
- 217 - Federal Treasury deposits use as a financial market "beacon".

218 Liquidity management mechanisms are not enough frequency used at the level of the budgets of subjects of the  
219 Russian Federation and municipalities. In making decisions, aiming at their introducing into a separate public legal  
220 institution, one should take into account the possible economic risks, the weightiest of which are critically low STA  
221 balances.

222

#### 223 4.2 Cash Management tools application

224

225 We believe that one of the necessary conditions of Treasury Single Account liquidity increase is Cash Management tools  
226 usage.

227 Cash Management term is widely spread abroad. Traditionally one defines it as a system of banking technologies  
228 for the corporate client financial flows management. In accordance with that, commercial banks are its main users.  
229 However today the system of Cash Management is used by Russian Treasury as an innovative payment instrument.

230 The main components of the Cash Management system products are: management of bank accounts, liquidity  
231 (management of bank balances), the interest rate; settlement and cash services; information services; electronic banking,  
232 card projects - acquiring (a procedure which provides settlement operations execution with payment cards). (Syarheenko  
233 N.S., 2014). New technology corresponds with treasury functions. Cash Management, in fact, is the basis of the Federal  
234 Treasury.

235 Cash Management instruments application aims in efficient government bankroll managing with the help of STA.

236 The main directions of Cash Management development in the Federal Treasury system are following:  
237 accumulation of funds in the single treasury account; improvement of mechanisms of control of the unencumbered  
238 balances of budget funds and processes of electronic services; increase of the speed of payments and cash  
239 management services qualitative characteristics of the budget system of the Russian Federation performance;  
240 minimization of cash circulation; and the development of information systems and technologies (IT systems) designed to  
241 serve as a cash services for public administration management.

242 This will ensure the maximum concentration of public sector funds on the Single treasury account, reduction of the  
243 amount of government borrowing and interest costs associated with them; increase of revenues within the placement of  
244 temporary spare funds.

245 To achieve these goals a number of activities requires: competent cash planning (especially in the main managers  
246 of budgetary funds); implementation of active operations in the financial market; revenue process control and all funds  
247 coming into the state treasury accounting ; timely and full budgetary payments ensuring.

248 Initial results are already achieved. A new mechanism of intergovernmental transfers and budget loans for subjects  
249 of the Russian Federation budgets account balances replenishment (local budget) is created. Spare cash balances  
250 targeting operations are carried out. They are to control the size of the daily balance in the single treasury account by  
251 monitoring the Federal Treasury for cash servicing of budget obligations. Targeting of the unused balance of the reserve  
252 fund and so on is performed in order to extract additional revenue due to operations in the financial market.

253 Note that the STA call for funds operations are comparable with the following banking product as the system Cash  
254 Pooling.

255 This system is a centralized cash management within the group. Differently, Cash Pooling – is a system for  
256 management of multiple accounts opened in the bank with their balances going to one account (cash concentration).  
257 However, the introduction of such commercial tools in the area of public finance management requires detailed study,  
258 including:

- 259 - mathematical apparatus for liquidity ratios calculation;
- 260 - the budgetary accounting transformational changes, associated with the individual balance sheet positions on  
261 market mechanisms isolation;
- 262 - planning and forecasting improvements, in particular the introduction of additions to the cash plan on these  
263 items;

264 - a system of risk events and their evaluation development.

265 In 2017 Russia Treasury should become a "Treasury - Bank", using modern electronic resources at that.

266 Work on the development of software products is continuing. The websites for the distribution of the information  
267 about the state (municipal) institutions ([www.bus/gov.ru](http://www.bus/gov.ru)), orders for goods, works and services for state and municipal  
268 needs ([www.zakupki.gov/ru](http://www.zakupki.gov/ru)) are used.

269 Web portal of electronic payments of population with general government organizations ([pay.budget.gov.ru](http://pay.budget.gov.ru)) by  
270 means of plastic cards, e-wallets, mobile phones is improving.

271 Public informational system for regional and local payments (PIS RLP) is developing.

272 PIS RLP federal portal is a key information contributor for general government segments on receipt of budget  
273 revenues within the interagency electronic interaction system (IEIS). Federal Treasury creates modern client-directed  
274 payments organization service model.

275 First of all we are talking about strengthening of the autonomy and responsibility of ministries and departments for  
276 the results of the programs implementation. One can say that the software architecture of the budget involves the  
277 construction of "chain of responsibility» (Barilari, A., Bouvier., M.), when on the federal and regional level the specific  
278 individuals responsible for the results of the implementation of programs / subprograms are defined. An important  
279 condition for efficiency is the existence of direct relationship between the activities and their evaluation indices.

280 Thus, information and telecommunication systems of the Federal Treasury (and its subsystems) on the scale, the  
281 list of the variables indices, its database volume, architecture complexity, internal links diversity and territorial branching  
282 can be attributed to the significant number of public information systems which users are authorities and government of  
283 all levels, businesses entities, budget process subjects, citizens.

284 To implement a Cash Management a new information systems is required. Developed IT systems are a  
285 prerequisite for Cash Management Services. A number of such systems are already successfully operating.

286 For example, centralized middleware product "Automated Federal Treasury System" (AFTS), aimed at the  
287 integration of accounting information within a subject of the Russian Federation, allowed not only to hold a series of  
288 optimization measures in the organizational structure of the Federal Treasury, but also significantly increase the  
289 transparency, information quality, as well as efficiency of its disclosure to external users.

290 AFTS web portal became principally new software for other budget process participants (subsystem for external  
291 users). It allows Treasury customers to implement information interaction with treasury bodies on-line with the Internet  
292 using.

293 Federal Treasury generates client-directed payment organization service model.

294 Efficiency and budget funds turnover are important elements, influencing the effectiveness of the Single Treasury  
295 Account. Federal Treasury bodies are included in the associated partners of Banking Electronic Speed Payment System  
296 (BESPS). BESPS implementation allowed accounts reinforcements in the current working day, minimizing even short-  
297 term diversion of funds from the Treasury Single Account, as well as increasing the efficiency of payments from the  
298 federal budget.

299 The basis of the Cash Management product line of the Federal Treasury body at the moment is for accounting  
300 services in the context of budget classification codes and budgets cash flow control. However, the development of  
301 individual products in the provision of additional treasury services for clients can be compared with some banking  
302 services.

303 Given operations are comparable to direct debit bank services (eng. Direct Debit). They allow to debit the customer  
304 account on behalf of the bank customer. Such a method is widely used in many countries (United Kingdom, Ireland,  
305 Israel, Germany, the Netherlands, Japan, Australia), although the payment technologies vary. In the context of the  
306 Russian treasury system this method can also be successfully developed.

307

### 308 4.3 State payment system operating risks management

309

310 While operating, certain specific risks appropriating to the state payment system arise. The risk of the state payment  
311 system can be defined as the probability of deviation of operation of the public payment system from the expected  
312 (planned) results for the worse or as the negative situations (trends) occurrence which causes damages (loss) of the  
313 participants of the state payment system.

314 Credit risk, liquidity risk, legal and operational risks apply to the main types of risks peculiar to the state budget  
315 payment system. When the organization and functioning of the state of the payment system must necessarily take into  
316 account the risks and analyzed the risk factors for the emergence of new risks and the state of the payment system in  
317 order to develop and implement measures to minimize the risks or leveling their negative effects.

318 During the state payment system organization and functioning one must necessarily take into account the present  
319 risks and analyze the present risk factors for the new risks occurrence and in order to develop and implement measures  
320 to minimize the risks or leveling their negative effects.

321 In our opinion, the key aspects of effective risk management are:

- 322 - development of a common policy of the subject of the Russian Federation, which defines the principles and  
323 procedures of the risk management system of the state payment system (as part of fiscal policy);
- 324 - institution-building (the Risk Management Committee (Department));
- 325 - the development of a risk management program of the state payment system;
- 326 - Monitoring and analysis of the effectiveness of risk management of the state payment system.

327 The risk management process consists of three stages:

- 328 1. Problem statement: risk identification, the scale of risk determination;
- 329 2. Problem solution: risk assessment, risk reduction (minimization);
- 330 3. Monitoring and control.

331 STA must have an effective system of state payment system risk control and management. It will help to make  
332 right management decisions and improve the effectiveness of problem activities of the Treasury.

333 As of today, a system of performance assessment is built in the Federal Treasury bodies. Great work on  
334 information collection and analysis about the quality of work units and their risk capacitance identification is taken place.

335 Under the internal risk the impact of external factors on the performance indicators is implied. To manage them  
336 helps functioning improvement and influence on the existence of external risks (i.e. the external factors).

337 Let's illustrate by an example the experience of the Federal Treasury Administration in the Rostov region  
338 (hereinafter - Administration). In the pattern of risk value determining the Administration systematically carried out  
339 analytical work on the basis of data on the results of the functions / tasks of structural subdivisions.

340 This takes into account the following violations:

- 341 1) identified by structural units during internal control activities;
- 342 2) identified by in audits conducted by the Internal Control and Audit Office.

343 The administration analyzes and takes into account the violations committed by the structural units of both the  
344 current rating period and in prior periods. This approach is used as a motivational tool of federal civil servants in order to  
345 improve the efficiency of their activity. In turn, the structural units effectiveness assessment is based on the relevant civil  
346 servants effectiveness assessment. To order the process the decision to develop appropriate risk management  
347 procedures was made. The main components of which are:

- 348 - risk management at the level of structural units;
- 349 - internal quality risk management audit conducted by the internal control and audit.

350 The key structural components of the Order include risk maps development, represents a set of spreadsheets with  
351 certain indicators (the level of violations, the level of risk at the beginning of the year / at the end of the rating period, the  
352 level of risk dynamics, the risk occurrence probability) - table. 1, 2.

353  
354 **Table 1.** Risks map in establishing the management functions of the Federal Treasury in the Rostov region Section I "The  
355 dynamics of the level of risk" during the year  
356

Risk group	Risk	Risk criteria at the beginning of the fiscal year		Risk criteria during the current fiscal year											
		The level of violations at the beginning of the current rating year ( $Q_{0,t}$ )	The level of risk at the beginning of the current rating year ( $V_{t,0}$ )	I quarter		II quarter		III quarter		IV quarter					
				The total number of violations detected by the Management Division at the end of the rating period ( $Q_{1,t}$ )	The level of risk at the end of the rating period ( $V_{t,1}$ )	Dynamics of the level of violations ( $\Delta$ )	The total number of violations detected by the Management Division at the end of the rating period ( $Q_{2,t}$ )	The level of risk at the end of the rating period ( $V_{t,2}$ )	Dynamics of the level of violations ( $\Delta$ )	The total number of violations detected by the Management Division at the end of the rating period ( $Q_{3,t}$ )	The level of risk at the end of the rating period ( $V_{t,3}$ )	Dynamics of the level of violations ( $\Delta$ )			
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16

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**Table 2.** Risks map in establishing the management functions of the Federal Treasury in the Rostov region Section II «The number of violations identified by the activity of structural divisions of the Federal Treasury in the Rostov region in the context of the risk and the probability of their occurrence" Risks criterion

Risk	The number of Management structural units violations							All violations in risk E	All violations in risk T	Total violations in all risks	The probability of the risk at the beginning of the year _____	The probability of risk in the I quarter of the year _____	The probability of risk in the II quarter of the year _____	The probability of risk in the III quarter of the year _____	The probability of risk in the IV quarter of the year _____
	Department A	Department B	Department C	"/"/	"/"/	"/"/	"/"/								
1	2							3	4	5	6	7	8	9	10
1.															
including:															
executors risks (E)															
technological risk (T)															
and etc.															

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The level of risk depends on the probability of its occurrence and possible consequences.

The definition of the level of violations at the beginning of the current year is defined as the averaged quarterly on the basis of data for the previous rating year violations.

In case of violations absence (data of violations absence), the value of their level at the beginning of the current rating year shall be assessed conventionally equal to 1.

The definition of the level of risk at the beginning of the current rating year is set relatively according to risk capacitance activities data for the previous rating year.

In case of activity area absence (activities risk capacitance data absence) risk index at the beginning of the current rating year shall be calculated conditionally based on the potential risk capacitance.

To indicate the level of risk the following criteria are used:

- 50-100% - a high level of risk (the number of violations detected during the processing of documents handling, operations performing, procedures towards the activities come to more than 50% of the total number of processed documents, executed operations, procedures);
- 10-50% - average risk;
- Up to 10% - a low level of risk.

Risk criteria are conditional rate.

Analyzing the risk management one uses:

- Comparison method;
- Graphical method.

Quarterly the Department of Internal Control and Audit provides the received analytical information following the results of the end of the rating period to the organization leadership

At that, the Management is in constant search for ways to improve the efficiency of functions performance under the limits of credentials and mechanisms for their implementation.

So, there are three main points related to risks management and their minimization.

In this regard, the work Performance measurement Getting Results (Hatry, H.P., 1999), in which a scientist G. Hatry indicates the state programs efficiency indicators during the monitoring of their effectiveness is of most urgency.

A particular problem of payment system risk monitoring is that the probability of the risk itself is small, but losses in the event of such risks can be enormous for the Treasury and for the whole system, including the national economy. These effects are comparable to the risks related to nuclear stations incidents or natural disasters and catastrophes.

The second payment system feature and characteristics is its high degree of computerization or electronization and system infrastructural dependence based on Internet communications. Improper and unlawful use of communication

394 channels can cause movement of funds for criminal purposes. In turn, the necessity of adequate security for the transfers  
395 in the system endurance gives rise to various problems.

396 Finally, the third feature connected with the changing operating environment, which is becoming more difficult for  
397 risks detection, assessment and monitoring. Thus, the rapid development of the Internet has opened up wide  
398 opportunities for new payment instruments, often operating outside the traditional banking and treasury systems.

## 400 5. Concluding Remarks

401  
402 Public finances require constant improvement, especially in the area of the budget funds turnover movement  
403 transparency, their turnover acceleration and their usage efficiency.

404 The examination shows that there are many methods for effective public financial management, ensuring the anti-  
405 crisis program execution of budget expenditures reductions that benefit state run public authorities, taxpayers, banks and  
406 the economy as a whole.

407 In accordance with the objectives set out in the scientific paper studied the structure of modern methods of creating  
408 a single treasury account to eliminate the problems associated with the timely estimation of the state treasury and liquidity  
409 to make informed decisions on its regulation and the simplified many business processes in the area of public financial  
410 management.

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## Business-Planning Quality Support Factors

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### Abstract

*The role of IT in effective business-planning support is defined. The author shows that business-plan should contain unified information supporting high return on investments. IT should contain information that is listed in the article. The author divides this information by source: accounting and extra-accounting sources. The author also proves that company management should make decisions regarding the depth of costs and profits structure on their own. Insufficient detailing hampers valuable accounting. The author also characterizes the main features of external and internal IT and their tasks. The author proves that IT in Russian companies does not satisfy requirements of the modern stage of economic development. It is necessary to revise the scientific heritage of Soviet accounting and analytic school and also rest upon the experience of foreign counties in effective business-plan development as the author has shown.*

**Keywords:** *enterprise, quality, business-planning, standard, algorithm, evaluation.*

Integral business-planning today plays a special role in the general system of industrial enterprise management system. It promotes development of the processes of managerial activity adaptation to business-planning.

But in practice complex character of business-planning operations is not fully understood now especially as concerned its preliminary stage, while the most important decisions regarding future activity are made on this stage.

This stage requires deep analysis and explanation of this idea. In the process of preliminary stage realization measures are carried out for adaptation of existing system of corporate management to the requirements of external environment, for necessary transformation of existing corporate structure, and for development of business-planning certification system due to processes unifying and standardization.

In the present state of Russian economic practice development it is necessary to make gradual shift from traditional project description to business-planning standards. The aim of the process is not radical transformation of old planning system but justifying the necessity of its adjustment in accordance with the requirements of market transformations of the economy.

Improvement of business-project plan development is directly correlated with the process of corporate development as a whole. Business-planning is critical for development of economy subject management system that is adequate to external environment requests and supports its long-term reliable functioning.

One of the tasks is to satisfy requirements of investors because the main aim of business-planning is capital raising for a certain project realization. The process of unification of information provided in business-plan is especially important because it allows corporate representatives and potential investors to develop the common language for better understanding of each other's aims and tasks. This approach is possible only on the ground of adaptation of information of business-plan to requirements of investor.

Different unions, natural and juridical persons, international and state financial intermediaries and institutions may act as investors. Considering the requirements of each potential investor it is possible to develop requirements to source information of business-project with investment character [1, p. 42-54]. These requirements are directly connected with investment standards that define effectiveness of investments in the scope of business-projects.

Still business-project plans that have been developed at present are not unified as required and holders of investment resources have too much information. So it is necessary to develop objective approaches to IT to make it fully satisfy the requests of maturing business-planning system due to integration of methodological tools that are used now for this purpose.

It is necessary to understand that the main aim of IT is provisioning corporate management (with limited number of workers) with information for carrying out enterprise productivity control procedures and justifying decisions basing of the results of this analysis. Information about fixed and direct expenses, average costs that determine cost price of products, production and sales profitability belong to this type of information.

56 Information sources used for corporate productivity analysis may be divided into two groups: accounting and extra-  
57 accounting.

58 IT development is important for corporate functioning internal reliability. Management of economy subject decides  
59 on its own how to make costs and costs centers classification and match them with a certain centers of competence and  
60 how to account for standard and partial costs. A certain types of analysis that are regularly realized by corporate  
61 management characterize the level of chart of accounts details that is necessary for a certain income item and cost.

62 If organization needs separating elements of fixed and direct expenses accounting database should be extended.  
63 (Semi-alternating costs may also be separated into fixed and direct.) Such extension may be required when enterprise  
64 management needs regular short-term alternative costs analysis or internal income statement with separated fixed and  
65 direct expenses. Later on card of accounts may be extended if organization needs to match costs to center of  
66 competence where they arise (or what they were related to) by their accountability in its accounting system.

67 There is no some sort of standard accounting structure detailing because corporate management should make  
68 decision regarding the depth of details of costs and income indicators on its own. But it is worth noticing that usually  
69 corporate accounting data is not adequately detailed that hamper valuable accounting [2]. A number of cases are known  
70 that enterprises have never revised their cards of accounts after automation. Still in economic practice there are also  
71 known the cases of unpractical investments in computer programs modernization for deeper data detailing. Anyway  
72 detailing of data that supports its regular use may be considered practical [3, 4, 5, 6]. There is no need to use expensive  
73 applications for extra-detailed presentation of information.

74 Detailed accounting information is important for alternative analysis of full costs. Trends of costs variations and  
75 distributions are more important for management accounting because it provides correlation between developing  
76 management control system and its aims [7, 8].

77 Analysis of big volumes of data both internal and external is necessary for enterprise functioning that in turn  
78 requires quality IT.

79 External IT is focused of the following tasks:

- 80 4. legislative legal information of the Federal level of economy management (governmental regulations and  
81 decrees, State laws). Main focus of this information is development of favorable conditions for external  
82 investors in the base of sustainable development and regulative base protecting investor's interests);
- 83 5. regional and municipal legislative legal information for settlement of the most important problems in regions.  
84 They may be related to creation and preserving jobs, dwelling provisioning to the people living in dilapidated or  
85 abnormal houses, environment protection. Settlement of these problems is necessary for creation of favorable  
86 investment conditions in regions or municipalities by lightening enterprise tax burden under the condition of  
87 fulfillment of socially valuable for region investment programs, facilities modernization by these enterprises;
- 88 6. intersectoral IT for different activities support for example in power saving;
- 89 7. information related to tax legislation, tax levy, duty and payments. Communication of tax information is critically  
90 important for correct understanding of the future return on today investments. It is necessary to keep correct  
91 correlation of federal, regional and local taxes taking into consideration possible benefits and the ways of tax  
92 optimization;
- 93 8. methodological information that defines rules and standards of investment business-projects plans  
94 development that describe methodological tools used in business-practice for calculating investment  
95 efficiency, development of final tables, etc. [9, 10].

96 Guidelines on evaluation of investment projects efficiency and selection of investment projects for funding is still  
97 the main legislative document for investment market. These guidelines highlight the most important aspects of analysis of  
98 investment project related to the following:

- 99 • modeling product, cash, resource and information channels;
- 100 • market state analysis and its impact on activity of enterprise that is realizing a certain business-project, its  
101 impact on ecological situation, etc.
- 102 • investment efficiency evaluation on the base of comparison of costs and returns with accepted yield and  
103 profitability standard;
- 104 • reduction of costs and returns considering different periods to commensurable cost-effectiveness indicators;
- 105 • impact of inflation factors, delays in wage payments and other aspects that impact the value of bankroll;
- 106 • uncertainty factors and risks related to investment project realization;
- 107 • International Financial Reporting Standards as important element that shows future results of business-project  
108 plan realization.



109 Internal IT contains information about the company: organizational structure, technological development level,  
110 availability of qualified personnel, market share, financial provision state, realized strategy.

111 Availability of internal and external IT presumes development of business-project investment plan as the main task.  
112 Besides, now there is positive experience of using foreign methods of business-planning in national enterprises.

113 Nevertheless development of unified approach to accounting in Russian and foreign enterprises does not mean  
114 their identity. Key distinguishing features are related to higher extent of market approaches development in economic  
115 activities in foreign countries. Market activity predetermines using of a certain methodological tools most closely related to  
116 market economical methods and requests of external environment of enterprise. This approach promote constant  
117 development of internal management of a company, stimulates top-managers to use the most advanced management  
118 methods [10, 11].

119 So the greatest obstacle for using scientific and methodological base that is used by foreign enterprises is the lack  
120 of IT corresponding to the requests of the present stage of economical development [12, 13].

121 Therefore one of the most important tasks is transformation of the national experience in business theory and  
122 practice in accordance with tasks of the ongoing market transformation.

123 The other task of development of modern and quality business-planning system in Russian industrial enterprises is  
124 application of the new methods of gaining information about product quality, cost of production, financial results of  
125 unconventional sources that support well grounded decisions.

126 It is also necessary to analyze individual elements of the system as a single unit from the point of view of  
127 effectiveness of goal achievement.

128 Deep analysis and revision of rich scientific legacy of Soviet accounting and analytic and economic and statistics  
129 school and application of advanced tools used for effective business-plans development in advanced countries is  
130 important requirement for high quality of business-project planning.

131 Special attention should be paid for extending calculating methods used in Russian industrial enterprises by  
132 methodological tools that are widely used in advanced countries and its legislative consolidation and correlation with  
133 existing tax code. Main task here is reasonable matching of national experience of accounting operation conduct by main  
134 element and application of different methods of flexible development of accounting practice typical for market  
135 transformations.

136 Important factor of effective management of Russian industrial enterprises is flexible and optimal combination of  
137 national results and foreign experience of business-practice.

138 The main condition that will characterize the trends of business-planning improvement in Russia is legislative  
139 consolidation of the further development and deepening of market oriented transformations. It is also necessary to take  
140 into consideration expediency of constant effect of management system on it quality. It supposes complex analysis of  
141 information flows related to each structural unit of an enterprise and validity of their transfer in communication process.  
142 Besides this process cause the necessity of development of effective communicative networks and links that optimize  
143 information transfer in an enterprise.

144 Any material resources flow is directly related to information flow that in turn generates organizational and  
145 economic and methodological support for the process of investment business-projects development.

146 Therefore information for any management system provides information about the state of managed system  
147 necessary to obtain a certain aims. These aims are set by the management of an enterprise to provide information for the  
148 process of making grounded management decisions.

149 To conclude, IT in connection with methodological support for this process and improvement of organizational  
150 structure of industrial enterprise is extremely important for high quality business-planning.

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# Changing Patterns of Privatization: A Comparative Study of University and Industrial Sub – Sectors of Nigeria’s Economy

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## Abstract

This paper analyzed the emerging trend of privatization in Nigeria, comparing the emergent realities between two sub- sectors- education and industry. Between 1985 and 1998, the wave of de-nationalization of public companies, utilities and boards did not flutter the university sector. However, from 1999 to date, university education had been opened up for private participation in educational delivery with private operators founding, funding, and operating universities in such a way that had not been witnessed before. Thus the monopoly of government as the sole provider of educational services at the tertiary level has been checked. The study which deployed a descriptive analysis relying heavily on secondary sources of data, examined the new patterns of privatizing in the educational sub – sector that is not in keeping with the government’s privatization model. The study argues that this radical departure from tradition was due to the failure of the government to govern for good reasons, and that privatization is bound to precipitate new and complex social problems to the university system in particular and the entire society in general.

**Keywords:** Deregulation, Privatization, Private Universities, De-industrialization, Cultural Lag.

## 1. Introduction

The Concise Oxford Dictionary of politics (2002) defined privatization simply as “the transfer of public assets to the private sector, by sale or contracting out”. Privatization could mean any of the following: Firstly, change of ownership from public to private hands where private may encompass small shareholders whether as individuals or groups, firms operating as single proprietors or companies, associations, partnerships, etc.(Orluwene 2011).

Secondly, transfer of management from public to private initiative while ownership still remains public (Adoga 2008).

Thirdly, privatization may not occur at the enterprises level but at the level of the economy in its entirety. In this case, the government may create the enabling environment for private sector to drive the economy. This will of necessity involve a complete system of new laws, regulation, tax regimes, foreign exchange management, human resources development, equity, political cum economic stability and so on. Lastly, privatization may mean opening up or breaking a public monopoly by allowing competition with private operators (Alabi 2009). Cordelli (2013), on his part defined privatization as “the way in which a government discharges critical public responsibilities through or in tandem with private associations”. The first order of privatization is called divestiture, a situation which involves change of ownership from public to private. The Nigerian state could not contemplate this type of privatization for public universities. In the second order of privatization, the state concedes a public industry for a fee or price but retains ownership. The Nigerian state applied this principle to the case of the moribund Ajaokuta Steel Complex (Momo 2011).

The problem of privatization in Nigeria as elsewhere is the leeway it offers public officials, to corruptly enrich themselves. Stiglitz (2007) identifies four basic mechanisms for diversion of public assets and resources into private use in the name of privatization:

First, reduce competition; secondly (particularly relevant in economies in transition when capital markets were not well developed), channel funds to favorites; third, provide favorites with inside information about the value of what is being sold; and fourth, enforce terms asymmetrically.

Nwachukwu (2009) notes a worst kind of corrupt privatization of public industry by government officials in Nigeria. This typology of corruption involves outright swindle in which public officials introduced “fake” investors to “fund”,

57 "reactivate", and "operate" a state – owned steel company for 10 years. He laments that these fake industrialists  
58 (SOLGAS American Energy Company (was merely a marketing outfit for small – scale capacity electric generators; and  
59 Global Infrastructure Nigeria Limited, Indian Company) had neither fund nor the technical know-how for running of the  
60 steel complex. As a result, the public steel sub-sector of the economy had been basterdized and abandoned.

## 61 62 **2. Pro-Privatization Arguments**

63  
64 The National Council of Privatization (in Nigeria) argues very copiously "that privatization permits government to  
65 concentrate resources on their core functions and responsibilities, while enforcing the rule of the game" so that the  
66 market can work efficiently, with provisions of adequate security and basic infrastructure, as well as ensuring access to  
67 key services like education, health and environmental protection (see Privatization Handbook, 2000:x)

## 68 69 **3. Anti – Privatization Argument**

70  
71 These debunk the above statement as it relate to Nigeria in view of the observable fact that privatization means  
72 weakening the power of public sector trade unions, loss of jobs, decaying infrastructure; corrupt officials who sell hitherto  
73 publicly owned industries are also the buyers. This widens the gap between the poor and the rich. Lastly, privatization in  
74 many of the developing countries automatically means de-industrialization (Nwachukwu 2009).

75 The concepts of de-industrialization, and cultural gap afford us the theoretic content of this analysis. Bluestone  
76 (1988:35) defined de-industrialization as "a systematic decline in the industrial base or the process whereby the  
77 proportion of jobs in the manufacturing sector of the economy decreases cover time". When de-industrialization is going  
78 on, as in Nigeria since 1999, factories, stores and government industries shut down with loss of hundreds of thousands of  
79 jobs. De-industrialization itself is attributed to the globalization imperatives. Its implication for the working class is far  
80 reaching. Giddens and Duneier (2000:323) insist that it makes for downward mobility, a common experience for blue-  
81 collar workers with serious implication for their economic and psychological welfare as well as for the wellbeing of their  
82 dependants. A lag in culture occurs when one of two sides of culture which are related changed before or in greater  
83 degree than the other part does; thereby causing little adjustment between the two aspects that existed previously (Bloom  
84 and Selznick, 1977:547). So this study holds a strong view that Nigeria economy is facing a serious maladjustment  
85 because of cultural lag i.e. a situation where the educational sector continues to increase by leaps and bounds as a result  
86 of the invention of private universities, while leaving the industrial sector behind. The latter is ailing, declining and winding  
87 down. The meaning is that today's university graduates in Nigeria have lost hope of working at all. Only few that could be  
88 self employed are exempt from this bleak future.

## 89 90 **4. A Heuristic Analysis of Privatization of Industry in Nigeria**

91  
92 The 1973 indigenization decree which sought to place the commanding heights of Nigeria's economy in the hands of  
93 Nigerians led to the take-over of internationally controlled corporations by the state. Consequently, over 1000 state  
94 owned corporations were established. These companies which included banks, education, agriculture, steel companies,  
95 housing, power, and manufacturing, among others, operated as monopolies and were easily funded by the burgeoning  
96 sovereign wealth from oil (Adoga, 2008). Barely 10 years after, the scenario had changed as international oil prices  
97 crashed, coupled with the fact that profits from these corporations stopped coming as a single slip corruption plummeted  
98 it.

99 In the face of these daunting problems, the question was whether Nigeria would revert to the status-quo by  
100 allowing a private sector driven market in order to ensure an efficient and quality service delivery with its concomitant  
101 improvement in infrastructure and the development of human capital while releasing the government from budgetary  
102 overstretch and expenditure (Adoga, 2008). Kingdom (1995) suggests three steps or modalities involved in policy change  
103 which we find to be germane to Nigeria's case when considering the change of gear from operating huge government  
104 owned monopolies that could not break – even to a political economy that is driven by market forces. These modalities  
105 are "problems", "policies", and "political processes". While the problem process deals with the issue (this time  
106 privatization) which has been able to climb up to national agenda and attracted political visibility, policy process ensures  
107 that potential solutions are provided for the problems. "Political processes" on the other hand incorporates, and operates  
108 on the same continuum with the first two factors. According to Colley and Head (2013):

109 It includes both stable and unpredictable elements, such as the changing national mood, diverse organized political  
110 forces, and changes in the political color of successive administrations.

111 However, Fink (2011) argues that deregulation and the concomitant privatization which swept across the globe in  
112 the 1970s and 1980s came as a result of unassessed contagious mood. Privatization became, for many developed  
113 nations an attractive pill for the cure of most of the economic problems of the period. But for the developing countries, it  
114 was prescribed by the multilateral institutions as a panacea to the problems of underdevelopment and poverty.  
115

## 116 5. Institutional Framework for Privatization

117  
118 By 1988, the Federal Military Government was already wearing the wood by embracing the neo-liberal approach that  
119 questioned the growing role of government, by privatizing some key industries. The first step taken by the government  
120 was to set up a Technical Committee on Privatization of Public Companies (TCPC). Its terms of reference were to sale off  
121 government equities in the Nigerian capital market, privatize commercial and merchant banks, steel companies, cement  
122 companies etc. Adoga (2012) averred:

123 The consequences were drastic as they were successful. The immediate impact was the expansion of the Nigerian  
124 economy buoyed by private sector involvement. Public services improved in the designated corporations as well as their  
125 financial bases by the injection of private sector capital.

126 To consolidate on this achievement the government went a step further and created the Bureau for Public  
127 Enterprises (BPE) in 1999. The National Council on Privatization (NCP) was also established to oversee the functions of  
128 (BPE). These regulatory bodies had to take over from the TCPC having come into existence by the promulgation of  
129 Public Enterprises (Privatization and Commercialization) Decree 1999 (Orluwene 2011).  
130

## 131 6. Policy Process

132  
133 The policy process on privatization in 1999 was set rolling by a policy statement made by President Olusegun Obasanjo  
134 on the occasion of the inauguration of the National Council on Privatization in July 1999, thus:

135 Up till recently, there had been many years of exhaustive deliberations by stakeholders on how to put the Nigerian  
136 economy on the path of sustainable growth and development. Right now, a consensus has emerged on the imperative of  
137 privatization and commercialization of state-owned enterprises.

138 Consequently, the BPE was assigned the statutory functions and activities leading to the privatization and  
139 commercialization of state industries. Some of these function which are listed in the privatization Handbook (2005:5-13)  
140 include among others:

- 141 a. Implement the Council's policy on privatization
- 142 b. Prepare public enterprises approved by the Council for privatization
- 143 c. Advise the Council on further public enterprises that may be privatized
- 144 d. Advise the Council on the capital restructuring needs of the public enterprises to be privatized.

145 To fast track the work of the "Bureau", all state-owned enterprises were identified and arranged into sectoral  
146 groups indicating the name of the enterprises, structure of the shareholding, privatization policy outline, time schedules  
147 etc as shown on table 1.5 below  
148

149 **Table 1.5:** Some of the enterprises scheduled for full or partial privatization as envisaged by the public enterprises  
150 (Privatization and Commercialization) Act No.28 of 1999.  
151  
152

Aviation			
No.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALIZATION
1.	Federal Airport Authority of Nigeria	Decree 9 of 1996	Privatisation
2.	Nigeria Airways Limited	Limited Liability	Privatisation

Communication			
No.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALIZATION
3.	Nigerian Telecommunications Limited	Limited Liability	Privatisation
4.	Nigerian Mobile Telecommunications Ltd	Limited Liability	Privatisation
5.	Nigerian Postal Service	Decree 41 of 1992	Commercialisation

Defence			
No.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALIZATION
6.	Tafawa Balewa Square Investments Ltd	Limited Liability	Commercialisation

157

**Finance**

No.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALIZATION
7.	Nicon Insurance Ltd.	LFN Cap 263	Privatisation
8.	Nigeria Reinsurance Company Ltd.	LFN Cap 325	Privatisation
9.	Nigerian Bank for commerce & Industry	LFN Cap 296	Commercialisation
10.	Assurance Bank Ltd. (former Arab Bank)	Limited Liability	Privatisation
11.	FSB Int. Bank Plc (NNPC/NMA/ etc shares)	Limited Liability	Privatisation
12.	Afribank Nigeria Ltd (BIAO Shares)	Limited Liability	Privatisation

158  
159

**Information and Culture**

No.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALIZATION
13.	Daily Times of Nigeria Plc	NICON Acquisition	Privatisation
14.	Federal Radio Corporation of Nigeria	Decree 8 of 1978	Privatisation
15.	New Nigerian Newspapers Limited		Privatisation
16.	News Agency of Nigeria	Decree 19 of 1976	Commercialisation
17.	Nigerian Television Authority	Decree 24 of 1977	Commercialisation

160  
161

**Industries**

No.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALIZATION
18.	National Fertilize3r Company of Nigeria	Limited Liability	Privatisation
19.	Federal Super-sphosphate Fertilizer Co. Ltd	Limited Liability	Privatisation
20.	Nigeria Machine Tools Co., Ltd	Limited Liability	Privatisation
21.	Nigeria National Paper	Limited Liability	Privatisation
22.	Nigerian Newsprint Manufacturing Co.	Limited Liability	Privatisation
23.	Nigeria Sugar Company Ltd, Bacita	Limited Liability	Privatisation
24.	Sunti Sugar Company Ltd	Limited Liability	Privatisation
25.	Lafiaji Sugar Company Ltd	Limited Liability	Privatisation
26.	Ashaka Cement Plc.	Limited Liability	Privatisation
27.	Benue Cement Plc	Limited Liability	Privatisation
28.	Cement Company of Northern Nigeria plc	Limited Liability	Privatisation
29.	Nigerian Cement Company Ltd., Nkalagu	Limited Liability	Privatisation
30.	Calabar Cement Company	Limited Liability	Privatisation
31.	Anambra Motor Manufacturing Co. Ltd	Limited Liability	Privatisation
32.	Leyland Nigeria Ltd	Limited Liability	Privatisation
33.	Nigerian Truck Manufacturing Co. Ltd	Limited Liability	Privatisation
34.	Peugeot Automobile of Nigeria Ltd	Limited Liability	Privatisation
35.	Volkswagen of Nigeria Ltd	Limited Liability	Privatisation
36.	Steyr Nigeria Ltd	Limited Liability	Privatisation
37.	Nigeria Romania Wood Industries Ltd.	Limited Liability	Privatisation
38.	West African Portland Cement Plc	Limited Liability	Privatisation

162  
163

**Petroleum Resources**

NO.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALISATION
39.	Nigerian National Petroleum Corporation	Decree 33 of 1977	Commercialisation
40.	Port Harcourt Refinery & Petrochemicals Ltd	Limited Liability	Privatisation
41.	Warri Refinery and Petrochemical Ltd.	Limited Liability	Privatisation
42.	Kaduna Refinery & Petrochemicals Ltd.	Limited Liability	Privatisation
43.	Eleme Petrochemicals	Limited Liability	Privatisation
44.	Nigeria Petroleum Development Co. Ltd.	Limited Liability	Privatisation
45.	Nigerian Gas Company Ltd.	Limited Liability	Privatisation
46.	Pipeline Products Marketing Company Ltd.	Limited Liability	Privatisation
47.	African Petroleum Plc	Limited Liability	Privatisation
48.	UnipetrolPlc	Limited Liability	Privatisation
49.	National Oil & Chemical Marketing Plc	Limited Liability	Privatisation
50.	Dresser Nigeria Ltd	Limited Liability	Privatisation
51.	Solus School Nigeria Ltd	Limited Liability	Privatisation
52.	A.C.M Nigeria Ltd	Limited Liability	Privatisation

53.	Baker Nigeria Ltd	Limited Liability	Privatisation
54.	SedcoForex Nigeria Ltd	Limited Liability	Privatisation
55.	Flopetrol Nigeria Ltd	Limited Liability	Privatisation
56.	Schlumberger Wise Line Co.	Limited Liability	Privatisation
57.	Dowell Schlumberger Nig Ltd	Limited Liability	Privatisation
58.	Key Drill Nigeri Ltd	Limited Liability	Privatisation
59.	Baroid Nigeria Ltd	Limited Liability	Privatisation
60.	D.C.P Ltd	Limited Liability	Privatisation

**Power and Steel**

NO.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALISATION
61.	Steel Rolling Mill, Oshogbo	Decree 60 of 1979	Privatisation
62.	Steel Rolling Mill, Jos	Decree 60 of 1979	Privatisation
63.	Steel Rolling Mill, Katsina	Decree 60 of 1979	Privatisation
64.	Delta Steel Company Ltd	Limited Liability	Privatisation
65.	Ajaokuta Steel Company Ltd	Limited Liability	Privatisation
66.	Aluminum Smelter Company Ltd.	Limited Liability	Privatisation
67.	National Iron Ore Mining Company Limited	Decree 60 of 1979	Privatisation
68.	National Electric Power Authority	LFN Cap 256	Privatisation

**Solid Minerals**

NO.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALISATION
69.	Nigerian Mining Corporation	Decree 39 of 1972	Privatisation
70.	Nigerian Coal Corporation	LFN Cap 299	Privatisation
71.	Nigerian Uranium Mining Co., Ltd	Limited Liability	Privatisation

**Transport**

NO.	PARASTATALS	ENABLING DECREE	PRIVATISATION/COMMERCIALISATION
72.	Nigerian Ports Authority	LFN Cap 361	Commercialisation
73.	Nigerian Railway Corporation	LFN Cap 323	Commercialisation
74.	Nigerdoc Ltd	Limited Liability	Privatisation
75.	NAHCO	Limited Liability	Privatisation

**Source:** Federal government of Nigeria Privatization Handbook (2000)

**7. Reasons for Deregulation of University Education in Nigeria**

A cursory look at the table above shows that no university was listed for full privatization, partial privatization, full commercialization or partial commercialization. Between 1988 and 1999 when government came up with the idea of deregulating the economy, there were 26 federal universities, and 12 state-owned universities making a total of 38 ivory towers that had been excluded from the traditional pathway to privatization in Nigeria. The central and important questions are (1) why were the existing universities not get fully or partially privatized given the appalling conditions under which they operate? For example the federal government committee on Needs Assessment of Nigerian Public Universities (CNANPU, 2012) found that “physical facilities for teaching and learning in Nigerian universities are inadequate, dilapidated, overstretched/over-crowded, improvised. (2) Why was privatization of university education patterned differently?

To the above questions, we opine strongly that government failed to *govern* in this matter due to the possible consequences and reactions from the stakeholders in higher education – Academic Staff Union of Universities (ASUU), Students, Parents and critical citizens – which would have been prompt and convulsive, had the university been treated like ordinary industry. Needless to emphasize that higher education at tertiary level plays the vital role of cultural transmission, social integration, selection and allocation, personal development, as well as gate-keeping (Broom and Selznick 2004). Oyobode (2007) also described the role of education as the “acquisition, conservation and transmission of knowledge and its application to the affairs of men. So, as the entire intellectual and professional life of Nigeria depends on sound university education that provides high quality human capital, it was sensible to treat government companies, boards, and parastatals and the university system as polar opposites. Therefore, when we talk of privatization

of university education in Nigeria, it did not come as the transfer of existing public universities to private sector, by sale or by contracting (although the feeding of students in virtually all the public universities in Nigeria has been contracted out); Nor did it come in the form of change of ownership from public to private hands or transfer of management from public to private initiative while ownership remains public. Rather, privatization of university education in Nigeria occurred at the level of the economy in its entirety. In this case, the government created the enabling legal environment by opening up or breaking a public monopoly of educational delivery by allowing competition with private operators. As of today Nigeria has over 50 private universities founded, funded, and operated by faith – based organizations, individuals, and partnerships.

Radical policy bandits in Nigeria insist that university education was privatized for the following reasons, among others. Firstly, the changing ideology of government over educational delivery which has been informed by the actions of multilateral agencies which redefined education as private rather than public good led to the privatization of universities.

Secondly private operators were brought into educational sector in order to relegate the public university system that has been 'troubling' the government by way of insisting on improved university education budget.

Thirdly the coming into existence of private universities is intended to solve the 'problem' of Academic Staff Union of Universities (ASUU) that has the penchant to twist the hand of government (through strikes, shut-downs, and energy – sapping haggling) for improvement in the overall conditions of the public universities.

Fourthly, private university ownership in Nigeria is a big business with profit motive. According to Kalama et al (2011), "the privatization of education that took place between 1980 and 1990 through the granting of private licenses to individuals was done indiscriminately without proper supervision and monitoring... the beneficiaries of the privatization exercise are either serving or retired senior public office holders".

Lastly, Erinsho (2007) dubbed the floodgate of private universities that now outstrip both the federal and state universities put together in less than 15 years, "the grand conspiracy against public universities".

The argument is that 74 public universities in Nigeria with a total enrollment of only **1,259,913** undergraduate and postgraduate students, respectively, could have been empowered in terms of physical infrastructure, learning resources, and financial resources, to expand rather than establishing private universities answering to market logic.

## 8. Challenges of Private Universities in Nigeria

Public universities in Nigeria had their heyday when they enjoyed international stature and had global recognition a few decades back (Balogun, 2012). But the private universities never had a respite before they plunged into the same or worse kinds of problems faced by the public ones. The other challenges facing the private universities as identified by Olanrewaju (2012) include inadequate finance, a mismatch between growth and facilities, brain drain as well as management problem. Commenting on administration problem, Olanrewaju (2012) avers that:

All over the world universities are expected to be traditional-based institutions where democratic culture and practice are established and maintained not only through orderly leadership succession at various levels but through the upholding of the democratic virtues and pursuit of truth. Today, in some of our private universities, not only have we witnessed half-backed academia being promoted beyond their competency level through the orchestrated affirmative action (in favour of gender, religion, accident of birth place, etc), such officers have also been saddled with responsibility for which they were ill – equipped or inexperienced.

Okigbo (1992) buttresses the above idea when he stated that:

*When a semi-illiterate but successful trader is appointed to the council of a university to oversee the work of outstanding scholars, it is an open denigration of the intellectual. A donkey may win prizes every year for twenty years for being the best load carrier, you do not on that account, promote it to a horse.*

Adeogun, Subair and Osifila (2009) indicate another dimension of challenges of private universities in terms of "excessive" and "exorbitant" school fees charged by these profit seeking private institutions. Some of them charge between N700,000 and N3million per session in tuition and boarding depending on the course offering. Although they acknowledge the fact that a modern and qualitative educational delivery must of necessity involve modern, update, and costly resources (human and material), this alone should not make access to these institutions an exclusive preserve for the children of the rich since this is bound to exacerbate the existing inequality and elitism in both university system and the society in its entirety. As they observed, the inequalities that would be created as a direct result of deregulation of educational sub-sector is against the letter and the spirit of the National Policy on Education (Federal Republic of Nigeria 2007), which insist on "the provision of equal access to educational opportunities for all citizens of the country at the primary, secondary, and tertiary levels". Another problem area for the private Universities, the government, and its



247 agencies as well as the entire society, is the rate at which illegal private Universities germinate, and the inability of the  
248 licensed ones to distinguish between "charter" or government approval to establish and run a University and accreditation  
249 of programmes. Kalama, Etebu, Martha and John (2011) assert that accretion of private Universities (both legal and  
250 illegal) makes it difficult if not impossible for the Government regulatory agencies to maintain control and ensure  
251 compliance. Citing of the case of Lead City University, which according to National Universities Commission (NUC), had  
252 no accreditation for law, Nursing and post-graduate programmes but which went ahead and commenced these  
253 programmes in 2010, the authors averred that such unfortunate development was in a bad taste, to say the least, for the  
254 nascent educational sub-sector. Private Universities suffers from chronic paucity of academic staff; they are also  
255 excluded from access to grants, among other problems.

## 257 9. Conclusion and Recommendation

258  
259 It is a well known fact that tertiary education is responsible for the production of leaders in all facets of national life:  
260 government, business, invention and innovation. But doing the same thing and expecting a different result, is unfortunate.  
261 The problems of public educational sector started with the advent of military misadventure in politics and governance in  
262 Nigeria beginning from 1967. From their actions, the successive Governments from that time showed that education was  
263 no longer the priority. Privatization which was bequeathed to Nigeria by the globalization imperative cannot solve our  
264 educational Problems. If it could, Privatization of the Universities would have followed the path trodden by industries,  
265 shops, land, banks, National insurance companies etc. Under 15 years of operation, the vulnerabilities of the private  
266 Universities are emerging to the extent that it feared that many of them might not survive these challenges to fulfill their  
267 vision and mission. Even the best among them cannot perform the feat of the old ones. This study therefore  
268 prognosticates that in no distant future, vast majority of these private Universities will suffer atrophy or merge or at best  
269 be taken over by the government.

270 The National Delegate Conference (NDC) of Academic staff Union of Universities (ASUU) which is the most  
271 competent when it comes to assessing the state of Education in Nigeria today, rose from its 17<sup>th</sup> bi-annual National  
272 Conference with a communiqué part of which reads that "Education SYSTEM as it exists and functions in Nigeria, cannot  
273 be the basis of the survival and progress of Nigeria and her peoples in the 21<sup>st</sup> century". The committee set up by the  
274 Federal Government in November 2012 to assess the needs of Nigerian public Universities, corroborate the NDC's when  
275 in one of its findings is stated that "no cutting edge research equipment/facilities" abound in our universities.

276 The meaning of the above is that the University system in Nigeria is operating in a squalid condition, and as such,  
277 it cannot fulfill the vision and aspirations of the people of Nigeria. Privatization is no solution to the complex problems  
278 facing higher education in Nigeria. Private Universities had only succeeded in marginally increasing the number of  
279 intakes. This paper therefore recommends that:

- 280 ➤ The Federal Government should stop building more Universities. The last 10 Federal Universities that were  
281 established in 2012 are finding it difficult to take-off.
- 282 ➤ The myriad applications for licensing more Private universities should be dumped in the waste paper basket.
- 283 ➤ The University system in Nigeria should shut down officially for six months. This will enable the stake holders-  
284 ASUU, Government, Parents, Students, and Civil Society Organizations- to convoke education conference.  
285 The conference would utilize the first three months for considering the issues that have become contingent on  
286 nursery, primary, secondary, and adult education in Nigeria. Education at this level has run riot witness the  
287 level of mass failure at primary and secondary school levels over the years that have a spill-over effect on the  
288 tertiary level. The last three months should be utilized in considering the educational *cul-de-sac* at the tertiary  
289 level.
- 290 ➤ This conference will determine the trajectory of future education that is not dependent, but one that can  
291 transform Nigeria to an economically viable, technologically strong, and politically stable country where peace,  
292 equity, justice, and employment are available to the vast majority of Nigerians who seek these values.
- 293 ➤ Privatized solution to the problem of education may not work out in Nigeria which has a different National  
294 history and experience from that of U.S.A. where private Universities are calling the shot. Head or tail,  
295 "modern capitalism is, by and large, based on a simple calculus: Each individual is concerned with how much  
296 he can get for himself" (Stiglitz 2007:28). This explains why one entrepreneur in Nigeria has built three private  
297 Universities located in different parts of the country. Could this be philanthropy?

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# Lean Accounting and Throughput Accounting: An Integrated Approach

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## Abstract

In conditions of increasing competition there is need for application of new production systems, new approaches to pricing, new approaches to calculation of costs for a product in the developed markets. Besides modernization of production, modernization of an enterprise management system is necessary. The traditional methods of management accounting do not cope with requirements for formation of information in modern enterprises and their management. The article presents two methods of management accounting – Lean accounting (LA) and Throughput accounting (TA) – and offers an integrated approach for its use in commercial enterprises. We study and introduce a model of integrated approach of LA+TA and note positive sides of this approach. The integrated approach will allow to generate information about costs and results of a modern enterprise more effectively than during application of separate methods.

**Keywords:** lean accounting, throughput accounting, management accounting, costs, commercial enterprises, integrated approach  
LA+TA, lean throughput accounting

## 1. Introduction

Two methods of management accounting considered in this article - lean accounting and throughput accounting – are modern methods of management accounting that are not studied in full. The majority of researchers compare management theories – a theory of constraints and lean production – and 6 sigma theory in addition to them (Nave D, 2002). For all management theories information must be formed, namely management accounting must be kept. Lean accounting and throughput accounting were repeatedly compared in scientific articles. For example, a complete literature review on this topic is made by such authors as Utiyama, M.H.R., Filho, M.G. (Utiyama, M.H.R., Filho, M.G, 2013).

An overall conclusion from the literary review is that it is impossible to say that one of the methods surpasses another, management of an enterprise shall decide on its own which of the management accounting methods suits the company more. Opinions on integration of these management accounting methods have been already expressed in literature (Najarian G, 2004.). Therefore study of an integrated approach to management accounting under the principles of lean production and a theory of constraints or LA+TA integrated approach is relevant.

## 2. Model and Data

The objective of the study is finding the points of intersection of two modern management accounting methods (Lean accounting and Throughput accounting) to create an integrated method of management accounting. The concept of lean production is introduced in many industrial enterprises throughout the world. The management system of Lean production is characterized in papers by scientists (Sokolov A.U., 2007) as well as in the management accounting standard of the USA, "Lean enterprise goals include: improving quality and customer satisfaction, creating more value for the customers, eliminating waste, reducing lead time, and reducing costs." The method of management accounting in lean enterprises is often called Value Stream Costing (VSC) because the flow of value creation is the main subject of management accounting and control (Sokolov A.U., 2007)]. In our opinion, the name of Lean accounting does not reflect complete essence of the method and is designation of the approach in accounting, but since it is generally accepted in international publications, we will adhere to this definition. Basic principles of the lean accounting method are as follows:

1. the principle of determination and removal of loss at different stages of production;
2. the principle of determination of a product value for a buyer;
3. the principle of determination of a flow of value creation;
4. the principle of continuous perfection of an accounting system.
5. the principle of integrity (integration).

57 The concept of the theory of constraints (TOC) began to be introduced a little earlier. The theory of constraints is  
58 successfully being applied abroad in such big companies as Avery Dennison, Bethlehem Steel, General Motors, National  
59 Semiconductor, United Airlines, Boeing, ITT, Procter & Gamble, IKEA, Wall-Mart, Zara. At present works are undertaken  
60 on introduction of the theory of constraints in the Russian enterprises. Besides TOC is introduced not only in production,  
61 but also in logistics, wholesale trade, and retail, human resources management.

62 The theory of constraints is defined as follows(Noreen E., Smith D., Mackey J.T., 1995) : «the fundamental thesis  
63 of TOC is that constraints establish the limits of performance for any system. Most organizations contain only a few core  
64 constraints. TOC advocates suggest that managers should focus on effectively managing the capacity and capability of  
65 these constraints if they are to improve the performance of their organization».

66 The throughput accounting (TA) method of management accounting is based on the principles of the theory of  
67 constraints, the main attention of which is given to management of constraints of the production-economic activity of the  
68 enterprise. Itsupplements this management system, providing all the necessary information to managers for management  
69 and control over the constraints of an enterprise. Basic principles of the TA method of accounting are as follows:

- 70 1. value of the product (work, service) is created at the moment of product (works, services) sale;
- 71 2. the principle of resources redeployment in places of restrictions for the purpose of Throughputmaximization;
- 72 3. the principle of urgency (management statements);
- 73 4. the principle of comparability of approaches to calculation of costs;
- 74 5. the principle of integrity (integration);
- 75 6. the principle of continuous perfection of accounting and analysis systems.

76 Both approaches in management accounting have similar features and differences. There is need for deeper study  
77 of these methods. According to studies of the scientists (Corbett T., 1998., Goldratt E., Cox Jeff., 1992)use of each  
78 separate method has certain advantages over traditional standard-costing, variable-costing, direct-costing, ABC and  
79 other methods of management accounting. We will try to model an integrated methodology of LA+TA (integrated  
80 approach) which will include the most efficient elements of both methods for achievement of an optimal result during  
81 maintaining accounting.

82 In production management the approaches of the theory of constraints and lean production (management as per  
83 flows of value creation) have many common grounds allowing the enterprises to introduce both approaches and receive  
84 additional benefits. Both the theory of constraints and lean production promote an idea of continuous improvement of  
85 theproduction flow in enterprises.

86 We will conduct comparative analysis of management accounting methods on the basis of the principles of the  
87 theory of constraints and cost accounting as per flows of value creation in table 1.

88 **Table 1.** Comparative analysis of TA and LA methods  
89  
90

Comparison criterion	Throughput accounting (TA)	Lean accounting (LA)
Time of emergence	1988, articles by D. Galloway and D. Valdrón in the journal "Management accounting" (Galloway, D. Valdrón, D. 1988) became one of the first scientific publications on exploration of the TA method	2004, after studies of V. Maskell and B. Bagalli "Practical Lean Accounting, A Proven System for Measuring and Managing the Lean Enterprise" (Maskell B.H., Baggaley B. 2004) were published
Main developers of the method	E. Goldratt, D. Galloway, D. Valdrón, T. Corbett, S. Bragg, D. Dagdeil, T. Jones, E. Norin., D. Smith (Noreen E., Smith D., Mackey J.T. 1995.)	V. Maskell, B. Bagalli, J. Womack, R. Kaplan, R. Krandell. O. Fume (Fiume O.J., Cunningham J.E., Adams E. 2003)
Management accounting standards (IMA USA)	SMA IMA "Theory of Constraints (TOC, 1999). Management System Fundamentals", 1999.	SMA IMA "Accounting for the Lean Enterprise: Major Changes to the Accounting paradigm", 2006.
Main task of the method	Increase of throughput (revenue net of total variable costs), cost cutting is not the key objective	Cost cutting due to increase of flow rate, reduction of loss, continuous improvement of business processes
Object of cost accounting	A product (work, service) is the target object of cost accounting	The object of cost accounting is a flow creating value – a set of types of activity which create the product value in terms of consumers
Effect on change of costs	The major factor influencing change of costs value is constraints of the production-economic activity of an enterprise, liquidation of constraints	Changes in costs occur after «lean transformations»: removal of loss, optimization of the flow
Classification of costs	Total variable costs, operating costs	Costs of the flow and costs outside the flow
Cost allocation	It is not used or operating costs are distributed under ABC/TBC method	It is not used or insignificant share of costs outside the flow is allocated
Determination of cost price	A cost price of products is estimated based on the overall variable costs	A cost price of ready products is not calculated
Reserve estimation	The reserves are estimated based on the overall variable costs (excluding costs for remuneration of labour), one of the tasks is diminution of reserves	Reserves are almost absent, production is organized as per just-in-time system (exactly on time)

Reflection of costs on book-keeping accounts	Use of management accounting accounts («Total variable costs» (TVC)), Operating costs (OE), Throughput (T)	Use of management accounting accounts (accounts "Costs of value creating flow", "Costs outside flows", etc.)
Units of measurement of operating efficiency indicators	Use of financial and non-financial indicators	Major use of non-financial indicators
Key indicators of activity	Throughput, profit, investments into buildings, constructions, reserves	Flow rate, average costs of the flow, percentage of rejected items
Taking management decisions	The decisions "whether to make or to buy" are taken on the basis of data about change of gross value of throughput	The decisions "whether to make or to buy" are taken on the basis of information about flows
Management statements	Management statements for a month (quarter), weekly planning of throughput in view of products, customers	A weekly management profit and loss statement in view of flows creating value

According to table 1, the management accounting methods under analysis, have a lot of similar elements based on which they can be combined. Both systems are flexible, simple in administration of accounting by analyst accountants, use non-financial indicators of activity, track manufacturing cycle time, are not focused on determination of full cost price of production (works, services), do not allocate overhead costs, are aimed at optimization of the production flow, provide operational management statements. The conducted comparative analysis of TA and LA methods allows to determine their advantages and disadvantages, to determine possibilities of their joint use in industrial enterprises. The proposals on refinement of cost and result accounting with the use of these methods allow to use advantages of these methods and lower influence of disadvantages. Using information of the integrated approach of two modern management accounting methods will allow to manage companies more effectively in terms of changing environment and competition.

### 3. Empirical Results

On the grounds of the conducted research we propose to apply the integrated LA+TA methodology where the elements of throughput accounting method are integrated in the established management accounting method of lean accounting, which will significantly simplify their introduction in the enterprise. Introduction of lean production significantly alters organizational structure of the enterprises, distribution of production capacities, therefore after these changes it is already easy to change the management accounting system. At the level of inventory control the launch of small lots into production, low level of material reserves, evaluation of reserves as per overall variable costs (total variable cost) will remain in the unified methodology.

As for classification of costs during unification of LA+TA methods of management accounting, operating costs of the flow and operating costs outside the flow must be separated (as in LA method) from the sum of operating costs (under TA method) during a period. Thus their control and reduction will be more effective.

According to TA method, the rate of throughput is estimated on each product as a difference between the product price and material costs for the product. Therefore separate flow must be analyzed for each manufactured product (or a homogeneous group of products), in other words, there is distribution of operating costs for each flow creating value. Operating costs of the flow creating product value include costs for remuneration of labour and insurance installments, costs for maintenance of equipment, other total production costs. Costs outside the flow are administrative and other general running costs not related to product manufacture. These costs will reduce an overall financial balance of the company. The TA method in classical form does not provide allocation of operating costs, but we propose to allocate operating costs of the flow in proportions to product processing time on constraining resource for calculation of profit from each flow.

**Table 2.** Proposed management statement of results of the enterprise "Smart" LLC for May 2014 to use an integrated methodology of LA+TA

№ Indicators	Flow/product						In total, m.u.
	Universal Programmable Controller "Standard"	Interface block the device ShGS5805	Radiomodem "Smart-160/2400"	Radiomodem "Smart-433/2400"	Vertical antenna AC 5/8 VHF	RF bandpass filter PF5-2VHF	
1 P-price of product, m.u.	600	487,29	852,60	556,10	621,0	223	
2 TVC –Total variable costs, m.u. (on each product.)	299	183,9	253,32	78,3	214,2	69,75	
3 T - Throughput, m.u (on each product)	301	303,39	749,1	477,8	406,8	153,25	
4 t - build unit of production, hour	9	24	8	12	15	11	
5 Target value of sales, unit.	1200	50	594	200	70	55	
6 T - throughput on the target volume, m.u	361200	15169,5	444965,4	95560,0	28476,0	8428,75	953799,7
7 Operating costs of the flow, m.u	301052,53	33450,28	132463,1	66900,56	29269,0	16864,52	580000,0
8 Profit of the flow, m.u	60147,47	-18280,78	312502,3	28659,44	-793,0	-8435,77	373799,7
9 Operating costs outside the flow, m.u.							70000,0
10 Profit of the enterprise over the period, m.u.							303799,7

126 Scientific and Production Company "Smart" LLC is located in Kazan, Russia and is engaged in development and  
127 production of industrial electronics products. During analysis of the production flows in the enterprise it was found out that  
128 (non-automated) the operation of assembly of finished units was limiting resource for manufacture of these products. At  
129 the same time the following management statement will be made up (table 2). Operating costs of all flows of the company  
130 have constituted 580,000 monetary units (m.u.) in the reviewed period (month) and are allocated between the flows in  
131 proportion to the product assembly time. Operating costs outside the flow have constituted 70,000 monetary units in the  
132 period (month).

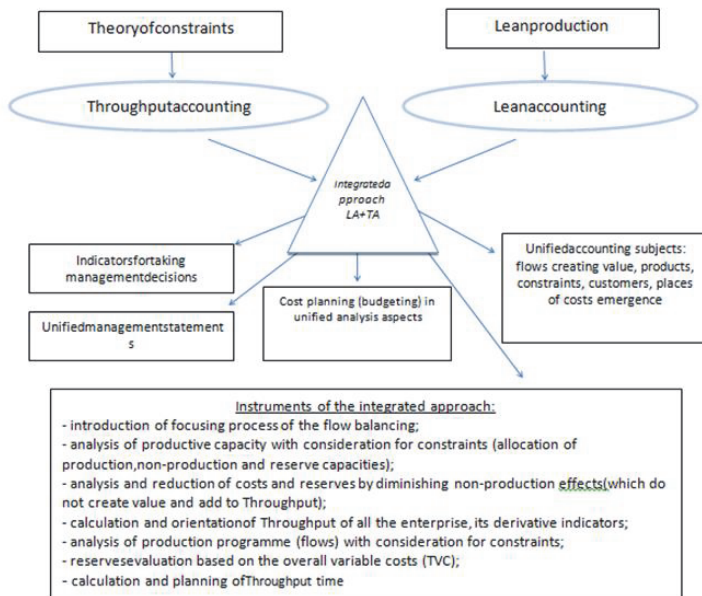
133 Profit of each flow is calculated as a difference between throughput and operating costs of the flow. During  
134 analysis of these management statement it can be seen that three flows of six turned loss-making, although in general  
135 the enterprise achieves positive profit level for a period. Costs of these flows must be analyzed for revelation of causes of  
136 the flow loss and control over efforts for reduction of these costs. The indicators of throughput for the flows are also used  
137 during planning of the production program of the enterprise, calculation of the planned throughput of all the enterprise,  
138 and at other strategic activity indicators.

139 These management statement (in table 2) can be made upon the plan indicators, as well as upon the actual  
140 indicators. So during introduction of TA method into LA method we receive an integrated methodology of costs  
141 accounting and results on the flows creating values with consideration for limiting resources of the enterprise.

142 We will consider a model of the integrated approach which includes positive sides of lean accounting and  
143 throughput accounting methods in figure 1.

144 In the enterprises applying the principles of lean production, we propose to use an integrated methodology of  
145 LA+TA (lean throughput accounting). The integrated methodology is aimed at increasing the financial balance and  
146 reduction of costs, which as a result will lead to an optimal final result of all the enterprise.

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Figure 1. Model of integrated approach LA + TA

151 At the expense of influence of the lean accounting method aimed at analysis of costs outside the flow creating value, and  
152 the throughput accounting method aimed at promotion of an enterprise and increase of the rate of production speed—  
153 increase of the capacity at the expense of internal reserves (without additional expenditure) is achieved. In the company  
154 under our analysis, introduction of the integrated methodology caused positively influence on financial balance of the  
155 company. Profitability of investments increases at the expense of increase of the flow rate and increase of the constraints  
156 capacity.

157 The LA method is the main method of management accounting in lean enterprises. In the framework of industrial

engineering approaches of the theory of constraints and lean production have many common grounds allowing the enterprises to introduce both approaches and receive additional advantages during introduction of tools of the integrated methodology. Both the theory of constraints and lean production as theories of production management promote the idea of continuous improvement of the production flow in enterprises. The key positive aspects of joint use of LA and TA methods of management accounting are as follows:

- a) improvement of the production flow at the expense of reduction of manufacturing cycle time; prevention of goods overproduction (planning of launch of resources into production, minimum of reserves);
- b) cancellation of local operating efficiency indicators (actual production cost and profitability on costs are replaced by new indicators – throughput and its derivatives; operating costs, investments into buildings, constructions, and reserves, non-financial and financial indicators of timely delivery of orders);
- c) introduction of focusing process of the flow balancing (optimization of the production system at the expense of focusing on limiting resources of the enterprise).

#### 4. Results

The management theories considered in the article – the theory of constraints (TOC) – and lean production (Lean) harmoniously supplement each other. The theory of constraints is a management approach for determination of restrictions in the flow that must be improved. The Lean methodology offers instruments of exercising technical improvements of production. The methods of management accounting can be also combined. During introduction of the principles of lean production in the enterprise it is proposed to integrate the lean accounting management accounting method together with the throughput accounting method, which will allow to increase the capacity of the enterprise and increase financial balance, on the one hand, and reduce unnecessary actions and costs associated with it, on the other hand. Operating management statements for the integrated methodology are proposed in the article.

#### 5. Conclusions

Use of the throughput accounting method refocuses the enterprises and their management on satisfaction of consumers' requirements and growth (extension) of business. Accounting of costs for flows creating value in lean enterprises - lean accounting - is also aimed at satisfaction of consumer demand, as well as at continuous cost cutting and optimization of the enterprise structure. The considered methods of management accounting are integrated in the proposed model (LA+TA) for more effective application in industrial enterprises of Russia and all other countries of the world.

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# Influence of Perceived University Support, Perceived Effective Entrepreneurship Education, Perceived Creativity Disposition, Entrepreneurial Passion for Inventing and Founding on Entrepreneurial Intention

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## Abstract

We modeled the relationship between entrepreneurship intention and five other variables, including two as formative second-order constructs. We therefore, employed the use of SmartPLS (2.0) to analyze the influence of perceived effective entrepreneurship education, perceived University support, perceived creativity disposition, entrepreneurial passion for inventing and entrepreneurial passion for founding on entrepreneurial intention. The PLS was readily employed in this study for its ability to estimate a formative measured variable. The first-order reflective and second-order formative variables model parameters were estimated by employing the two-stage approach. Using a sample of 595 students from three Federal Universities in Northern Nigeria, the study found a significant positive relationship between perception of University support, perceived creativity disposition, entrepreneurial passion for inventing, entrepreneurial passion for founding and entrepreneurial intention. However, an unexpectedly significant negative relationship was found between perceived effective entrepreneurship education and entrepreneurial intention. Implications for the findings are provided.

**Keywords:** Entrepreneurial intention, University support, effective entrepreneurship education, creativity disposition, entrepreneurial passion.

## 1. Introduction

Entrepreneurship contributes significantly to any country's economy by spurring job creation, innovativeness and creativity, high employment, positive social development as well as economic growth (Acs & Audretsch, 2005; Rowley, Baregheh, & Sambrook, 2011; Schiavone, 2011; Shane & Venkataraman, 2000). Accordingly, entrepreneurial attitudes, entrepreneurial intentions (EI) and entrepreneurial actions must be appreciated to comprehend entrepreneurship (Krueger, 2007).

Entrepreneurial intentions (EI) is fundamental to comprehend the entrepreneurial procedure as it precede any attempt in entrepreneurial behaviour (Arendt & Brettel, 2010; Krueger & Carsrud, 1993; Lin, Lin, & Lin, 2010) and it is the most excellent predictor of entrepreneurial behaviour (Ajzen, 1991; Fitzsimmons & Douglas, 2011; Shapero & Sokol, 1982). Hence, appreciating the factors that influence EI is useful to explain entrepreneurial behaviour (Shane & Venkataraman, 2000).

Scholars have recognised the importance of entrepreneurship education as it influences students' intention to become entrepreneurs (Autio, Keeley, Klofsten, & Ulfstedt, 1997; Franke & Lüthje, 2004; Packham, Jones, Miller, Pickernell, & Thomas, 2010; Schwarz, Wdowiak, Almer-Jarz, & Breitenecker, 2009; Souitaris, *et al.*, 2007). It develops and enhances managerial skills necessary for business success (Wilson, Kickul, & Marlino, 2007). Hence, the calls for more researches about its link with outcome variables, given also that the value and effect of entrepreneurship education is yet to be established (Albornoz & Rocco, 2013; Peterman & Kennedy, 2003)

Passion also occupies a central place in entrepreneurship (Cardon, Zietsma, Saporito, Matherne, & Davis, 2005). It encourages creativeness and the realization of novel important information necessary to recognise and invest in successful business prospects (Baron, 2008; Sundararajan & Peters, 2007). Most studies on passion (Baum & Locke, 2004; Chen, *et al.*, 2009) however, focuses on individual entrepreneurial passion in relation to outcomes related to organisations and other outcomes that are behavioural (Murnieks, *et al.*, 2011) or otherwise without direct emphasis on



entrepreneurial intentions. This research therefore took a step further to examine the direct relationship between entrepreneurial passion and entrepreneurial intentions.

Creativity and innovation are important personality traits for entrepreneurship (Luca & Cazan, 2011; Ward, 2005). Literature indicates that creative individual will most probably engage in entrepreneurial behaviour (Ward, 2004). Consequently, investigating creative dispositions and entrepreneurial intentions of students is necessary believing that, students' entrepreneurial intentions depends to an extent on how they perceived themselves as creative. Moreover, several studies have supported self-assessment of creativity disposition (Batey & Furnham, 2008).

Furthermore, some studies considered the effect of both personal and contextual/environmental factors including university environment on intention, but the role of university support in promoting intention need to be established (Liñán, Urbano, & Guerrero, 2011b). This research is conducted with the aim to improve on the understanding of the determinants of entrepreneurial intention among students towards creating their own ventures after graduation.

## 2. Literature Review

The review of the literature indicates that entrepreneurship kick-starts with opportunity identification and the process is undoubtedly an intentional process (Wang, *et al.*, 2011). EI is the deliberate state of mind that precedes action and push thought in the direction of establishing business as a target (Bird, 1989; Shane & Venkataraman, 2000). Entrepreneurial intention can also be use to predict involvement among students in entrepreneurship and explain why students decide to venture into business (Ariff, *et al.*, 2010). Understanding the real factors responsible for shaping intention of students to begin a new venture is fundamental for building the programmes and policies aim at promoting entrepreneurial behaviour (Bakotić & Kružić, 2010; Lüthje & Franke, 2003).

Generally, researchers describe entrepreneurial intention in terms of three common factors influencing it; individual attitude to behaviour, perceived social norms, and individual self-efficacy (Krueger Jr, *et al.*, 2000; Liñán, *et al.*, 2005). Subsequently, A number of studies (Franke & Lüthje, 2004; Rodrigues, *et al.*, 2008) investigated to find the most important variables that influence graduates to initiate a business venture. According to Lee & Wong (2004) the intention to exhibit entrepreneurial behaviours could be influenced by some cognitive factors like; needs, values, wants, habits, and beliefs. The significance of cognitive variables in understanding the individual decision process has been pointed out by researchers like Baron (2004) and Shaver & Scott (1991). Therefore, the cognitive perspective makes understanding the difficult process of entrepreneurship easier.

In prior study, personal and environment determinants of entrepreneurial intention including attitudes toward entrepreneurship, personality traits and social environment have been given much concern (Davidsson, 1995; Franke & Lüthje, 2004; Robinson & Haynes, 1991; Segal, *et al.*, 2005). Even though, there are inconsistencies across studies, there is a general link between personality factors and entrepreneurial intention, but personality is exhibited within certain domain of demographical, cultural, economical, social, political and technological factors (Hisrich, 1990). For this reason, past literature categorize individual domains and contextual variables as the two important categories necessary for shaping EI (Bird, 1988).

Furthermore, the ability to think creatively or the perception that one poses creative ability could explain why some people would choose to be or not to be entrepreneurs. Hence creative individuals are more expected to engage in entrepreneurship behaviour (Ward, 2004). Moreover, several studies have supported self-assessment of creativity disposition (Batey & Furnham, 2008). Therefore, people should be allowed to make effort to judge themselves as capable of generating new and valuable ideas necessary to succeed as entrepreneurs (Darini, *et al.*, 2011). This study thus, investigated further, the influence of individual students' creativity disposition on entrepreneurial intentions, which has hardly been considered in intention based models (Hamidi, *et al.*, 2008).

Another factor of concern is entrepreneurship education, which its definitions connotes effectiveness of entrepreneurship education that provides individuals with practical sense of business, building self-confidence and developing skill for a successful business venture (Wilson, *et al.*, 2007). The relative expensiveness of running a successful and effective entrepreneurship education program (Charney, *et al.*, 2000) exposes the need therefore, of faculties and universities to intervene in their various roles to enhance the achievement of this goal of initiating and encouraging business start-up by young graduates. Hence, the challenge for the developing world is to help develop graduate entrepreneurs and provide suitable and supportive environments that can contribute to the growth of entrepreneurship (Nabi & Liñán, 2011). University here becomes a focal point as the first initiator to consider. While also in developing countries the research on enterprise/entrepreneurship education and entrepreneurial intentions is highly under research (Nabi & Liñán, 2011). Hence, this study determined the influence of Perceived effective entrepreneurship education on entrepreneurial intention of university students.

Passion is yet another fundamental factor in entrepreneurship (Bird, 1988; Cardon, *et al.*, 2013) and has affective, cognitive, and behavioural components (Chen, *et al.*, 2009), which influence people behaviour (Cardon, *et al.*, 2009b; Murnieks, *et al.*, 2011). Consequently, if passion is quite integral to successful entrepreneurship activities, then, it is only logical that this must be present or build prior to setting up of ventures. Also, most studies on passion (Baum & Locke, 2004; Chen, *et al.*, 2009) focus on individual entrepreneurial passion in relation to outcomes that affect organisations and other outcomes that are behavioural (Murnieks, *et al.*, 2011) or otherwise without direct emphasis on entrepreneurial intentions. Even, studies that considered passion with intention, does so indirectly by observing the impact of passion as a moderator to other antecedent factors (De Clercq, *et al.*, 2011) or as antecedent to other variables that explain its impact (Murnieks, *et al.*, 2011; Vallerand, *et al.*, 2007). This study therefore went further to investigate the direct relationship between entrepreneurial passion and entrepreneurial intentions. Consequently, we develop the following Hypotheses:

*Hypothesis 1. Entrepreneurial passion for founding has a positive influence on entrepreneurial intention.*

*Hypothesis 2. Entrepreneurial passion for inventing has a positive influence on entrepreneurial intention.*

*Hypothesis 3. Perceived creativity disposition has a positive influence on entrepreneurial intention.*

*Hypothesis 4. Perceived effective entrepreneurship education has a positive influence on entrepreneurial intention.*

*Hypothesis 5. Perception of university support has a positive influence on entrepreneurial intention.*

### 3. Method

#### 3.1 Participants and procedures

Conducting a survey research, this study sampled 595 students from three federal universities in the North-western Nigeria. Based on a stratified random sampling, students were drawn in proportionate to the total number of students in their respective strata and subsequently random sampling was employed to arrive at the sampled population from various departments of faculties. The administration and collection process of the questionnaire involved research assistants with the help of entrepreneurship coordinating teams of the various universities, whom ensured efficient and effective data collection.

#### 3.2 Instrumentation and Measurement of Variables

The summary of measures of variables adopted is presented in table 1.

**Table 1:** Summary of measures of variables

Variables	Items	Sources
Entrepreneurial Intentions	6	Linán and Chen (2009)
Perceive effective Entrepreneurial Education	5	Souitaris <i>et al.</i> (2007)
<b>Entrepreneurial Passion Domain:</b>		
Entrepreneurial Passion for Inventing	5	Cardon <i>et al.</i> , (2013)
Entrepreneurial Passion for Founding	4	
Perceive Creativity Disposition	8	Zhou and George (2001)
University Support	14	Autio <i>et al.</i> (1997) & Keat (2011)

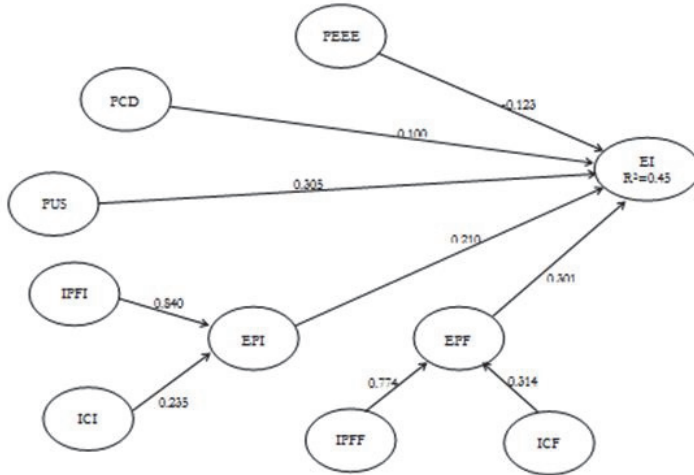
**Note:** All variables were measured on a 7-point Likert scale.

#### 3.3 Analysis Technique

Smart Partial Least Square (SmartPLS) was employed to run multivariate test and analyses and also for testing hypothesis formulated for the study. The PLS approach was employed for its ability to analyze the relationship between the latent variables and their measures, modeled in a reflective or formative ways as well as hybrid formative and reflective constructs (Hair *et al.*, 2014). The model for this study involves a formative second order variable. We used the SmartPLS 2.0 (Ringle *et al.*, 2005) to compute the path model and estimated the parameters based on path weighting scheme (Henseler *et al.*, 2012). We first assessed the measurement models and then evaluated the structural model and reported our results in that order.

157 **4. Results**

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 159 The study used a two-stage approach in the analysis because the constructs of entrepreneurial passion for inventing  
 160 (EPI) and entrepreneurial passion for founding (EPF) consisted of formative measures. In the first stage we assessed the  
 161 measurement model of the first-order constructs with the presence of the second-order constructs and in the second  
 162 stage we considered the structural relationships using factor scores for all the variables in our model (Ringle et al., 2012;  
 163 Wilson, 2010). Figure 1 shows the structural model.  
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165 **Figure 1:** Structural model

166 Table 2 shows the descriptive statistics for the research constructs.

167 **Table 2:** Descriptive Statistics

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Construct	Mean	Std. Deviation
Perceive Effective Entrepreneurship Education	5.367	1.120
Perceive Creativity Disposition	5.187	1.075
Entrepreneurial Passion for Inventing	5.366	1.161
Entrepreneurial Passion for Founding	5.610	1.136
Perception of University Support	4.827	.847
Entrepreneurial Intention	5.431	1.366

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 174 **4.1 Measurement Model**

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 176 In evaluating the measurement model we examined the outer model (Hair et al., 2014) by assessing the relationship  
 177 between the constructs and their indicators. As shown in Table 3, for the internal consistency reliability, the composite  
 178 reliability ranged from .85 to .94 for the first-order constructs, exceeding the minimum requirement of .70. The average  
 179 variance extracted (AVE) for the measurement model is more than .57 for all constructs, exceeding the cutoff of .50 (Hair  
 180 et al., 2012), hence meeting the convergent validity for all constructs. In Table 4, the AVEs are shown on the diagonal  
 181 and the squared interconstruct correlations are off the diagonal. Following Fornell-Larcker (1998) in assessing  
 182 discriminant validity table 4 demonstrated that all AVEs are higher than the squared interconstruct correlations, which has  
 183 also satisfied the requirement for discriminant validity. To further assess the discriminant validity we examined the  
 184 indicators cross loadings and all indicator loadings were higher than their respective cross loadings. This further confirms  
 185 discriminant validity (Hair et al., 2014). The study hence, confirmed the reliability and validity of our constructs.  
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**Table 3:** Item loading, internal consistency, and average variance extracted for the first-order constructs

Construct	Indicators	Loadings	Composite Reliability	AVE
Entrepreneurial Intention	EI2	.776	.941	.762
	EI3	.899		
	EI4	.914		
	EI5	.896		
	EI6	.872		
	Identity Centrality for Founding	ICF		
Identity Centrality for Inventing	ICI	1.000	1.000	1.000
Intense Positive Feeling for Founding	IPFF1	.825	.866	.682
	IPFF2	.852		
	IPFF3	.801		
Intense Positive Feeling for Inventing	IPFI1	.815	.898	.688
	IPFI2	.835		
	IPFI3	.851		
	IPFI4	.816		
Perceive Creativity Disposition	PCD2	.742	.904	.574
	PCD3	.747		
	PCD4	.748		
	PCD5	.740		
	PCD6	.801		
	PCD7	.802		
	PCD8	.720		
	Perceive Effective Entrepreneurship Education	PEEE1		
PEEE2		.839		
PEEE3		.784		
PEEE4		.708		
PEEE5		.745		
Perception of University Support	PUS5	.738	.846	.579
	PUS6	.775		
	PUS7	.781		
	PUS8	.748		

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**Table 4:** Square Root of AVE and correlations of latent variables for the first-order constructs

	1	2	3	4	5	6	7	8
1) Entrepreneurial Intention	<b>.873</b>							
2) Identity Centrality for Founding	.446	<b>Single Item</b>						
3) Identity Centrality for Inventing	.426	.407	<b>Single Item</b>					
4) Intense positive feelings for founding	.528	.623	.450	<b>.826</b>				
5) Intense positive feelings for Inventing	.532	.492	.603	.620	<b>.829</b>			
6) Perceive Creativity Disposition	.447	.388	.493	.481	.599	<b>.758</b>		
7) Perceive Effective Entrepreneurship Education	.261	.347	.384	.398	.528	.491	<b>.782</b>	
8) Perception of University Support	.522	.314	.410	.358	.459	.420	.320	<b>.761</b>

Note: Diagonal elements (figures in bold) are the square root of the variance (AVE) shared between the constructs and their measures. Off diagonal elements are the correlations among constructs

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We also examined the weights significance and collinearity issue for the formative indicators. Table 5 shows that all indicators weights are significant and there is no multicollinearity bias (Hair, Ringle, & Sarstedt, 2013) as all VIFs are below the 5.00 threshold (Hair et al., 2014). Hence we assessed the structural model.

**Table 5:** Formative indicators weights, significance and test of multicollinearity

Construct	Indicators	Weights	T Stat.	P Value	Tolerance	VIF
Entrepreneurial Passion for Inventing	IPF-I	.840	89.845	.000***	.586	1.706
	IC-I	.235	31.478	.000***	.618	1.618
Entrepreneurial Passion for Founding	IPF-F	.774	74.550	.000***	.481	2.078
	IC-F	.314	36.349	.000***	.479	2.088

\*\*\*: P<0.001

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200 4.2 Structural model

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202 To examine the model's structural relationships we considered the path coefficients and their significance, and the R<sup>2</sup>  
203 value (Hair et al., 2014). To establish the significance of the path coefficients we ran bootstrapping in PLS using 5000  
204 subsamples (Hair et al., 2014). Table 6 shows the results of the hypotheses test, their coefficients, t values and the p  
205 values. Our analysis shows that all the hypotheses of the study were accepted.

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207 **Table 6:** Path analysis and hypothesis testing (First Model)

Hypotheses	Hypotheses Path	Path Coefficient	Standard Error	T Value	P Value	Decision
H1	Entrepreneurial Passion for Founding -> Entrepreneurial Intention	.301	.052	5.784	.000***	Supported
H2	Entrepreneurial Passion for Inventing -> Entrepreneurial Intention	.210	.053	3.971	.000***	Supported
H3	Perceive Creativity Disposition -> Entrepreneurial Intention	.100	.042	2.392	.009**	Supported
H4	Perceive Effective Entrepreneurship Education -> Entrepreneurial Intention	-.123	.041	3.004	.001	Not Supported
H5	Perception of University Support -> Entrepreneurial Intention	.305	.041	7.491	.000***	Supported

\*\*\*: P<0.001; \*\*: P<0.01

209 Hypotheses 1 predict a positive relationship between EPF and EI, hence supported at p<.001. The relationship between  
210 EPI and EI (H2) was also accepted (p<.001). Hypothesis 3 predicts a positive relationship between PCD and EI and  
211 accepted at p<.01. The positive relationship between PEEE and EI (H4) was not accepted as the path coefficient is  
212 negative ( $\beta = -.123$ ). The last hypothesis (H5), showing the relationship between PUS and EI (H5) was also accepted  
213 (p<.001). We also examined the R<sup>2</sup> value of the endogenous construct (Entrepreneurial Intention). The R<sup>2</sup> is classified as  
214 .25 (weak), .50 (moderate) and .75 (substantial) (Hair et al., 2010). Based on our R<sup>2</sup> of .45 (see figure 1) we assumed  
215 close to moderate. We therefore, consider the results meaningful for interpretation purposes.

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218 **5. Discussion**

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220 Our findings show that the proposed positive relationship between perception of University support, perceived creativity  
221 disposition, entrepreneurial passion for inventing, entrepreneurial passion for founding and entrepreneurial intention were  
222 supported. These suggest that these variables will influence students to engage in entrepreneurial behaviour. Exception  
223 is the proposed positive relationship between perceived effective entrepreneurship education and entrepreneurial  
224 intention, which unexpectedly shows a significant but negative relationship and therefore was not supported. This  
225 suggests that the students' perception of effectiveness of the entrepreneurship education discourage them from wanting  
226 to engage in entrepreneurial activities after graduation.

227 This realization should be of a serious concern for the relevant agencies of the Nigerian government, as the  
228 introduction of compulsory entrepreneurship education to all higher institutions in Nigeria by the government is aimed at  
229 reducing graduate employability problem, by encouraging self-employment. We believe that the probable explanation is  
230 that this course is treated as a normal course that fulfills graduation process, so students do not see entrepreneurship  
231 education as intended to build their interest and push them to be self-employed towards becoming successful  
232 entrepreneurs and employers of labour.

233 To realize the government dream, the relevant stakeholders including the agencies and universities must support  
234 and monitor this programme. For example, by introducing practical aspect of entrepreneurship education and other  
235 strategies like running prototype companies in campuses by students could make the course more effective. This is  
236 confirmed by our finding of the significant positive relationship between the students' perception of University support and  
237 entrepreneurial intention, suggesting their perception of University support towards building their interest in  
238 entrepreneurship behaviour to be strong. We therefore provide empirical evidence of the positive influence of certain  
239 variables on entrepreneurial intention and subsequently entrepreneurship behaviour.

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# The Specificity of the Differential Regulation of Economic Integration in the Context of Contemporary Labor Migration

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## **Abstract**

*The issues of integration in the modern world become relevant in the rapidly changing geopolitical realities, and the strategic imperative of time for the vast majority of States. Today in accordance with the principle of multi-level and various-speed integration on Eurasian space are successfully developing various integration formats. They complement each other to provide a wide partnership platform. The authors argue that the main participants in labor migration in the post-Soviet space reflect the actual path of social and economic interaction worked out historically. Common historical fate and similar paths of development, similar mental conceptosphere steel trigger mechanism for the implementation of the Eurasian Economic Union. Researches show that labour of migrant workers from different countries is widely distributed in different sectors of Russia's economy, their labour is used almost everywhere. In many industries a mechanism was established where officially Russian workers are registered at enterprises, but foreign migrant workers are actually employed. Russians began to actively move, migration processes have increased substantially, new forms of temporary migration. These processes have become more active throughout Eurasia. The authors analyze the causes and characteristics of migration in the Eurasian economic union at the present stage.*

**Keywords:** migration, labor migrants, the Eurasian Economic Union, the integration, geopolitics.

## **1. Introduction**

Scientific understanding and practical implementation of Eurasian integration ideas are important areas of many scientific institutions research (Ivakhnyuk, 2007; Sadovskaia, 2006, Karabulatova and Polivara, 2013; Riazantsev et al, 2014; Salimov, 2014; Piketty, 2014; Simone and Noelke Andreas, 2010).

Currently the development of integration processes and factors that affect the escalation of these processes take on special significance. Mechanisms of the formation of multi-level economic integration obtain an important role in the world economy.

Analysis of domestic and foreign scientific literature shows that there is no clear definition of "multi-level economic integration" today. We understand this process as follows. International multi-level economic integration is the process of variable, in some cases, asymmetrical economic cooperation in the field of international trade of goods and services,



57 movement of capital and labor, technology transfer, division of labor, as well as cooperation in the sphere of investment  
58 and innovative infrastructure development. In other words, it is the interaction between the economies of the countries  
59 participating in integration unions at various levels and in various forms.

60 Multilevel economic integration is characterized by a number of factors, among which the most important are:

- 61 • deepening of processes of international division of labor;
- 62 • globalization of the world economy;
- 63 • increasing openness of national economies
- 64 • scientific-technical progress and the global scientific and technological revolution.

## 65 2. Materials and Methods

66  
67  
68 The basic methods of research: analytical description of migration processes, statistical analysis. Methods of  
69 mathematical statistics (variance and krrrelyats. analysis, sampling theory, the calculation of time series and the relative  
70 magnitudes and others.), game theory, modeling, system analysis and others. In order to provide data on migration flows  
71 and balance sheets are used mixed statistical and mapping methods.

72 **Eurasian Economic Union – the bright example of multi-level economic integration.** The presidents of  
73 Russia, Belarus and Kazakhstan signed the Eurasian Economic Union Treaty on May 29. It will come into force on  
74 January 1, 2015, taking integration to a higher level. Members of the Eurasian Economic Union (EaEU) will guarantee  
75 free trade of products, services, capital and labour force, coordinated policy in energy, industry, agriculture and  
76 transportation. A market of 170 million consumers will be formed, becoming a major center for economic development.

77 The Eurasian Union is a model of a powerful supranational Union, which is able to become one of the modern  
78 world poles and which can play the role of an effective link between Europe and dynamic Asia-Pacific region (Ryazantsev  
79 and Bozhenko, 2014). Thus, currently we can consider the Eurasian Economic Union, as the highest form of economic  
80 integration. By 2015 EaEU will include 5 countries: Russia, Belarus, Kazakhstan, Armenia, and Kirgizia. Tajikistan and  
81 Syria were also taken the initiative of entry into EaEU, but has not yet officially confirmed their intention.

82 Today we can bravely say that the Eurasian Union is the multi-level economic integration of countries.

83 Especially with the accession of Kyrgyzstan and Armenia. This fact is confirmed by different levels of economic  
84 development, demographic and migration potential. Moreover, not all countries will become members of the Eurasian  
85 Union at once time. For example Kyrgyzstan in the beginning will join to the Customs Union, and only then to the  
86 Common Economic Space.

87 **Kyrgyzstan, Armenia and the Eurasian Economic Union: impact of accession.** The majority of Kyrgyzstan  
88 labor migrants come to Russia (about 41 558 people a year), in comparison with Kazakhstan it is about 3 700 people a  
89 year (The CIS Statistics Committee, 2012). And there are a great many of reasons which explain this process. For  
90 example social networks, cultural and historical ties, liberal migration policy of Russia.

91 According to the survey of Eurasian Development Bank, the majority of labour migrants from Kyrgyzstan decided  
92 to come to Russia due to assistance of relatives and friends. Thus, we can say about the additional factor in this case.  
93 Social factors are gradually becoming mature form and become independent from economic ones. In Russia were formed  
94 communities and social networks of migrant workers. Held in 2012 in Kyrgyzstan large-scale congresses of Diasporas  
95 "Zamandash" and "Makendester" with participation of the country leadership indicate starting the process of  
96 institutionalization and the growing political and economic role of these associations (Ivakhnyuk, 2006; Ryazantsev and  
97 Bozhenko, 2014).

98 Labour migration in conditions of the Customs Union shall bring to the Kyrgyzstan economy positive implications in  
99 the short term (in particular, from cash remittances and acquired skills of migrants, in case of their return), but in the long  
100 term can become a threat to innovation and production potential of the country.

101 We believe that for the long-term positive effect, it is necessary to promote Russian and Kazakh investment in  
102 Kyrgyzstan, which would not only reduce the cost of the basic factors of production to these countries and increase the  
103 strength of economic relations, but also positively affect the country's economic growth.

104 Thus, given the entry of Kyrgyzstan into the Eurasian Union governmental and intergovernmental bodies and non-  
105 governmental organizations, leading its activity in this area, have space for improving the system of informing, supporting  
106 and protecting the rights of migrant workers.

107 As for Armenia, the main problems of Armenian economy currently are mean level of GDP per capita, high rate of  
108 unemployment, low income, red ink of balance of payments and others.

109 Given the integration of Armenia it will receive only benefits under any conditions. The joining of Armenia to EaEU  
110 is a «window of facilities». Armenia will receive the access to the large market, will improve GDP rate, will solve transport

111 and energy problems.

112 Labour migration flows from Armenia to Russia are developing very rapidly. Today 93% of labor migration from  
113 Armenia falls on Russia. This is due to the visa-free regime and the size of the Armenian Diaspora. However, the  
114 Armenian workers still need to get a work permit. After Armenia's accession to the Common Economic Space Armenia  
115 will become a full member of the common labour market, and this problem will be solved.

116 Thus, one of the main benefits of Armenia joining the CES consists in the entry to single labour market. The CES  
117 agreements in the field of the labour migration directed to the unification of the member states labour resources, as well  
118 as the creation and effective functioning of the common labour market of. 85% remittances today come from labor  
119 migrants from Russia (15% of Armenia's GDP). The quarterly growth of transfers is estimated to be \$9 million, and annual  
120 growth is estimated to be about \$36 million, thus annually increasing the volume of transfers from the CU to Armenia  
121 approximately by 3 percent (forecast of Eurasian Development Bank, 2013). Joining the CES agreements will provide the  
122 remittances growth to 40 million dollars a year. This will help the stable financing of Armenia balance of payments  
123 (Ivakhnyuk, 2006; and Ryazantsev, 2014).

124 **Russia and Kazakhstan as the main countries recipients of the labour force in Eurasian Union – the**  
125 **problem of regulation of illegal labour migration.** According to I.V. Ivakhnyuk's estimates, in 2005 Russia had 28  
126 times more labor migrants from abroad and 108 times more citizens going abroad to work than Kazakhstan. According to  
127 her, this is evidence of Russia's higher migration turnover (Ivakhnyuk, 2006). According to the data of Integration  
128 barometer of Eurasian development Bank, measurements the most preferred destination for emigration within the Post-  
129 Soviet space is Russia. Especially Russia is attractive for workers from Tajikistan, Moldova, Kyrgyzstan, Kazakhstan and  
130 Armenia (Eurasian Development Bank, electronic resource). Russia has the largest rates.

### 131 3. Results

132  
133  
134 At present Russia is a center of Eurasian migration system; it surpasses other former USSR countries in terms of  
135 economic potential and labor market size. Politically Russia is interested in strengthening integration in the post-Soviet  
136 space and considers interaction with CIS countries a priority of its migration policy. Geographically Russia is the closest  
137 neighbor for most former Soviet countries and has direct transportation ties with them. Evolution of the Eurasian migration  
138 system structure and emergence of Kazakhstan and Ukraine as new centers of labor migrants' attraction indicate that in  
139 the nearest future directions of migration flows in the post-Soviet space may become more diverse, and Russia will face  
140 growing competition for labor resources at the regional level (Ryazantsev, 2014).

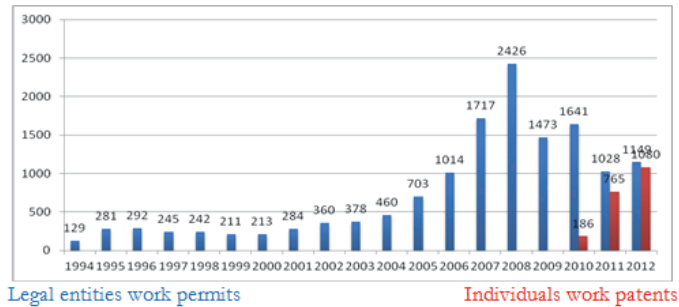
141 Between Russia and Kazakhstan on the one hand and the countries of Central Asia on the other hand a migration  
142 subsystem formed, characterized by large-scale migration flows and a stable geographic focus. The main flow of labour  
143 migrants to Russia and Kazakhstan during the last decades comes from Central Asian states. In addition, labour  
144 migration "intertwines" and transforms into other forms (migration for permanent residence, marriage migration,  
145 educational migration). Increasingly, temporary labour migrants from Central Asia receive Russian citizenship and remain  
146 for permanent residence in the Russian Federation.

147 Central Asian countries remain the main suppliers of illegal migrant workers to Russia, Kazakhstan and some other  
148 states in the Post-Soviet space. Approximate number of illegal labor migrants from Central Asia who are outside their  
149 countries ranges between 2.6 and 4.0 mln. persons, which constitutes 10% to 15% of the economically active population  
150 of those countries (Ryazantsev and Norie, 2011).

151 There is a considerable gap between official data and real scale of labor migration in Russia. Estimates given by  
152 the expert community are closer to reality, but they also vary a lot.

153 In Russia and Kazakhstan downsizing and aging of the population are noted which will have a range of  
154 demographic, socio-economic and geopolitical consequences.

155  
156



**Figure 1** – The number of work permits issued to foreigners in Russia in 1994-2012 (during the relevant year), thousand.  
**Source:** Federal Migration Service. <http://www.fms.gov.ru>.

It is obvious that despite all the government efforts there are still large pools of labor migrants in Russia who are staying without a fully official status. This is due to the following main reasons: absence of transparent and accessible procedures for obtaining the status; system of corruption surrounding labor migration in the country; low level of labor migrants' awareness.

As for Kazakhstan, it ranks second among CIS countries in terms of migration attractiveness for labor migrants. Geographical distribution of foreign workforce officially attracted to Kazakhstan differs significantly from the Russian situation. According to official data, approximately 85% of migrant workers come from outside the former Soviet Union. These are mostly workers and professionals from Turkey, United Kingdom, China, India, Hungary, Italy, USA and other countries.

#### 4. Discussion

Researcher A.V.Topilin suggests a figure between 7.5 and 8 mln., 5.5 mln being citizens of the CIS states and the rest coming from "far abroad". Later M. Vyshegorodtsev names a figure between 4 and 5 mln migrants, 2 mln among them being citizens of the CIS countries. According to estimates by E.S Krasinets, E.S.Kubishin and E.V.Tyuryukanova, there are between 4 and 4.5 mln illegal migrants in the country, among them 1/8 to 2 mln coming from the CIS countries. According to V.I.Mukomel, 4-5.5 mln undocumented migrants in the Russia.

According to official data, in Kazakhstan labor migrants from former Soviet countries account for only 15%. The share of Central Asian countries in the overall structure of official labor migration in Kazakhstan is minuscule. Although in fact migrant workers from this region are unofficially employed practically everywhere in the markets, at construction sites, service sector and trade. Experts note that in Kazakhstan unregulated labor migration has been on the rise over the recent years. However it is difficult to estimate its scale for several reasons, including absence of the visa regime with most former Soviet countries and high level of informal employment in some economic sectors, such as trade, construction, hospitality business and transportation (Ryazantsev and O. Korneev, 2013).

Despite some progressive steps in the legislation of Kazakhstan, there have been no visible improvements in the real position of migrant workers, many of whom are still outside the legal field, live and work without documents, in very harsh conditions, affected by corruption and exploited by employers. Unregulated large-scale influx of labor migrants from Central Asia might increase social tension in the cities of Kazakhstan. From time to time police carry out special raids and mass deportations of migrants. Hundreds of persons are deported, but hundreds of thousands are coming to Kazakhstan in search of jobs (Ryazantsev and Bozhenko, 2014; and Salimov, 2014). Their number is not going down in Kazakhstan, as far as migrant workers are determined to earn their living here and constantly keep coming back thanks to corruption and transparent borders. Furthermore, law enforcement agencies lack efficient organization and coordination of actions for regulation of migration flows. Meanwhile, policy ought to be guided not by the principle of prohibition that does not work in the long term, but by the principle of regulation that ensures intergration of migrants (Ryazantsev and O.Korneev, 2013).

But largest flows of illegal labour migrants are coming to Russia from Uzbekistan, Kyrgyzstan and Tajikistan.

Russia currently does not have a clear justification for labor migration regulation. At present Russian authorities simply register labor migration from abroad instead of managing it. The system of quotas for foreign workforce in Russia

200 raises serious criticisms. First of all, there is no clear mechanism for evaluation and methodology for identification of the  
201 real need for foreign workforce and the system of permits is non-transparent and corrupt.

202 As we know there is no visa regime among CIS countries excepting Turkmenistan. Turkmenistan has introduced a  
203 visa regime with all the CIS countries in 1999.

204 The issues of the visa regime has been discussed for a long time. The main issue of Russian government: Is there  
205 a need to introduce visas to citizens of Central Asian countries in order to limit the uncontrolled movement of labour?

206 Some Russian political parties have proposed to introduce a visa regime with all the CIS countries. Especially with  
207 the countries of Central Asia. However, the Russian President and the Head of the Federal migration service said that  
208 there is no need to do so. It is wrong position.

209 There are many points of view among experts currently. Let's consider some of them.

210 Russian President Vladimir Putin has not approved the idea to introduce visa regime with the CIS countries.  
211 According to him, it would mean that we push away former Republics of the Soviet Union.

212 Ryazantsev Sergey, one of the leading Russian scientists in the sphere of labour migration considers that it is quite  
213 possible the introduction of the visa regime with the CIS countries. In fact, the visa regime can protect labour migrants.  
214 Now they are in the slave position. In fact, labour migrants in Russia are slaves of the XXI century. They are manipulated,  
215 employers do not pay them, they are humiliated, they are not considered for the people. The problem is not only in the  
216 visa regime, of course. It is necessary to change the attitude of officials, police, employers, local population. It is important  
217 to develop migration infrastructure, organized recruitment of labor force. Migrant workers must be trained to work in  
218 Russia, must know Russian language, basic rights. Migrants should have labour contracts, health insurance, normal  
219 living conditions».

220 Another well-known important Russian scientist, Topilin Anatoliy considers that it is unlawful to introduce visa  
221 regime with the countries of Central Asia. Because this is not only economy, but also policy. In an increasingly  
222 international environment we can observe the displacement of the centers of world development, centers of the capital.  
223 The loss of friendly countries, primarily Tajikistan and Kyrgyzstan in the conditions of external geopolitics, this is not the  
224 result, which needs Russia. The visa regime is the easiest way of selection. But low-skilled workers are also needed.  
225 Therefore, the visa regime is unreasonable decision.

226 The head of the organization «Migration and Law», Dzhuraeva Gavkhar argue that Russia shouldn't introduce visa  
227 regime with Central Asian countries.

228 She considers following shortcomings: the exclusion of those countries which are fate with Russia. It is necessary  
229 to include the migrants from countries of Central Asia in Russian society through the adaptation and integration. The visa  
230 regime will give nothing, except aggravating the situation. There will be more illegal migrants. Basically, those who will  
231 cross the border illegally.

232 Within the common labour market citizens of Russia Belarus and Kazakhstan can work without obtaining a work  
233 permit. But there are some exceptions.

234 The procedure of work permits obtaining for citizens of CIS countries, with which Russia has a visa-free regime, is  
235 significantly simplified. Labour migrants from these countries have easier access to the Russian labor market, making a  
236 work permit independently.

237 For legal labour activity on the territory of the Russian Federation citizens of the following CIS countries must  
238 obtain a work permit: Azerbaijan, Armenia, Kyrgyzstan, Moldavia, Tajikistan, Uzbekistan, Ukraine.

239 It is important to mention the new rules of labour migration regulation in Russia (Thongkolal Haokip, 2012;  
240 Ryazantsev, 2014; and Ryazantsev et al, 2014). From 2014 the new law came into force in Russia, which is changing the  
241 conditions of CIS citizens staying on the territory of the Russian Federation. Under the new rules, foreigners from most  
242 Post-Soviet States may as usual stay in Russia for 90 days, but the period of their staying now may not exceed 90 days  
243 during each period of 180 days. Previously, citizens of other States having visa-free regime with Russia could stay there  
244 for 90 days, then they returned home, and then again moved to Russia.

245 Without any doubt this legislative provision is aimed against illegal migration. The following new rule aimed  
246 struggle against illegal migration too. It is the judgment of 17 June 2014, which determines that citizens of Tajikistan will  
247 enter and leave Russia only by foreign, official passports, diplomatic passports, the seafarer's passport and certificate of  
248 return to the Republic of Tajikistan.

## 250 5. Conclusion

252 Analysis of possibilities of the EaEU expansion allows to draw the following conclusions:

- 253 1. Increasing the Customs Union by bringing in new members is a necessary condition for improving the

- 254 competitive position and the growing importance of this integration formation on the world economic and  
255 geopolitical map (World Bank – [electronic resource] URL: <http://www.worldbank.org> (date of access  
256 20.06.2014));
- 257 2. Joining of all potential participants of Customs Union is concerned with the large number of economic, social  
258 and political risks, making the integration process rather complicated;
  - 259 3. Given the entry of Kyrgyzstan and Armenia in a Single Economic Space and a Common labour market the  
260 trends and the magnitude of labour migration will not change. However, all participants of the integration  
261 process will be able to earn benefits.

262 They are: legalization of migrants, increasing tax payments for the recipients countries and increasing remittances  
263 for donor countries.

264 With regard to the regulation of illegal labour migration we have a different point of view. More precisely, we prefer  
265 other instrument. We call it «Substitution Effect». Russian investment influx in Tajikistan and Kyrgyzstan countries is very  
266 weak. We can observe quite clearly relationship between remittances and the dynamics of trade and investment  
267 cooperation (Taylor, M., 2015, [http://assets.cambridge.org/97805213/39902/excerpt/9780521339902\\_excerpt.pdf](http://assets.cambridge.org/97805213/39902/excerpt/9780521339902_excerpt.pdf)).

268 From our point of view it is real to reduce the rate of illegal labour migration from the countries of Central Asia  
269 through investments and accordingly creation in these countries job vacancies. An example could be the so-called  
270 Maquiladora - industrial enterprises, created by the USA in the border areas with Mexico.

271 Thus, trade and investment in inter-state exchange can become a real alternative to international migration, if the  
272 effects of this activity will create new jobs.

273 The direct mechanism of regulation of labour migration might look as follows. Firstly, it is necessary to calculate the  
274 needs of the host countries (Russia and Kazakhstan) in the labour force on the basis of labour resources balance  
275 (Ryazantsev and Norie, 2011). Secondly, to determine their own opportunities (potential employment of the unemployed,  
276 students, pensioners, the possibility of internal labour resources migration) and clear need for foreign labor migrants.  
277 Thirdly, to identify the priorities of the migration policy in respect of partner countries in the context of political and  
278 economic integration and to sign interstate agreements on organized labour supply. Most of them are citizens of the CIS  
279 countries who use their right of visa-free entry, but then do not get work permits or obtain fake documents (more often  
280 than not – registration in the place of stay). Many of them live in Russia for several years. In the classical scientific papers  
281 length of stay of man in the new place of residence was considered as one of the basic indicators for the identification of  
282 the phenomenon of migration. At a time when people made the migration of one or two times in my life and almost  
283 always, this approach was certainly justified and did not cause any conflicts with life. Proponents of the "narrow"  
284 interpretation of the migration has traditionally argued that migration should be a complete form of territorial displacement  
285 and meet two conditions:

- 286 1) the people should move between different localities;
- 287 2) The movement necessarily accompanied by a change of residence. These approaches are reflected not only  
288 in science but also in the practice of accounting and regulation of migration in Russia.

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## Access to Justice for Children, An Evolving Concept

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### Abstract

Nowadays, the access to justice for children has gained widely importance and has been addressed at the international as well as the domestic level. In the last decades this concept is further developed which led to considerable modifications of international and European legal framework. Access to justice for children is affected by social and cultural practices that should aim to enable children to seek justice without fearing of reprisal and stigmatization. What is worth mentioning is the approach that combines the need to always guarantee the rights of the child in relation to information, participation and representation in administrative and judicial proceedings, recognizing these rights in all stages of the proceedings, considering that the private life, interests, special needs, individual dignity of the child must be respected and protected. It is not enough to have laws that outline and prescribe children's rights. These ought to be accompanied by interventions and mechanisms that allow all children to gain the awareness and resources required to access the justice system.

**Keywords:** access to justice; equitability; children's rights; rule of law; international and European treaties

### 1. The Concept of Access to Justice for Children and Its Dimensions

Broadly speaking, children's access to justice in the international and European area is an evolving concept. It is affected by legal and administrative frameworks, an ad-hoc approach to child-sensitive issues in civil and administrative processes, and general resources available. Particular attention must be paid to the most excluded, the poor, and the most difficult to reach, recognizing that these children often face particular challenges regarding access to justice. Also, children's own views must be brought to the forefront so that children can become active stakeholders in policies and programming around access to justice.

Over the last few decades, the concept of access to justice has evolved from a right to take legal action for violation of rights into a term that more broadly encompasses equitable and just remedies.<sup>1</sup> Access to justice is "not only a fundamental right in itself, but it is an essential prerequisite for the protection and promotion of all other civil, cultural, economic, political and social rights."<sup>2</sup> Bridging procedural justice and substantive justice, access to justice is strictly interconnected to the right to justice, as articulated in international and regional human rights standards. Access to justice for children means challenging violations of children's rights and ensuring that the law and justice systems work for children. Equitable access to justice means ensuring that all children, including those who are disadvantaged or vulnerable, are served and protected by justice systems. Children's access to justice is important for equity, but also to help ensure that all children have opportunities to fulfill their true potential as members of society. In many countries, justice systems, both formal and informal and judicial and non-judicial, are unaware of children's needs and ill-equipped to address them.

<sup>1</sup>Access to justice is defined by the United Nations Development Programme (UNDP) as "the ability of people to seek and obtain a remedy through formal or informal institutions of justice, in conformity with human rights standards." A more recent practitioners' definition has also been suggested by UNDP: "the right of individuals and groups to obtain a quick, effective and fair response to protect their rights, prevent or solve disputes and control the abuse of power, through a transparent and efficient process, in which mechanisms are available, affordable and accountable." See UNDP Justice System Programme, 'Access to Justice Concept Note', 2011, p.2.

<sup>2</sup>'Extreme poverty and human rights', UN Special Rapporteur on extreme poverty and human rights, 9 August 2012, A/67/278, para. 91.

50 Access to justice is also an integral part of any good rule of law framework<sup>3</sup>. In 2012, the High-Level Meeting of the  
51 UN General Assembly on the Rule of Law “recognized the importance of the rule of law for the protection of the rights of  
52 the child, including legal protection from discrimination, violence, abuse and exploitation.” Increasingly, the rule of law is  
53 also seen as a prerequisite to sustainable development, the decrease of poverty, and greater equality.

54 It is shown that very often, children face laws, policies and practices that are not adapted to children’s experiences  
55 or otherwise lend themselves to unjust results in criminal matters, family disputes, including domestic violence, etc.  
56 Where poverty is a factor, children are even less likely to approach the justice system to claim their rights: the stigma of  
57 poverty and the multi-dimensional deprivations suffered by the poor or those excluded and marginalized on other grounds  
58 such as disability, gender or ethnicity are enhanced by the child’s dependent status. Access to justice must be equitable  
59 in its implementation, not only in form. Equitable access to justice for children requires enhanced child-friendly legal and  
60 policy reforms, including capacity building and the provision of adequate staffing and services to meet children’s needs.  
61 Further, beyond the justice sector, changes are needed across the spectrum of child services so that children obtain an  
62 understanding of their rights, are able to access services, and seek justice. This means that social workers, teachers,  
63 psychologists, community stakeholders and government officials must become allies in helping children access justice.<sup>4</sup>  
64

## 65 2. Children’s Access to Justice as an Integral Part of the International Human Rights Framework

66  
67 For the purpose of this paper, it is essential to consider the relevant international and regional human rights norms that  
68 have developed over time. These norms guide law and policy through binding legal obligations, guidelines, best  
69 practices, and recommendations. The concept of access to justice is an evolving one, and even more so with respect to  
70 children.

71 The basis of the right to access justice can be found in international human rights instruments including the  
72 *Universal Declaration on Human Rights* (UDHR)<sup>5</sup> and the *International Covenant on Civil and Political Rights* (ICCPR).  
73 These human rights instruments recognize the right of an individual to take legal action to defend their rights, when these  
74 rights have been violated.

75 The Universal Declaration of Human Rights enshrines the notion of access to justice. Thus, article 8 of the UDHR  
76 provides that: “Everyone has the right to an effective remedy by the competent national tribunals for acts violating the  
77 fundamental rights granted him by the constitution or by law.” Article 10 confirms that: “Everyone is entitled in full equality  
78 to a fair and public hearing by an independent and impartial tribunal, in the determination of his rights and obligations and  
79 of any criminal charge against him”, without excluding persons of any age.

80 The ICCPR reaffirms this right. While the UDHR refers to the right to a remedy for violations of rights recognised by  
81 national constitution and law, Article 2 of the ICCPR recognises the right to a remedy for internationally recognised  
82 human rights. Article 14 recognises the right of access to courts, in particular, for a fair hearing on issues concerning any  
83 legally recognised right. This right, as recognised by Article 14, is not limited to human rights violations, but covers  
84 practically any issue concerning any legal right, regardless of whether the other party is a public official, private individual,  
85 corporation, or any other entity. Article 26 of the ICCPR confirms the principle of non-discrimination and equality in this  
86 context: “All persons are equal before the law and are entitled without any discrimination to the equal protection of the  
87 law.”

88 In its General Comment No. 18, the Human Rights Committee<sup>6</sup> clarified that discrimination should be understood as  
89 “any distinction, exclusion, restriction or preference ...which has the purpose or effect of nullifying or impairing the  
90 recognition, enjoyment or exercise by all persons, on an equal footing, of all rights and freedoms.”<sup>7</sup> The general principle

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<sup>3</sup> In the United Nations definition, the rule of law is a “principle of governance in which all persons, institutions and entities, public and private, including the State itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards.” See: United Nations, ‘Guidance Note of the Secretary General UN Approach to Rule of Law Assistance’, 2008.

<sup>4</sup> Report of the United Nations High Commissioner for Human Rights, ‘Access to Justice for Children’, December 2013, A/HRC/25/35, para. 5. The UN High Commissioner for Human Rights has emphasized that children must be legally empowered and “enabled to access relevant information and to effective remedies to claim their rights, including through legal and other services, child rights education, counselling or advice, and support from knowledgeable adults”, while accounting for children’s evolving maturity.

<sup>5</sup> Universal Declaration of Human Rights, art 8.

<sup>6</sup> This is a body established under the International Covenant on Civil and Political Rights (ICCPR) to monitor State party compliance with the Covenant.

<sup>7</sup> See also: Committee on Economic, Social and Cultural Rights, ‘General Comment No. 20, Non-discrimination in economic, social and cultural rights’ (42<sup>nd</sup> session, 2009), E/C.12/GC/20, 2009.



91 should be applied to the specific needs of children in situations of particular significance to them or where discrimination  
92 is a risk, such as birth registration, schooling, primary health care, and family situations.

93 The Human Rights Committee has further noted in relation to Article 2(3) that: "remedies should be appropriately  
94 adapted so as to take account of the special vulnerability of certain categories of person, including in particular  
95 children."<sup>8</sup> There are also procedural guarantees in Articles 9 and 14 relating to arrest and detention and fair trial,  
96 respectively, which apply also to children. Access to justice must be seen as a tool to realize children's economic, social  
97 and cultural rights as foreseen also in the International Covenant on Economic, Social and Cultural Rights (ICESCR).  
98 With respect to children in particular, the ICESCR codifies children's right to education and protection from social and  
99 economic exploitation.

100 At the centre of access to justice considerations remains the **principle of the best interests of the child** widely  
101 elaborated in the Convention on the Rights of the Child (CRC). The *Convention on the Rights of the Child* (CRC) is the  
102 foundational document in articulating children's rights. It has also created specific complaint mechanisms should these  
103 obligations not be met, for instance, *The Optional Protocol to the Convention on the rights of the child on the sale of*  
104 *children, child prostitution and child pornography* and *The Third Optional Protocol to the Convention on the Rights of the*  
105 *Child on a communications procedure*.<sup>9</sup>

106 Article 3 of the CRC is particularly pertinent to issues concerning remedies and decisions taking on behalf of  
107 children. It provides that in "all actions concerning children, whether undertaken by public or private social welfare  
108 institutions, courts of law, administrative authorities or legislative bodies, the best interests of the child shall be a primary  
109 consideration".<sup>10</sup> It also provides that "States Parties undertake to ensure the child such protection and care as is  
110 necessary for his or her well-being, taking into account the rights and duties of his or her parents, legal guardians, or  
111 other individuals legally responsible for him or her, and, to this end, shall take all appropriate legislative and  
112 administrative measures" as well as that every State party "shall ensure that the institutions, services and facilities  
113 responsible for the care or protection of children shall conform with the standards established by competent authorities,  
114 particularly in the areas of safety, health, in the number and suitability of their staff, as well as competent supervision".  
115 Access to justice for children encompasses the right to be heard, to participate in legal proceedings and to be protected,  
116 according to the provisions of this Convention<sup>11</sup>.

117 A number of other CRC provisions seek to ensure that children enjoy access to justice. One must recall also Article  
118 19 of the CRC which obliges States Parties to take "all appropriate legislative, administrative, social and educational  
119 measures to protect the child from all forms of physical or mental violence, injury or abuse, neglect or negligent treatment,  
120 maltreatment or exploitation, including sexual abuse, while in the care of parent(s), legal guardian(s) or any other person  
121 who has the care of the child".

122 Further the children's right to a remedy can be found also in Article 39 of the CRC which recognizes a right to  
123 reparation and obliges States Parties to: "take all appropriate measures to promote physical and psychological recovery  
124 and social reintegration of a child victim of: any form of neglect, exploitation, or abuse; torture or any other form of cruel,  
125 inhuman or degrading treatment or punishment; or armed conflicts." The child's right to reparation, depending on the  
126 nature of the injury or violation of rights suffered, may include the right to assistance in repairing the consequences of a  
127 wrong or injury, and/or financial and/or moral compensation.

128 European regional human rights instruments incorporate access to justice provisions pertaining to the rights of the  
129 child, reinforcing the international human rights framework and providing an additional layer of protection and opportunity  
130 for redress.<sup>12</sup> Briefly, the Council of Europe and European Union's standards in this area will also be mentioned, as they

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<sup>8</sup>Human Rights Committee, 'General Comment No.31, The Nature of the General Legal Obligation Imposed on States Parties to the Covenant', CCPR/C/21/Rev.1/Add.13, 2004, para.15.

<sup>9</sup>The protocols a significant development that allows children or those representing the child, in countries which have ratified the protocol, to submit individual complaints about rights violations under the CRC or the OPSC to the Committee on the Rights of the Child. Albania has ratified this protocol.

<sup>10</sup>In determining 'best interests', all the legal rights of the child as well as their individual circumstances must be taken into account. Determining best interest should involve adequate child participation without discrimination, due weight to be given to the views of the child and input from decision makers with relevant areas of expertise.

See also: Committee on the Rights of the Child, General Comment No. 14 on the right of the child to have his or her best interests taken as a primary consideration, 2013, CRC/C/GC/14.

<sup>11</sup>Children have the right to express their views freely on all matters affecting them. Article 12(2) provides that: "the child shall in particular be provided the opportunity to be heard in any judicial and administrative proceedings affecting the child, either directly or through a representative or an appropriate body, in a manner consistent with the procedural rules of national law".

<sup>12</sup>For example, the European Convention on the Exercise of Children's Rights.

131 are increasingly relevant in the region. The Lisbon Treaty makes it clear that the European Union will be directed by the  
132 following principles: democracy, rule of law, versatility and indivisibility of human rights and fundamental freedoms,  
133 respect human dignity, the principles of equality and solidarity, and respect for the principles of the United Nations  
134 Charter and international law. These principles are reinforced by the Charter of Fundamental Rights of the EU, which  
135 includes all of these rights in a single text. Furthermore, the importance of European Convention of the Human Rights  
136 and Fundamental Freedoms (ECHR) and the respective jurisprudence of the Strasbourg Court are recognized at the  
137 union level and are of paramount importance.

138 ECHR applies to children and adults alike and it recognises the right to an effective remedy<sup>13</sup>. Article 1 provides  
139 that States "shall secure to everyone within their jurisdiction the rights and freedoms" contained in the Convention.  
140 Children are not excluded from lodging an application with the court by virtue of their age, and while difficulties could arise  
141 when considering whether the child has exhausted all avenues for domestic remedies, the Court's practice has been to  
142 have a "benevolent attitude towards access by minors".<sup>14</sup>The Court stated: "*Children and other vulnerable individuals, in*  
143 *particular, are entitled to State protection, in the form of effective deterrence, against such serious breaches of personal*  
144 *integrity*". This approach has been followed in several cases concerning neglect, physical and sexual abuse<sup>15</sup>. The Court  
145 has taken the view that principles of child-friendly justice must be applied in national courts, and has made clear that a  
146 child must be "dealt with in a manner which takes full account of his age, level of maturity and intellectual and emotional  
147 capacities, and that steps are taken to promote his ability to understand and participate in the proceedings, including  
148 conducting the hearing in such a way as to reduce as far as possible his feelings of intimidation and inhibition."<sup>16</sup>

149 The jurisprudence of the Strasbourg Court offers a variety of occasions in cases implicating the implementation of  
150 human rights for children. What is worth mentioning is the approach that combines the need to always guarantee the  
151 rights of the child in relation to information, participation and representation in administrative and judicial proceedings,  
152 recognizing these rights in all stages of the proceedings, considering that the private life, interests, special needs,  
153 individual dignity of the child must be respected and protected<sup>17</sup>. The Court has also been instrumental in advancing  
154 children's access to remedies with respect to the right to education, right to respect for family life, right to privacy, and  
155 right to be free from discrimination.<sup>18</sup>

156 Additionally, the *European Social Charter (Revised)*, an instrument focused on social and economic human rights,  
157 contains provisions specifically directed at the enhancement of children's rights.<sup>19</sup> Article 7 requires States to undertake  
158 action to ensure the "effective exercise of the rights of children and young persons to protection" and Article 17 provides  
159 for the right of children and young persons to social, legal and economic protection. The European Committee of Social  
160 Rights oversees conformity of national law and practice with the Charter. Importantly, the Social Charter includes a  
161 'collective complaints procedure' which allows non-governmental organizations and other specified groups to lodge  
162 complaints where it has been alleged a State has not complied with the provisions of the Charter. This procedure has  
163 been described as an innovative, efficient, accessible and simple mechanism to uphold children's rights.<sup>20</sup> Albania has  
164 ratified the European Social Charter, but it has not accepted the optional collective complaints procedure.

165 Another important instrument for children's access to justice in Europe is the *European Convention on the Exercise*  
166 *of Children's Rights*, which has been ratified by Albania. Article 1(2) sets out its objectives: in the best interests of children,  
167 to promote their rights, to grant them procedural rights and to facilitate the exercise of these rights by ensuring that  
168 children are, themselves or through other persons or bodies, informed and allowed to participate in proceedings affecting  
169 them before a judicial authority.

170 The 2011 *Council of Europe Convention on preventing and combating violence against women and domestic*  
171 *violence*, also referred to as the Istanbul Convention, requires, among other things, that children are afforded adequate  
172 protection and support as victims and witnesses of domestic violence ratified by Albania. Children's rights in the context

<sup>13</sup>Article 13 of ECHR.

<sup>14</sup> Council of Europe, 'International Justice for Children', 2008, p. 71.

<sup>15</sup>For example see *Stubbings and Others vs. the United Kingdom* (1996); *Scozzari and Giunta v. Italy*, (2000); *Z and others v. UK* (2001); *Michaud v. France* (2012); *Fabris v. France* (2013), etc.

<sup>16</sup>S.C. v United Kingdom, No. 60958/00, European Court of Human Rights, 15 June 2004.

<sup>17</sup> Migena Leskoviku, "Albanian legislation on prevention of violence against the children in Albania. Its harmonization with European standards", paper presented in the National Conference 'Violence against children in Albania', organized by UNICEF and other partners, Tirane, November 2012 (Albanian version)

<sup>18</sup>For example see *Bajrami v. Albania* (2006), European Court of Human Rights; See also *D.H. and Others v. The Czech Republic* (2007), European Court of Human Right, etc.

<sup>19</sup> 'European Social Charter', adopted 1961 (ETS 035), revised 3 May 1996 (ETS 163), revision entered into force 1 July 1999.

<sup>20</sup> Council of Europe, 'International Justice for Children', 2008, p. 12.

173 of access to justice have been further articulated by other UN and regional treaty monitoring bodies through general  
174 comments and concluding observations. Additionally, while not binding in the same manner as treaty instruments,  
175 international and regional guidelines support and further clarify this framework. Key examples of such guidelines are  
176 those on child-sensitive or child-friendly approaches<sup>21</sup>.

177 The Council of Europe *Guidelines of the Committee of Ministers of the Council of Europe on child-friendly*  
178 *justice*<sup>22</sup>(2010) re-emphasize the key principles of the CRC – the best interests of the child, the right to life, survival and  
179 development, participation and non-discrimination, and affirm that: “As bearers of rights, children should have recourse to  
180 remedies to effectively exercise their rights or act upon violations of their rights.” Interestingly, the *Guidelines* look at the  
181 “rights and needs of the child in judicial proceedings as well as in alternatives to such proceedings”. Moreover, the  
182 *Guidelines* defines in detail what measures States should take to ensure that children fully enjoy the right of participation  
183 in judicial proceedings, the fulfilment of their best interests and their right to be treated with dignity, and the right not to be  
184 subject to discrimination, as well as the rule of law.

185 The rule of law, as is defined in Article 3, encompasses the same rights as those applicable to adults, namely:  
186 “elements of due process such as the principles of legality and proportionality, the presumption of innocence, the right to  
187 a fair trial, the right to legal advice, the right to access to courts and the right to appeal”, in all judicial and non-judicial and  
188 administrative proceedings. The same article states clearly that: “Children should have the right to access appropriate  
189 independent and effective complaints mechanisms”.

190 We can also mention the Council of Europe Policy Guidelines on Integrated National Strategies for the Protection  
191 of Children from Violence<sup>23</sup> aiming at a national multi-disciplinary framework and systematic approach to prevent and  
192 respond to cases of violence against children. Through Guidelines expected to have an institutional cultural change much  
193 needed in the perception of children as actors change and childhood as an important factor for society as a whole, which  
194 will impact policies and internal practices.

195 The practice shows that the justice experience for children does not always reflect the legal and policy framework  
196 in place in a given country. Overall, access to justice for children is largely affected by their age and consequent  
197 dependent status, as well as by cultural perceptions of children’s place in society and within the family. Due to their  
198 evolving capacity, children have less knowledge, fewer financial resources and are generally less-equipped to deal with  
199 the complexity of the justice system, in all its forms. They depend on adults to receive information regarding their rights,  
200 to approach and understand available remedies and to access justice fora and mechanisms. Children also need support  
201 from parents or guardians to file complaints as they do not have legal capacity or standing below certain ages.

### 202 3. Conclusions

205 Looking at access to justice for children as an integral component of the rule of law, the focus is put on the legal, policy  
206 and institutional frameworks, reflecting on whether this framework is aligned to international standards and implemented  
207 effectively for children, and looking at how children, especially those in vulnerable situations, experience justice. Albania  
208 has ratified the main international and European instruments on this regard, as mentioned above, thus adopting them  
209 within the domestic legislation. Under the Constitution of Albania, there are a certain number of protections which  
210 specifically address the rights of children. For example Art. 54(3) of Albanian Constitution provides that every child has  
211 the right to protection from violence, ill-treatment, exploitation and his or her use for work, especially under the minimum  
212 age for work, which could damage their health and morals or endanger his or her life or normal development. Several  
213 laws are adopted and are actually enforced mentioning here one of them dedicated specifically to the rights of  
214 children *The Law on the Protection of the Rights of the Child*<sup>24</sup> which creates legal obligations for public institutions to  
215 apply the main articles of the Convention on the Rights of the Child, including its Optional Protocols. The law itself sets

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<sup>21</sup> *The Report of the United Nations High Commissioner for Human Rights, Access to Justice for Children, treats these terms as synonymous and they are used as such in this paper.*

<sup>22</sup> *According to the Guidelines, the concept of child-friendly justice refers to: “justice systems which guarantee the respect and the effective implementation of all children’s rights at the highest attainable level, bearing in mind the principles listed below and giving due consideration to the child’s level of maturity and understanding and the circumstances of the case. It is, in particular, justice that is accessible, age appropriate, speedy, diligent, adapted to and focused on the needs and rights of the child, respecting the rights of the child including the rights to due process, to participate in and to understand the proceedings, to respect for private and family life and to integrity and dignity”.*

<sup>23</sup> *Adopted by the Committee of Ministers of the Council of Europe, November 2009.*

<sup>24</sup> *Law No. 10347 date 4.11.2010 “On the Protection of Children’ Rights”, available at: [www.qpz.gov.al](http://www.qpz.gov.al)*

216 the anchor for institutional mechanisms guaranteeing development and protection through a coordinated approach.

217 For children, justice concerns a whole range of decisions by a whole range of people - not just police, lawyers and  
218 judges – which affect them in various ways, in terms of family, education, identity, or immigration status. Distrust of  
219 institutions and of those tasked with supporting children remains pervasive, reflecting cultural realities and social and  
220 cultural approaches that prevent children from making full use of the justice system.

221 To properly address the issues discussed above on Access to Justice for children one should focus on at least  
222 three key factors affecting children's empowerment in justice processes: a) Knowledge of the law, legal procedures, and  
223 available judicial and non-judicial complaint mechanisms. b) economic, social and cultural practices that perpetuate  
224 inequality in the community and in societies at large and that make it acceptable for children to bring about a complaint  
225 against family or community members. c) Justice mechanisms in place and process which must be child-sensitive, to  
226 protect all children from discrimination, and to provide effective support services.

227 In order to improve access to justice for children, public authorities need to look critically at the whole spectrum of  
228 child services linked in one way or another to the justice system: not only police or courts, but also teachers, social  
229 workers, psychologists and community stakeholders, all of whom interact with children in their pathways to justice.  
230 Despite international treaties and their adoption within the domestic legal system, and thus the legislative and policy  
231 frameworks are generally developing, important gaps remain, especially in civil and administrative matters. Research  
232 findings show a significant divide between law and practice, as well as considerable discrepancies in the understanding  
233 of justice by justice system professionals, as opposed to children, their advocates and their family members.

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*International Covenant on Economic, Social and Cultural Rights* (ICESCR), 1966 (ratified by Albania in October 1991).

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*European Convention on Human Rights and Fundamental Freedoms*, adopted by Council of Europe, 1950 (ratified by Albania on 2 October 1996).

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*European Social Charter* (revised), (ratified by Albania in 2002).

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*European Convention on the Exercise of Children's Rights*, 1996 (ratified by Albania in 2011, enforced in 2012).

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*Convention on preventing and combating violence against women and domestic violence*, Council of Europe (approved in 2011 and enforced on 1 August 2014).

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*Guidelines of the Committee of Ministers of the Council of Europe on child-friendly justice*, adopted by Committee of Ministers of the Council of Europe (2010).

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*Policy Guidelines on Integrated National Strategies for the Protection of Children from Violence*, adopted by Committee of Ministers of the Council of Europe (November 2009).

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## 266 **Case-law of the European Court of Human Rights**

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*Fabris v. France* (2013), European Court of Human Rights

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*Michaud v. France* (2012), European Court of Human Rights.

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- 274 *D.H. and Others v. the Czech Republic*, (2007), European Court of Human Rights.  
275 *Bajrami v. Albania* (2006), European Court of Human Rights.  
276 *S.C. v United Kingdom*, (2004), No. 60958/00, European Court of Human Rights.  
277 *Z and others v. UK* (2001), European Court of Human Rights  
278 *Scozzari and Giunta v. Italy*, (2000), European Court of Human Rights  
279 *Stubbings and Others vs. the United Kingdom* (1996), European Court of Human Rights, etc.

## Understanding of Gold Investment Among Muslim Professionals in Terengganu, Malaysia

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### Abstract

Gold investment is a good alternative to maintain financial stability, especially during the global economic turn-down and uncertainties. This becomes a common phenomenon among Muslims today due to the availability of its multiple products, techniques, marketing plans in the current market. Many Muslim investors are eager to get involved in the gold investment, however, some of them do not realize about there are certain products, techniques and marketing plan which are not invalid from a legal standpoint. Therefore, this study was carried out in order to explore about the basic understanding of gold investment among Muslim professional investors. This is a field study that employed the quantitative method where data were obtained through questionnaires. The respondents comprised 300 Muslim professionals from three selected higher institutions which are located in Kuala Terengganu namely Universiti Sultan Zainal Abidin (UniSZA), Universiti Malaysia Terengganu (UMT) and Universiti Teknologi MARA (UiTM). The result of linear regression analysis indicated that, seven significant predictor variables were contributing factor to the level of knowledge about basic gold investment among Muslim professionals in Kuala Terengganu. This suggests that, nul hypothesis were rejected and it could be concluded in general, the seven predictor variables were contributing about 73.9 per cent ( $r = 0.859$ ) changes of variance in the level of their knowledge about basic investment gold. While a total of 26.1 percent change in variance was influenced by other variables which do not contribute to this analysis.

**Keywords:** gold investment, understanding, Muslim professionals, financial stability

### 1. Introduction

Gold is a very special metal. Its interesting colors and the difficulty of getting it cause it is considered worthy to mankind. The specialty of gold and its importance in human life are also much mentioned in the Quran as The God the Almighty says:

58 *Among the People of the Book there is he who, if thou trust him with a treasure, will return it to thee; and among them*  
59 *there is he who, if thou trust him with a dinar, will not return it to thee, unless thou keep standing over him. That is*  
60 *because they say, 'We are not liable to blame in the matter of the unlearned;' and they utter a lie against Allah*  
61 *knowingly. (al-Imran: 76).*  
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63 In the context of this verse, the gold refers to the currency of dinar. The permissibility of making gold as a stable  
64 saving can be observed through its value mostly are still equivalent since the time of Prophet Muhammad to the present  
65 day. Meanwhile, in a hadith, Syahib bin Garqadah said:  
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67 *I hear people were talking about 'Urwah, indeed the Prophet SAW gave him one dinar to buy a goat for him, then with*  
68 *one dinar, he bought two goats and then he sold one for one dinar. When he came back, he brought along one dinar*  
69 *and one sheep. The Prophet SAW prayed for him with the blessing on his business. If Urwa bought the land, he is*  
70 *definitely gaining profit.*  
71 *(Reported by al-Bukhari)*  
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73 This hadith indicates that the price of a goat at the time of the Prophet was about a dinar. Interestingly, the stability  
74 of the gold price is clearly proven in the price of a goat today is about RM750 or one dinar (equivalent to the value of 4:25  
75 grams gold ). It is undeniable that gold has become an essential source of wealth because it cannot be destroyed and will  
76 not decrease its value, but always increasing for a long term. The history has witnessed that that most communities and  
77 cultures consider gold has high value. Even though, nowadays gold is no longer used as the main currency, but it still  
78 becomes one of the most valuable assets.

79 Recently, gold investment has become one of the best alternative investments to protect individual wealth due to  
80 the issue raised regarding paper money may lose its value (Syukor, 2009). There are various forms of products and  
81 techniques gold investment that available in the current market . Yet, in the enthusiasm of the gold investment activities,  
82 many investors, including the Muslim professional gold investment are being lured into fraud cases as a result of  
83 confusion and lack of understanding about gold investment. Lately, many fraud cases done by investment companies had  
84 been reported, for instance, gold investments promoted by Geneva Malaysia Sdn. Limited company. There were about  
85 50 000 investors suffered losses when the company did not get the approval from Central Bank of Malaysia. In fact, the  
86 three directors of the company were charged in the Sessions Court for the case of accepting deposits from the public  
87 without a valid license (Star 2012 <http://www.theedgemaalaysia.com>).

88 As a consequence, the 100<sup>th</sup> Dialogue of the Fatwa Committee of the National Council for Islamic Religious Affairs,  
89 Malaysia held on 4<sup>th</sup> -6<sup>th</sup> July 2012 have debated on the ruling of such transaction and gold investment undertaken by the  
90 company. As a result of the discussion, the Council has decided that such transaction does not fully comply Gold  
91 Investment Parameters as has been recommended by the 96<sup>th</sup> Dialogue of the Fatwa Committee of the National Council  
92 for Islamic Religious Affairs Malaysia in 13<sup>th</sup>-15<sup>th</sup> October, 2011.

93 Such well-planned scam syndicates should be dealt immediately because it can trigger a variety of economic and  
94 social problems among victims and society. Therefore, this study is necessary to identify what are the factors in choosing  
95 gold, investment or what are the advantages of this kind investment? Does a Muslim professional make an investment  
96 based on a clear understanding or just following the current trend or lured by advertisements and promotions that  
97 promise quick returns. There are a variety of products, marketing plans and techniques of gold has caused many people  
98 are tend to get involved in gold investment. Hence, this research is vital to guide the community in general and Muslims in  
99 particular in a proper way of gold investment.

100 The investment has a positive impact in improving the economy among Muslims and capable of competing with  
101 non-Muslims who have already practiced this long time ago. Thus, it is very necessary to make some recommendations  
102 in order to enrich information about it and to create awareness about Shariah-compliant gold investment among Muslims.  
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## 104 2. Literature Review

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106 There are various writings and researches on gold done by scholars. However, their focus is on the role and mechanism  
107 of the gold dinar as currency (Salmy Edawaty, 2011: Hussin & Zanirah, 2011). The proposal of using the gold dinar was  
108 commenced by former Prime Minister of Malaysia, Tun Dr. Mahathir Mohammed in 2001. Subsequently, this issue began  
109 to be highlighted by financial experts and scholars in Malaysia. Until today, several alternatives of its use have been  
110 proposed and implemented which are the use of the gold dinar in international trade, the electronic payment system (e-  
111 dinar), savings, payment of tithes, gifts, investments, and a marriage dowry (Salmy Edawaty & Hailani, 2011). Rab (2002)  
112 also emphasizes the stability of the gold dinar against the paper money.

In a study of gold investment, Mansor (2010), Umar Azmon (2002) and Zuhaimy (2003) conclude that the saving of gold dinar as assets is a good investment compared to other investments which are not based on gold. It is due to the stability of its value and the popularity of gold investments in global markets is increased (Syed Alwi, Suhaimi & Mohamed Kamil, 2013). Baur and Lucey (2010) prove the potential of gold as a stable asset when their findings indicate the value of gold remains stable even when the stock market declined significantly in the United States, the United Kingdom and Germany. Gold is also inflation-proof investment (Louis Ng, 2011; Hafizi *et. al*, 2012 ).

One of the important aspects of gold investment is in terms of its compliance with the Islamic law. Recent trends show a tendency in the Malaysian community to invest in gold as a form of Sharia-compliant investment gold (Hafizi *et al.*, 2012). Studies done by Akhtarzaita (2012), Lokmanulhakim *et.al* (2012) and Burhanuddin (2012) analyze a number of products, plans and investment techniques which are available in the market based on the principles and rulings of gold investment from Islamic law. The findings of the researches have shown that most of the investment plans available in the market do not meet the basic transaction of gold, especially regarding handover of gold. It is also supported by findings from Hafizi *et. al* (2012), which shows that only one out of seven that offer gold savings account in Malaysia is syariah compliant.

Although there are studies on gold investment have been done, no studies done specifically to examine the level of knowledge, especially among the Muslim community. Lack of literature related to case studies on gold investment as a mechanism of investment implies strong justification on why such study should be performed. Despite the fact that gold investments are gaining momentum among investors (<http://www.imoney.my/articles/pelaburan-emas-di-malaysia>). Accordingly, a study focuses on gold investments among Muslim professionals is very significant, especially for the economic survival of Muslim people. The level of understanding in basic knowledge and rulings, especially among the Muslim community should be explored and studied. This information is important for the authorities to take certain steps to increase awareness and provide a clear explanation to the public at large and Muslims in particular.

### 3. Research Methodology

This study involves an analysis of data obtained from 300 questionnaires. Although the researchers initially distributed 600 questionnaires, only 300 questionnaires were returned. The data from the questionnaires were analysed using SPSS. The sample of this study consisted of 300 academic staff from three selected higher institutions which are located in Kuala Terengganu namely University of Sultan Zainal Abidin (UniSZA), Terengganu Malaysia University (UMT) and University of MARA Technology Institute (UiTM). The respondents were purposely selected from academic staff consisted of tutors, lecturers and professors. They were assumed to be qualified to be called as a Muslim professional due to their high qualifications in academic background and having degree in bachelor or master or doctor of philosophy. The collection of data for this study is conducted from January until March 2013.

The content of questionnaire covers specifically the research issues. The questionnaire consists of two parts; part A is the demographics of the respondents and part B is a basic understanding of the respondents about gold investment. The respondents were assessed based on Five-Point Likert Scale, 1: Not important at all, 2: slightly important, 3: moderately important, 4: very important, 5: absolutely important. To analyze the data, the study employs two methods of analysis: descriptive and linear regression.

### 4. Empirical Findings

The questionnaire consists of sections A and B. Part A contains 8 questions consisting of age, gender, level of education, job, income, universities, faculty, and involvement in the gold investment . While section B contains 10 questions.

#### Section A: The Respondents' Profiles

Table 1: Social Demographic of the respondents

Respondents' Profiles	Category	Frequency	Percentage
Age	20-30 years old	108	36.0
	31-40 years old	108	36.0
	41-50 years old	59	19.7
	51 years old and above	25	8.3
Sex	Male	90	30.0
	Female	210	70.0



<b>Level of Education</b>	Bachelor's Degree	54	18.0
	Master Degree	192	64.0
	Doctor of Philosophy	54	18.0
<b>Position</b>	Professor	6	2.0
	Associate Professor	13	4.3
	Lecturer/ Senior Lecture	212	70.7
	Tutor/ Fellow/ Assistant Lecturer	69	23.0
<b>Income</b>	RM 2000-RM3999	90	30.0
	RM4000-RM5999	94	31.3
	RM6000-RM7999	49	16.3
	RM8000 and above	67	22.3
<b>Period of Involvement in Gold Investment</b>	Below 5 years	80	26.7
	6-10 Years	6	2.0
	11-15 Years	4	1.3
	15 Years and above	4	1.3
	Not involved	206	68.7

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The age of respondents was categorized into four levels: 20 to 30 years is 108 respondents (36%), 31 to 40 of 108 (36%), 41 to 50 is 59 respondents (19.7%) and 51 years and above was 25 respondents (8.3%). The majority of respondents from a total of 210 respondents are female (70%) and male was 90 respondents (30%). Highest education level of the respondents was master degree is 192 (64%) both Bachelor's degree and PhD were 54 respondents (18%). A total of 212 (70.7%) were the respondents comprised lecturers and senior lecturers and tutor, fellows and assistant lecturers 69 respondents (23%), the Professor was 13 respondents (4.3%), and Professor was 6 respondents (2%). A total of 31.3% of respondents had income between RM4000 to RM5999, followed by 30% had income between RM2000 to RM3999. While 22.3% had income RM8000 and over; and 16.3% RM6000 had income RM7999. A total of 30.7% of the respondents involved in gold investment while 69.3% did not get involved with this investment. A total of 79 respondents (26.3%) had involved in gold investment for 5 years, 2% for 6 to 9 years, 1.0% for 10 to 14 years and 1.3% for 15 years.

## Section B: Understanding about Gold Investment

**Table 2:** Understanding about Gold Investment

Bil. Item	Min	Standard Deviation
1. I study the ins and outs of gold investment.	2.71	1.207
2. There are various brands of gold available in the market such as Kijang Emas, Rabbani Dinar, Dinar Hana, Public Gold Dinar and other forms of gold.	3.68	1.030
3. There is a difference in terms of purity of gold among the types of gold 999 or 916 or 917, gold bars or coins dinars etc.	4.02	1.003
4. The price of gold may go up and down	4.52	0.782
5. The return of gold investment is high.	3.98	0.886
6. I will start investing after getting a clear formation about it.	3.80	1.137
7. Gold investment is a long-term mechanism of savings	4.27	0.848
8. There are several types of optional form of gold investment, such as the purchase of physical gold and gold savings accounts.	3.88	0.933
9. Physical gold consists of gold bars, gold coins and jewelry.	4.13	0.863
10. Not all forms of gold investment practiced are Shariah compliant.	3.85	0.969
Alpha Cronbach = 0.845		
Number of Item = 10		
Number N = 300		

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Reliability of instruments is very important for maintaining the accuracy of the instrument exposed to the defect. The higher the value of the Cronbach Alpha coefficients and the level of the validity and reliability of the instrument, the more accurate the data will be obtained in order to produce a good quality research. Based on table 2, the Cronbach Alpha coefficients generated was 0.845 and it is acceptable as a tool of measurement as mentioned by Sekaran (2003).

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**Table 3:** Linear Regression Analysis for Level of Knowledge about Basic Gold Investment

Predictor variables	B	Standard Deviation	Beta (β)	p-value
Various Brands of Gold	0.064	0.021	0.126	0.002
Different originality of gold	0.102	0.019	0.194	0.000
The Fluctuation of gold price	0.049	0.023	0.073	0.034
Higher returns of GI	0.098	0.022	0.165	0.000
Starting GI After Getting Information	0.070	0.018	0.151	0.000
Mechanism of Long-Term Savings	0.027	0.026	0.044	0.299
There are Several Types of Choices in GI	0.028	0.023	0.049	0.240
Physical gold Made From Gold Bars, Gold Coins and Jewelry	0.140	0.029	0.229	0.000
Not all Shariah-compliant	0.034	0.019	0.062	0.077
Studying the intricacies of GI	0.088	0.016	0.201	0.000
R = 0.859				
R <sup>2</sup> = 0.739				

Value –  $p \leq 0.05$  = Significant Value

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Hypothesis Nul = No significant predictor variables the level of knowledge about the basics of investing in gold among the Muslim professional as in Kuala Terengganu. Alternative hypothesis = There is at least one significant predictor variable in the basic knowledge of gold investments among Muslim professionals in Kuala Terengganu. The result of data had been analyzed using linear regression analysis for the level of knowledge about the basics of gold investment shows there are seven significant predictor variables, namely:

Studying the intricacies of GI ( $\beta = 0.201, p < 0.05$ )

Various brands of gold ( $\beta = 0.126, p < 0.05$ )

Different Purity of Gold ( $\beta = 0.194, p < 0.05$ )

Fluctuation of gold price ( $\beta = 0.073, p < 0.05$ )

Higher Return of GI ( $\beta = 0.165, p < 0.05$ )

Start GI after getting information ( $\beta = 0.151, p < 0.05$ )

Physical Gold consists of Gold Bars, gold coins and jewelry ( $\beta = 0.229, p < 0.05$ )

The seven variables above were contributing factor to the level of knowledge about basic gold investment among Muslim professionals in Kuala Terengganu. Therefore, nul hypothesis were rejected and it could be concluded in general, the seven predictor variables were contributing about 73.9 per cent ( $r = 0.859$ ) changes of variance in the level of their knowledge about basic investment gold. While a total of 26.1 percent change in variance was influenced by other variables which do not contribute to this analysis.

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## 5. Concluding Remarks

Investment is the action of placing funds for a certain period to earn the rate of return required, with fully aware of the risks involved (Rosli, 1997). Generally, investments made to gain profit. In order to begin an investment, an individual needs certain funds and capital, whether in form of currencies, real estate, gold, stocks and so on. As such, investors have a wide choice of investment instruments such as investing in gold, real estate, trust and many others. However, there is a tendency among investors to choose gold investment compared to other forms of investment.

Gold investment is a smart alternative to maintain financial stability, especially during the great depression. This has become a phenomenon among Muslims today with the existence of various forms of products, techniques and investment plans of gold in the current market. However, in the passion of Muslim investors to invest in gold investment, there are products, techniques and investment plans of gold not permissible legally.

This study was conducted to find out how far Muslim among professional investors having the understanding about gold investment. The results of the research showed the level of knowledge of respondents in the understanding of investment gold is moderate because they were lacking in reviewing about the information and issues pertaining gold investment and were less exposed to the information about gold investment either through mass media or electronic media.

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# Development of Financial and Economic Instruments for the Formation and Management of Innovation Clusters in the Region

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## Abstract

*The article discusses the main directions of stimulating economic development of the region and one of its most important components – innovation. The need to expand the use of financial and economic instruments is justified, the analysis of the development of regional innovation clusters, means and directions of scientific and technological development of the country is conducted. The guidelines to improve the mechanisms to foster innovation, tools of implementation and evaluation of innovative clusters are given.*

**Keywords:** *innovation, innovation clusters, financial and economic instruments, innovative processes.*

## 1. Introduction

Investment policy focused on strengthening the innovation potential of the regional economy is an important instrument to enhance its competitiveness, increase the quality and standard of living of the population. One of the mechanisms to improve the innovative potential of the region is the creation of innovation clusters.

Formation of regional clusters is made by means of financial and economic instruments that can help mobilize the objective prerequisites for effective investments in innovation and ensure the participation of sufficient financial resources to fund innovative projects.

If we consider certain aspects of the cluster, the assessment of its innovation potential can be carried out in the context of the following areas: assessment of innovation level; assessment of production activity; assessment of the development of small enterprises in the cluster; assessment of export opportunities of the cluster; evaluation of the financial capacity of the cluster (Pogodina T.V. and Medvedev T.A., 2013).

Interrelatedness of the researches focused on building complex financial and economic instruments to stimulate the development of innovative potential of regional social and economic systems based on the cluster approach will harmonize the existing methods and instruments of development with the most effective ones and those of high priority for stimulating the development of innovation clusters in the regions.

This work is aimed at validating the theoretical and methodological approaches to the study of the processes of creation of innovation clusters using financial and economic instruments and at developing practical recommendations on

the content, forms and methods of management of innovative potential of the regional social and economic system on this basis.

The conducted research is aimed at building sustainable growth of innovative potential of social and economic systems of the North Caucasus Federal District of the Russian Federation, taking into account the multiplier effect on the development of the core innovation clusters in order to optimize the territorial organization and ensure sustainable dynamics of the main mesoeconomic indicators.

## 2. Methodology

When conducting the study on the identification of features of the development of the regional economy in the conditions of its transition to an innovative way of development, the authors used the methods of empirical knowledge. They served as a means of collecting scientific and empirical facts that were exposed to theoretical, economic and statistical analysis. Theoretical analysis involved the allocation and consideration of individual aspects, features and peculiarities of the use of financial and economic instruments of cluster development. Economic and statistical analysis included the study of innovation potential of the regions. The individual facts were analyzed, regrouped and systematized. The common patterns of innovative development of regional clusters were identified. The analysis is accompanied by synthesis that facilitated the penetration into the essence of innovation and their impact on the economy of the regions of the Russian Federation.

The study also contains inductive and deductive methods. These logical methods made it possible to generalize the theoretical empirical data on the impact of innovation on economic growth of the regions of Russia.

Theoretical methods were needed to identify the problems on improving mechanisms to encourage innovation, to formulate the main hypotheses of the study and to assess the evidence collected in the field. Theoretical methods have also been associated with the study of specialized literature (Drucker P., 1981).

The study of literature has given the opportunity to learn the most studied issues and identify problematic ones in the use of financial and economic instruments for the development of innovative clusters. Much attention has been paid to the issues that are under scientific debate, which is already well studied, and what problems have not been resolved yet.

## 3. Results

### 3.1 Key approaches to improving the innovative capacity of the regional social and economic system

Innovative potential of regional social and economic system is a unified interactive set of features and capabilities of business, government and society to accumulate, implement and develop its innovatization providing an adequate level of competitiveness. Innovatization of the regional social and economic system is a deliberately organized and managed process of search, selection, storage, implementation and development of its innovative capacity through innovation and innovative activities of business, government and society. Innovativeness of the regional social and economic system is the capacity and the ability of businesses to creative activities.

Innovative potential of each of the regional social and economic system can simultaneously be part of various innovative potential supersystems whose goals may be inconsistent. In this case, the only option to improve the innovative potential of supersystems at different levels is to identify the most innovative global goals formed on mega- and macro levels (Lyasnikov N.V., Dudin M.N., Sekerin V.D., Veselovsky M.Y., Aleksakhina V.G., 2014).

Identification of factors affecting the current status and trends in the development of innovative potential of the region, in our view, should also be based on two principles: identification of causal and functional connections and setting their targets. These connections and goals can serve as a key factor in the development of innovative potential of spatial social and economic systems of any level (Sandu I.S., Atarov N.Z., 2014).

A key approach to improving the innovative capacity of the regions of Russia is the formation of innovation clusters. Let us analyze the effect of innovative technological factors on the ability of the central (CFD), Northwestern (NWFD), South (SFD), the North Caucasus (NCFD), Volga (VFD), Ural (UFD), Siberian (SFD) and the Far East (FEFD) federal districts of Russia to the creation of innovation clusters (Table 1) (the official website of the Federal State Statistics Service).

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**Table 1.** Analysis of the impact of innovative technologies and informational resources on the region's ability to create innovative regional clusters

Indicators	Districts	2000	Average for 2005-2008	Average for 2009-2012	Deviation of 2012/2009 from 2008/2005
Innovative activity of enterprises, %	RF	8.8	9.8	9.9	0.1
	1. CFD	10.0	10.1	9.6	-0.5
	2. NWFD	7.7	9.8	10.3	0.5
	3. SFD	8.1	8.7	7.2	-1.5
	4. NCFD	6.2	6.6	5.9	-0.7
	5. VFD	10.1	11.9	12.4	0.5
	6. UFD	10.6	11.3	11.0	-0.3
	7. SFD	6.1	7.9	8.2	0.3
	8. FEFD	6.3	6.3	9.7	3.4
Share of innovative products, works, services, %	RF	4.4	4.8	5.9	1.1
	CFD	7.4	4.5	6.1	1.6
	NWFD	5.7	3.7	4.9	1.2
	SFD	2.4	4.3	4.8	0.5
	NCFD	0.6	5.1	8.1	3.0
	VFD	6.2	9.7	10.9	1.2
	UFD	2.0	2.9	2.3	-0.6
	SFD	1.0	1.8	2.0	0.2
	FEFD	0.9	1.5	11.5	10.0
Ratio of created and used advanced manufacturing technologies, %	RF	0.98	0.45	0.53	0.08
	1. CFD	1.14	0.46	0.55	0.09
	2. NWFD	2.00	0.96	1.27	0.31
	3. SFD	0.42	0.41	0.40	-0.01
	4. NCFD	0.27	0.42	0.40	-0.02
	5. VFD	0.67	0.31	0.32	0.01
	6. UFD	1.43	0.49	0.37	-0.12
	7. SFD	0.81	0.63	0.67	0.04
	8. FEFD	1.29	0.26	0.26	0.00
Proportion of enterprises using information and communication technologies, %	1. CFD	84.6	91.7	93.9	2.2
	2. NWFD	83.6	92.8	94.2	1.4
	3. SFD	89.5	92.7	95.2	2.5
	4. NCFD	84.5	90.6	91.7	1.1
	5. VFD	81.5	93.2	95.2	2.0
	6. UFD	81.5	91.4	94.9	3.5
	7. SFD	83.0	94.7	96.0	1.3
	8. FEFD	85.3	89.1	92.7	3.6
	1. CFD	85.1	91.0	92.6	1.6

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The leader by the force of the impact of the innovative technology factor in 2009-2012 was the Northwestern Federal District, followed by the Volga Federal District. A marked improvement in the provision and efficiency of innovation and technological factors occurred in the Far East and the North Caucasian Federal Districts. At the same time, a significant reduction in the innovative capacity was observed in the South and the Ural Federal Districts (Kopylova, 2011).

### 3.2 Modern trends in the development of innovation clusters in the regions of Russia on the example of the North Caucasian Federal District

Innovative processes based on the cluster approach have received differentiated development in the federal districts of Russia. One of the regions lagging far behind in this area is the North Caucasian Federal District. What are the causes of this gap and what methods and tools should be used to tackle this problem? Note that this issue is relevant not only for this district, but also for Russia as a whole, since the effective promotion of the national economy on an innovative way will be possible only due to the reduction in the level of differentiation of social and economic development of the

128 territories (Davydov A.A., 2014, Mingaleva Z., Mirskikh I., 2014).

129 *North Caucasian Federal District* includes seven subjects of the Russian Federation – Republic of Dagestan,  
130 Republic of Ingushetia, Kabardino-Balkar Republic, Karachay-Cherkess Republic, Republic of North Ossetia-Alania,  
131 Stavropol Territory and Chechen Republic.

132 *North Caucasian Federal District* has a favorable geographical position and favorable conditions for the  
133 development of agriculture, tourism, health resort industry, electric power, mining and manufacturing sectors of the  
134 industry, as well as the developed transit functions. Despite these virtues, its absolute benefits still remain unfulfilled,  
135 because the district still does not have the investment attractiveness due to the unstable social, political and economic  
136 situation. The complex social, economic and political processes are intertwined with the complex ethnic and inter-ethnic  
137 problems in the region, which largely prevents the dynamic development of the district.

138 Some subjects of the *North Caucasus Federal District* are among the least economically developed regions of the  
139 Russian Federation due to the extremely insufficient level of development of the economic and social sphere. In  
140 particular, the district is characterized by high unemployment, complex crime situation and tense social situation. By such  
141 key social and economic indicators as gross regional product per capita, labor productivity, average wage, fiscal capacity,  
142 the level of development of the real sector of the economy and involvement in foreign economic activities, *North*  
143 *Caucasian Federal District* lags well behind other federal districts of Russia. The low level of investment attractiveness of  
144 the *North Caucasus Federal District* is combined with a high level of financial and investment risks.

145 At the same time, the district has a significant natural resource potential, which is currently a key factor for the  
146 successful development of innovative clusters. In addition, as it was revealed earlier, the importance of the impact of the  
147 factor of innovative technology increases in the *North Caucasus Federal District*, which enhances optimism about the  
148 future innovation development of the district.

149 *North Caucasian Federal District* has a unique combination of balneology resources – mineral drinking waters,  
150 thermal waters and therapeutic mud. About 30 percent of all Russian mineral water resources are concentrated there,  
151 which is comparable with the resources of the central regions of the European part of the Russian Federation. More than  
152 70 percent of reserves of thermal waters of the Russian Federation are also located in this territory.

153 Production potential is primarily represented by the production of refined products, as well as food and chemical  
154 industry, mechanical engineering, metallurgy and production of construction materials.

155 Restoration of ore mining production and production of tungsten and molybdenum concentrates on Tyrmayuz  
156 tungsten and molybdenum plant is very important for the economy of the *North Caucasus Federal District* in connection  
157 with the projected increase in demand for rolled alloy steel – instrumental, bearings and stainless – by 2020. The  
158 prospects for the production of precious metals should also be noted.

159 Depreciated fixed assets of industrial enterprises in the *North Caucasus Federal District* need to be renewed. This  
160 in particular applies to Chechen Republic, Republic of Dagestan and Republic of Ingushetia. Therefore, the real  
161 investment processes aimed at modernization and renewal of the material and technical base are particularly relevant for  
162 this district.

163 At the same time, the *North Caucasian Federal District* has a number of advantages - convenient geographical  
164 location in relation to the major markets, the availability of natural resources (oil, ores, building materials) and spare  
165 capacity (production sites, on the basis of which it is possible to increase production), a relatively developed transport  
166 network (rail and road) and the growing demand for industrial products, both in the regions of the Russian Federation and  
167 in countries near and far abroad (Sandu I.S., Ryzhenkova N.E., Veselovsky M.Y., Solovyov A.Y., 2014).

168 On the basis of available economic resources, potential demand and opportunities to create competitive products,  
169 there are following priority sectors of social and economic development, on the basis of which it is advisable to carry out  
170 the process of the creation of innovative clusters:

- 171 • production of building materials (cement, plaster, floor and wall materials, cellular concrete, bricks, concrete,  
172 sheet and foam glass, concrete products, products made of basalt, composite nanomaterials);
- 173 • consumer goods industry (wool processing, manufacture of textiles, clothing manufacture, footwear, leather  
174 goods, furs);
- 175 • chemical industry (nitrogen fertilizers, plastics, organic monomers, olefins, aromatics, pharmaceuticals);
- 176 • mechanical engineering (automobiles and automotive components, small tools and equipment, electrics and  
177 electronics, shipbuilding, medical equipment);
- 178 • metallurgy (refined metals and primary products, metal building constructions);
- 179 • extraction of minerals and ores (mining and production of concentrates of nonferrous metals, mining and  
180 production of copper and zinc metals, mining of mineral raw materials for construction);

- 181 • fuel industry (extraction and processing of crude oil).  
182 In the meantime, there are following priorities for the development and creation of clusters in some subjects:  
183 • *Republic of Dagestan* – production of construction materials, food processing, mining of minerals and ores,  
184 fuel industry and consumer goods industry,  
185 • *Republic of Ingushetia* – consumer goods and fuel industry, construction materials,  
186 • *Kabardino-Balkar Republic* – consumer goods industry, mining of minerals and ores, metallurgy,  
187 • *Karachay-Cherkess Republic* – consumer goods industry, mining of minerals and ores, construction materials  
188 and metallurgy,  
189 • *Republic of North Ossetia-Alania* – manufacture of building materials, consumer goods industry, metallurgy,  
190 mining of minerals and ores, chemical industry,  
191 • *Chechen Republic* – production of construction materials, fuel, food and consumer goods industry,  
192 • *Stavropol region* – almost all sectors of industry, the most promising of which are chemical industry, machine  
193 building and construction materials.

194 Regional authorities pay great attention to the innovative development of their region. There are a significant  
195 number of legal and target documents regulating this area, including regional laws, development strategies and decrees  
196 (Dudin M.N., Lyasnikov N.V., Veselovsky M.Y., Sekerin V.D., Aleksakhina V.G. 2014).

197 In addition to the regional development support of these industries, the district participates in the state program  
198 "Development of the North Caucasus Federal District" for the period up to 2025". The above program is designed to  
199 promote an integrated social and economic development of the region, increase its investment attractiveness, stimulate  
200 the development of the priority areas of social and economic field, develop high-tech and knowledge-intensive industries,  
201 create and develop the industrial and innovation clusters, including the tourism sector (Dzhamalidina M., Sidorov V.,  
202 2012).

203 At the same time, it should be noted that in addition to target mechanisms of creating innovative clusters in the  
204 North Caucasus Federal District, it is advisable to actively use and develop other financial and economic methods,  
205 including the tools of risk management, direct and indirect government support. The district has insufficiently developed  
206 infrastructure of innovation activity, lacks many development institutions and neglects innovative entrepreneurship.

207 The regional government is advisable to pay more attention to the formation of an effective system of education,  
208 training and retraining of personnel, which, on the one hand, can reduce social tensions in the region, and on the other  
209 hand, will ensure an inflow of highly qualified personnel to industrial and social facilities that are necessary to ensure  
210 transition of the economy to an innovative way of development (Pogodina T.V., Stanovova N.N., 2014).

### 211 3.3 Investigation of financial and economic instruments used to stimulate the formation of innovation clusters in the 212 region 213

214 The development of innovative clusters necessitates the use of financial and economic instruments to stimulate these  
215 processes. Financial and economic instruments should be used at different levels, including, in particular, the federal and  
216 regional levels.  
217

218 At the federal level, there is support for the processes of formation and development of innovative clusters. The  
219 most common financial and economic instruments to stimulate cluster formations are:

- 220 • provision of inter-budget subsidies;
- 221 • inclusion of cluster development activities to the federal target programs and state programs of the Russian  
222 Federation;
- 223 • tax exemptions on VAT and income tax, property tax, etc.;
- 224 • involvement of state development institutions.

225 To encourage the development of innovative clusters at the federal and regional levels, quite diverse economic  
226 and financial instruments are used. At the federal level, government development institutions are involved into the cluster  
227 development programs: GC "Vnesheconombank", OJSC "HMLA", Foundation for Assistance to Small Enterprises in  
228 Science and Technology, OJSC "Russian Venture Company", JSC "RUSNANO", Foundation for Assistance of the Centre  
229 of Development and Commercialization of New Technologies. Large companies with state shares, performing innovative  
230 development program, will be involved into activities of pilot clusters. Organizer and coordinator of the innovation process  
231 is the Ministry of Economic Development of Russia, tasked to form and to provide financial and economic support to  
232 create innovative regional clusters (Dudin M.N., Ljasnikov N.V., Pankov S.V., Sepiashvili E.N., 2013).

233 Regional authorities are interested in the development of not only the federal branches and production values, but



234 also other sectors of the economy through the creation of innovation clusters of regional importance. In most regions,  
235 there are a significant number of documents regulating this area, including regional laws and development strategies,  
236 decrees and orders. In many regions of the district, the state provides support in the following forms: (Table 2).  
237

238 **Table 2** – Financial and economic instruments used at the regional level to foster the creation of innovative clusters  
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No	Financial instruments	Economic instruments
1	Provision of budget investments	Provision of state guarantees of the federal subject for the implementation of innovation project
2	Provision of subsidies from the regional budget	Provision of minimum rents to small and medium-sized businesses in the use of objects of regional state property
3	Provision of investment tax loan, tax benefits in terms of the amounts to be paid to the regional budget	Provision of information and consulting support for the innovative projects, help in the formation of project documentation

240 Thus, the financial and economic instruments of direct regulation and indirect stimulation of the development of innovative  
241 clusters are actively used at the federal and regional levels. We consider it appropriate to supplement the existing  
242 economic and financial instruments with methods of strategic planning, organizational and institutional nature (Troshin  
243 A.S., Kupriyanov S.V., Stryabkova E.A., Saldanha H.F.D., 2014).  
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#### 245 3.4 Priorities of development of financial and economic instruments to promote cluster development in the field of 246 innovation 247 248

249 The cluster approach has been widely used in developed and developing countries to encourage innovation processes.  
250 According to estimates of various experts, the total number of successful and stably functioning clusters in the world is  
251 more than 800 units, of which about 80 percent come from the developed countries. Leaders in the number and scope of  
252 activities of innovation clusters are the United Kingdom, the United States and Canada (Igonina L.L., 2014). In these  
253 countries, the task of establishing and strengthening regional innovation clusters was placed among the top national  
254 priorities. There are four forms of state support of innovation clusters in these countries:

- 255 • direct budget support of the development and introduction of new technologies and products;
- 256 • indirect support through tax policy and using administrative regulation;
- 257 • investments in the education system;
- 258 • support for infrastructure elements needed to promote innovative processes (Volkova N.N., Sakhno T.V.,  
259 2008).

260 Given the accumulated international experience (Menshikov M.A., 2012), these tools, in our view, can also be  
261 supplemented with the following:

- 262 • support of the infrastructure elements needed to promote innovation;
- 263 • creation of a system of subcontracting relationships between a range of the large companies and the network  
264 of small and medium ones;
- 265 • implementation of government programs to reduce risks and compensation of risk losses;
- 266 • development of innovative clusters around major research universities (Menshikov M.A., Levitsky A., 2013).
- 267 • increase of cooperation between the business and academic communities, including the field of information  
268 technology, biotechnology, pharmaceuticals and other sectors and industries.

269 Introduction of advanced production technologies, business and marketing innovation, commercialization of  
270 research and development are only possible if there is a developed innovation infrastructure that includes techno parks  
271 and policies, innovation and technology centers, business incubators, as well as other centers of collective use of  
272 scientific developments (Mingaleva Z. and Mirskikh I., 2014).

273 At the level of the Government of the Russian Federation, a key objective should be to coordinate the state and  
274 market regulation mechanisms to ensure implementation of these objectives. In connection with the task of economy  
275 transition to an innovative way of development, the state cannot ignore the regulation of innovative activity  
276 (Kenzhebayeva A., Turchekenova R., 2014). Therefore, the tools of direct state regulation should be combined with the  
277 tools of indirect financial and economic incentives (Afonasova M.A., 2010).

278 Similar activities should be carried out at the regional level. Only in this way the coherence of federal and regional  
279 authorities will be ensured. That will allow the best use of financial and economic instruments to promote the  
280 development of innovative clusters in the regional social and economic system.

281 **4. Discussion**

282  
283 The presented study about the identification of the specific use of financial and economic instruments to stimulate the  
284 creation and development of innovation clusters in the transition of the Russian economy to an innovative way of  
285 development is based on the methods of theoretical and empirical knowledge. As a result of the collection, generalization,  
286 systematization and analysis of economic, statistical and theoretical information about the impact of the financial and  
287 economic instruments on creation of innovative clusters and economic development of regions, we were able to confirm  
288 the hypothesis of the need to improve the financial and economic instruments to stimulate these processes. High  
289 reliability of the results is based on the writings of scientists Afonasyova M.A., Drucker P., Dzhamaidina M.D.,  
290 Menshikov M.A., Sandu I.S. and others. The distinctive feature of this study is the account of the specifics of the Russian  
291 regions, as well as financial and economic instruments used to stimulate the development of scientific and technical area.  
292 Individual aspects, features, sides of this regulation were isolated and examined during theoretical analysis. The role and  
293 impact of the financial and economic instruments on increase in the number and quality of innovative products and  
294 services to the civil area were determined. The paper describes the main factors that hinder the development of science  
295 and scientific progress. The conclusions are provided about the internal and external threats to regional markets, in the  
296 absence of mechanisms of stabilization of innovation policy. Reliability of the results is confirmed by official statistical  
297 institutions in the country, located on the website of the State Statistics Committee.

298  
299 **5. Conclusion**

300 Thus, over time and the development of economic science and economic practices, the approaches and methods to  
301 study the dynamics of innovative regional economy have undergone significant changes. They were affected by the  
302 development of scientific concepts in general and the accumulation of extensive statistical material that allowed to identify  
303 some general principles and laws of development of innovative potential of regions and social and economic processes  
304 that occur or origin there.

- 305  
306 1. The key area to improve the social and economic development of regions is the creation of innovation clusters  
307 using financial and economic instruments.
- 308 2. The key financial and economic instruments to stimulate the development of clusters at the federal level are:  
309 provision of inter-budgetary subsidies; inclusion of cluster development activities to the federal programs and  
310 state programs of the Russian Federation; tax exemptions on VAT and income tax, property tax, etc.;  
311 involvement of state development institutions.
- 312 3. The most common instruments to stimulate the creation of innovation clusters at the regional level include:  
313 provision of budget investments; provision of subsidies from the regional budget; provision of minimum rents  
314 to small and medium-sized businesses in the use of objects of regional state property; provision of information  
315 and consulting support for innovative projects, help in the formation of project documentation, etc.
- 316 4. To encourage the further development of innovation clusters in the regions of Russia, it is advisable to use the  
317 financial and economic instruments including support for infrastructure elements needed to promote  
318 innovation; creation of a system of subcontracting relationships between a number of large companies and a  
319 network of small and medium ones; implementation of government programs to reduce risks and  
320 compensation of risk losses; development of innovation clusters around major research universities; increase  
321 in cooperation between the business and academic communities, including the field of information technology,  
322 biotechnology, pharmaceuticals and other sectors and industries.

323  
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# Calculating Financial State Losses due to Corruption in Indonesia: Financial State Losses in Whose Eyes?

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## Abstract

Indonesian regulations authorize state financial losses calculation to several institutions such as Audit Supreme Board of Republic of Indonesia (BPK), Financial and Development Supervisory Board (BPKP), Inspectorate Agencies, and law enforcement officers (police, prosecutor, and Anti-Corruption Commission). It becomes a problem if the institutions give different conclusions in financial state losses calculation. As a rule of law, financial state losses calculation should be done using the legality principle where the calculations should be carried out by the competent authority, with proper procedure, and proper substance. This research uses normative juridical research by using legislation theory. The data used is legislation as legal materials data. The results of this study found that the state's financial losses can be caused by an administrative error or corruption. An authorized institution calculating the financial state losses due to administrative error is Audit Supreme Board of Republic of Indonesia, while the inspectorate calculation can be used if it is not counted by Audit Supreme Board of Republic of Indonesia. An authorized institution calculating the financial state losses due to corruption is Anti-Corruption Commission, while the police and prosecutor can be used if it is not counted by Anti-Corruption Commission.

**Keywords:** administrative law, calculating, corruption, criminal law, state losses

## 1. Introduction

Stolen asset recovery issue is one of the central issues in the corruption prosecution in every country. UNCAC 2003 put the asset recovery issue in chapter 1 as well as (1) preventive measures, (2) criminalization and law enforcement, (3) international cooperation, (4) technical assistance, training and collection exchange, and analysis of information, (5) mechanism for implementation, and (6) final clauses (UNCAC 2003). The ultimate goal of asset recovery is to deprive criminals of their illegally acquired assets and return these assets to their country of origin. As noted by a recent study on asset recovery and development assistance, asset recovery represents a significant improvement when compared with the traditional focus of law enforcement, which was limited to obtaining a conviction and prison penalty (Gretta Fenner Zinkernagel, Pedro Gomes Pereira, Francesco De Simone, 2014).

In Indonesia, stolen asset recovery due to corruption is limited to the amount of state assets that should be returned as restitution in the amount specified based on the court's sentence. The compensation is to be paid as an additional criminal convict. If the convicted person does not pay within 30 days, then the assets will be seized and auctioned to pay the compensation. If the convicted person does not have enough assets to pay the compensation, the convict will be penalized imprisonment (Article 18 Indonesian Anti-Corruption Law).

Before making a decision, the judge considered the amount of financial state losses based evidence in the court by the relevant authorities. Determination of the amount of state financial losses becomes a problem because the calculation of financial loss to the state is not monopolized by one institution. The authority of the state financial loss calculation is

owned by Audit Supreme Board of Republic of Indonesia (BPK), Financial and Development Supervisory Board (BPKP), Inspectorate Agencies, and law enforcement officers (police, prosecutor, and Anti-Corruption Commission).

Ensuring legal rule, various agencies calculating financial state losses require the same perspective to determine the loss of the state and the amount of losses that occurred. However, in practice, various institutions have differing opinions about the state of financial losses. Audit Supreme Board of Republic of Indonesia argues that the state has no losses if the state losses have been restored, while the law enforcement officers argue that the state's financial indemnification does not remove the element of state financial losses. Also, differences can occur in the method of calculation. The method of calculating financial state losses that can be done by (1) apple to apple comparison method, (2) cost of production method, (3) comparison between the value of the contract with the comparative market price or value of certain methods, and (4) total loss method also resulted in differences in the amount of financial loss to the state (Sistem Informasi Keuangan Negara/Daerah, 2012).

According to Indonesian Corruption Watch, institutions that are often included in the calculation of the state's financial losses are: (1) Audit Supreme Board of Republic of Indonesia (BPK) and (2) Financial and Development Supervisory Board (BPKP). Thus, the authority of the state financial losses calculation is not limited to the Audit Supreme Board of Republic of Indonesia and Financial and Development Supervisory Board. Constitutional Court Decision No. 31 / PUU-X / 2012 dated October 23, 2012 allows other agencies to calculate the financial state losses.

The importance of certainty in calculation of financial state losses as a basis for determining the stolen assets recovery requires investigation of the authorities that determine the state of financial losses. This paper investigates the calculation of financial state losses from the laws and regulations perspective by using the law and regulations principles in Indonesia.

## 2. Research Method

The authors decided to use normative juridical research by using regulations as legal materials data. This research was carried out in four phases: (1) Collecting regulation related to state losses calculation, (2) Describing state losses calculation mechanism in Indonesia regulation, (3) Analyzing state losses calculation regulations inkages, (4) Developing recommendations for determining competent institutions in calculating state losses.

## 3. Finding

### 3.1 Financial Regulations History in Indonesia

During the colonial era, Indonesia was known as Dutch East Indies. As a colony, financial management in the Dutch East Indies was governed by Indonesische Comptabiliteit Wet (ICW), which provides state financial control functions to the parliament. Although the ICW had been established since 1917, the Governor-General of the Dutch East Indies has the authority to set a budget without the control of parliament as stipulated in the ICW. State financial oversight started running since 1925 with the establishment of the People's Council that provides oversight authority to control the parliament.

After Indonesian independence, the ICW existed based on Article II Transitional Provisions of Indonesia Constitution 1945. Then, it was amended by Indonesia Law No. 6 of 1968 on State Treasury. Furthermore, the change of paradigm is to build effective state finances that are efficient, consistent, and according to the principles of good corporate governance. The change of paradigm is done with publishing (1) Law No. 17 of 2003 on State Finance, (2) Law No. 1 of 2004 on State Treasury, (3) Law No. 15 of 2004 on Management and Responsibility of Financial State, and (4) of Presidential Decree No. 42 of 2002 on Guidelines for Implementation of the state budget. Through this law, the previous state financial management is complementary to the bureaucracy of public policy being converted into a specific bureaucratic system that needs to be regulated through a specific bureaucracy (W. TiawanTjandra, (2014), Hukum Keuangan Negara, Jakarta: Grasindo).

### 3.2 Rekonstruksi Pengelolaan dan Pengawasan Keuangan Negara

Financial state system reform has established a new legal framework and provides some important implications in the state finances management through organization reconstruction. Organization reconstruction emphasizes delegation of authority in management and supervision of state finances.

### 3.2.1 Reconstruction of State Financial Management

Prior to the establishment of legal framework of public finance, public finance was limited to the state budget that is managed centrally by the president as an executive leader. Implementing the state finance management, the president is responsible to the Assembly as a mandate holder. After four times amendment to the constitution, the state power is divided into four parts, namely (1) the Executive is the President; (2) the Legislative is the Assembly (DPR) and the House of Representatives (MPR), (3) the Judiciary is the Constitutional Court, Supreme Court, and The Judicial Commission, and (4) the Financial Control is Audit Supreme Board of Republic of Indonesia (BPK). In the executive institution, state budget management authority is handled by the President as the chief executive who is assisted by (1) The Minister of Finance as Chief Financial Officer; (2) The minister/head of the institution as Chief Operation Officer (COO), and (3) the Central Bank to establish and implement monetary policy. Local budget management authority is also in the hands of the President and the President delegates its authority to the local leader (governors, regents, and mayors) as per (Law No. 23 of 2014 on Regional Government). In the legislative institution, state budget management authority is handled by The Assembly and The Parliament. In the judiciary institution, state budget management authority is handled by the leadership of the Constitutional Court, Supreme Court, and the Judicial Commission.

### 3.2.2 Reconstruction of State Financial Management Supervision

Legal framework of state finances has established surveillance systems to use state finances to minimize mistakes or abuse of authority resulting in losses to the state finances. State finances monitoring system is supplied through (1) internal controls and (2) external supervision. According to Fachruddin (2004), internal control is conducted by a unit that is structurally still included in the government's organizations, while external control is done by the organization that is structurally outside the government.

Internal control is the executive through Government Internal Control System. The President delegated to the Minister / Head of Institution, the Governor, the Mayor, and the Regent to organize the internal control system by establishing institutions inspectorate in each institution (Government Regulation of the Republic of Indonesia No. 60 of 2008 on Government Internal Control System). In addition, the internal control in the executive is also done through the Financial and Development Supervisory Board (BPKP) who have task to control financial and development of government (Presidential Decree of the Republic of Indonesia No. 103 of 2001 on the Position, Duties, Functions, Structure, and Work Non-Government Institutions department). In contrast to the executive, the internal control on the legislative and judiciary is done by inspectorate at each institution.

External control implies the use of state finances of the entire body (executive, legislative, and judicial) conducted by the Audit Supreme Board of Republic of Indonesia based on various laws such as Section 23E paragraph: (1) Indonesia Constitution 1945, Article 1 paragraph 1 Law No. 15 of 2006 on BPK and Article 2, (2) Law No. 15 of 2004 on Management and Financial Responsibility State. The authority of internal and external control can be seen in Figure 1.

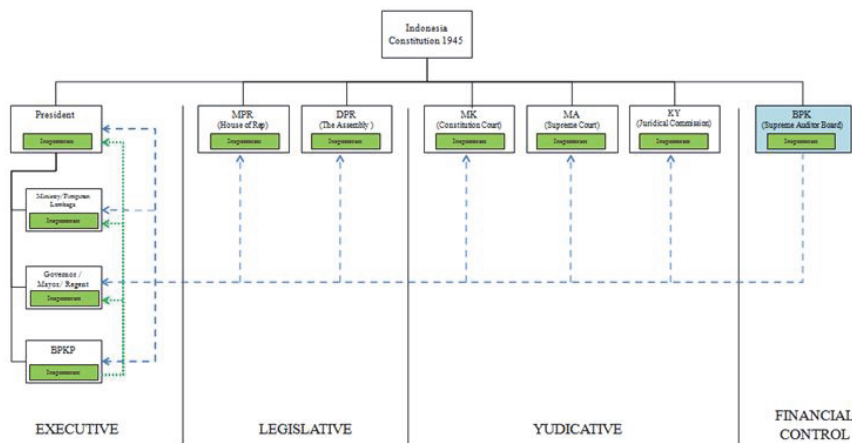


Figure 1. State Financial Control

### 3.3 Financial State Losses Finding due to Corruption and Its Follow-Up

Internal and external control can find the state's financial losses in the financial management, both in the judiciary and the executive. The findings of the state losses are followed in accordance with the errors committed by state financial managers. Internal control found violations followed by the administration to report to the respective leaders of relevant ministries and institutions. While external control found administration errors, the follow-up is to (1) determine the amount of financial loss to the state and the party is obliged to return loss, (2) supervise the implementation of the return of the financial losses.

Criminals found by inspectors followed up in coordination with law-enforcement agencies in accordance with the authority possessed by each institution. Internal control as Financial and Development Supervisory Board does not have the authority to investigate the handling of cases of financial irregularities in the management of state finances that indicated corruption done by coordinating with the police, prosecutor, and Anti-Corruption Commission (Memorandum of Understanding between the Prosecutor of the Republic of Indonesia, the Indonesian National Police, and the Financial and Development Supervisory Board No. KEP -A09 / A / JA / 2007, No.POL. B / 2718 / IX / IX / 2007, and No.KEP-1093 / K / D6 / 2007 on Cooperation in Case Handling Deviations of State Financial Management of the Indicated Corruption).

Financial and Development Supervisory Board has also been coordinating with the Anti-Corruption Commission to (a) support the investigative audit, (b) submission of the case, as indicated by corruption, (c) the calculation of losses to the state aid, (d) provision of expert testimony, (e) corruption prevention programs, (f) the dissemination of anti-corruption, (g) education and training, (h) the exchange of information related to cases of corruption (Decision of the Joint Commission and the Head of BPK April 30, 2007 on cooperation Pidana Corruption Eradication). Different from internal control, the Audit Supreme Board of Republic of Indonesia has the authority to conduct investigative audit to find indications of corruption. Cooperation with law enforcement officials conducted after the Audit Supreme Board of Republic of Indonesia found corruption indications of investigative audit results.

## 4. Discussion

### 4.1 Rule of Law Principle in Indonesia

Article 1 point (3) Indonesia 1945 Constitution states that Indonesia is a country of law. According to Philip M. Hadjon (2011), the principle of rule of law state is the principle of legality. Based on the principle of legality, every act of government must be based on (1) the legal authority, (2) proper procedures, and (3) the substance of the right. As a state law, state financial loss calculation should be done using the principle of legality where the calculations should be carried out by the competent authority to use the procedure and substance of appropriate legislation. Based on the principle of legality, the calculation of state financial losses can only be carried out in accordance with the laws and regulations with regard to the principle of *lex superior derogat legi inferiori*, the principle of *lex specialis derogat legi generali*, and the principle of *lex posterior derogat legi priori*.

The principle of *lex superior derogat legi inferiori* stated that regulations are above and override rules below. In Indonesia, the principle of *lex superior derogat legi inferiori* reflected in the Law 12 of 2011 on the Establishment of legislation that states the force of law in accordance with hierarchy legislation consists of (1) 1945, (2) MPR Decree (3) Law / Government Regulation in Lieu of Law (regulation) (4) government regulation (5) Presidential Decree (6) Provincial Regulation, and (7) District Regulation. In addition, there are also recognized rules and have binding legal force throughout ordered by Legislation higher or formed under the authority of such rules established by the People's Consultative Assembly, House of Representatives, Regional Representatives Council, the Supreme Court, Constitutional Court, Audit Board, the Judicial Commission, Bank Indonesia, the Minister, body, agency, or commission level formed by Law or Government at the behest of the Act, the Provincial House of Representatives, Governor, House of Representatives District / City, Regent / Mayor, Village Head, or equivalent.

The principle of *lex specialis derogat legi generali* states that there are specific rules that override the general rules. This principle is reflected in (1) Article 63 Point 2 of the Code of Criminal Justice Act, which states that "If a deed entered into a common criminal rule, regulated in a special criminal rule, then that's just the special ones are applied." (2) Article 1 of the Law on Commercial Law states "For the book of this Act to the Code of Civil Law held no particular deviation, then the Code of Civil Law applies also to the things spoken of in the Book of the Law." This principle can only be used if both rules are in the same position on hierarchy legislation.

The principle of *lex posterior derogat legi priori* states that the new rules overriding the old regulations were equal. The principle of *Lex Posterior derogat legi Priori* can be seen from the legislation, which generally states that the

204 regulations are still applicable to the extent not in conflict with the old regulations.

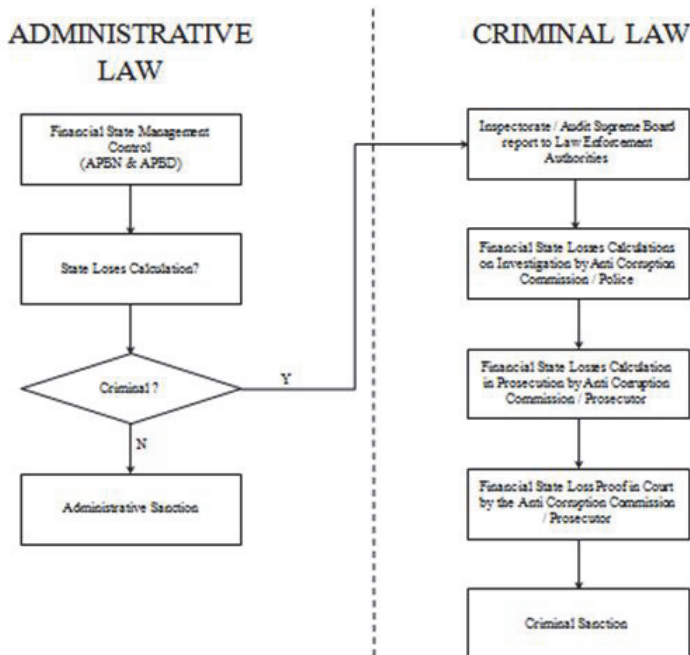
205 In the event of any discrepancy in the state loss calculation performed by the authority by the regulations, the  
206 determination of the competent institutions calculate that losses to the state should be based on the principles of the rule  
207 of law, namely the principle of *lex superior derogat legi inferiori*, the principle of *lex specialis derogat legi generali*, and the  
208 principle of *lex posterior derogat legi priori*.

#### 210 4.2 Authority of the State Financial Losses Calculation on Administrative Law and Criminal Law

212 Regulation principles that provide the state financial losses can be seen in (1) the perspective of administrative law when  
213 state financial loss is caused by an administrative error, which resulted in perpetrators accountable administration and (2)  
214 the perspective of criminal law when state financial loss is corruption, which resulted in criminal perpetrators responsible.

215 On the one hand, internal and external oversight is part of the administrative law that is based on the principle of  
216 *lex specialis derogat legi generali* the state financial losses calculated by the internal and external supervisory and  
217 administrative impact cannot be used in criminal law enforcement. On the other hand, the calculation of losses to the  
218 state as part of criminal law enforcement cannot be done by the internal auditor and external monitoring, but should be  
219 done by law enforcement officers with reference to the formal criminal law.

220 In accordance with the formal criminal law, there are three criminal law enforcement stages: (1) the initial  
221 investigation that the research activities undertake to determine whether or not it is a crime, (2) investigation that the  
222 activities undertake to make light of an incident of crime by gathering evidence, (3) the prosecution. Authorized agency in  
223 the enforcement of criminal law in corruption are: (1) The police has the duty of inquiry and investigation by Act No. 2 of  
224 2002 on the Indonesian National Police. (2) The Attorney General has a duty to prosecute under Law No. 16 of 2004 on  
225 the Prosecutor of the Republic of Indonesia, and (3) Anti-Corruption Commission, which has the task of investigating,  
226 investigation, and prosecution by Law No. 30 of 2002 on the Anti-Corruption Commission. Although the authority of the  
227 state financial loss calculation is not stated explicitly in the legislation mentioned above, the authority is included as part  
228 of the inquiry, investigation, and prosecution as provided in formal criminal law in Indonesia.  
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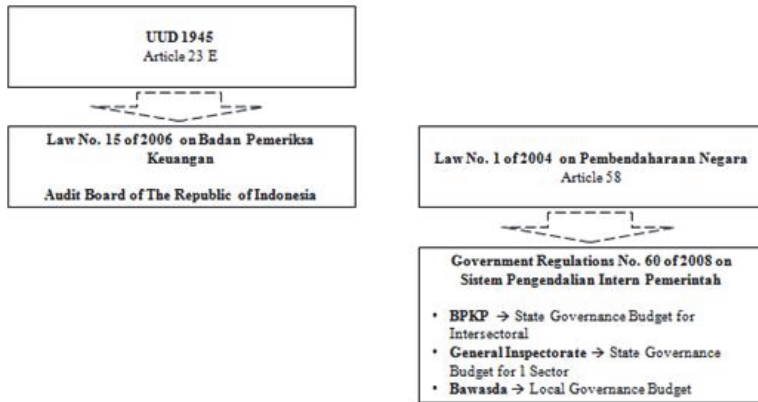
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232 **Figure 2.** State Financial Losses Calculation Process  
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234 4.3 Difference Calculation on Administrative Law and Criminal Law

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The number of parties who have authority to calculate the financial losses resulting state does not rule out differences in the results of the calculation of financial loss to the state. That difference can occur among inspectorate (internal control), the inspectorate with external control, or even between internal control with law enforcement officer. In case the differences in the calculation are done in administrative law, the error is solved by using the principle of *lex superior derogat legi inferiori* and the principle of *lex specialis derogat legi generali* as follows:



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Figure 3. *Lex superior derogat legi inferiori* principle in financial state losses calculation

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Based on the above scheme, the calculation of the difference between the internal control (Audit Board of The Republic of Indonesia and general inspectorate), the calculation of financial state losses refers to the principle of *lex superior derogat legi inferiori*; so, the calculation used is the calculation of the Audit Board of The Republic of Indonesia because it is based on Indonesian Constitution 1945.

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In terms of differences in the calculation of financial loss to the state that occurred between the General Inspectorate, the calculation of financial loss to the state refers to the principle of *Lex specialis*. Based on this principle, the calculation of the financial losses, which refers to the use of state finances, namely (1) Audit Board of The Republic of Indonesia when the state financial authorities used cross-cutting, (2) General Inspectorate to use state funds of a certain sector, and (3) Provincial Inspectorate/Inspectorate District/City to use Governance Local Budget.

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Unlike the administrative law, criminal law enforcement corruption calculation based on Law No. 30 of 2002 on the Anti-Corruption Commission provides that the Commission has authority to conduct supervision over the corruption cases. Thus, the calculation of the financial loss that is used is a version of the Anti-Corruption Commission. The calculation of the financial state losses made by the police and the attorney can be used if the case has not been supervised by the Anti-Corruption Commission.

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### 5. Conclusion

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Financial state losses are related to administrative law and criminal law; so, it should be based on the rule of law principle of the legislation to avoid the mistakes of the implementation of legislation.

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In case of administrative law error, the calculation of state assets used is the calculation of the Audit Supreme Board of Republic of Indonesia in accordance with *lex superior derogat legi inferiori* principle. In terms of differences in the calculation of financial state losses made by the inspectorate, the calculations used by *lex specialis derogat legi generali* principle depends on the parties that use state finances.

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In case of criminal law error, the calculation used is the calculation of the Anti-Corruption Commission. The calculation of losses to the state by the Police and the Attorney can be used throughout the calculation of the Anti-Corruption Commission, which has not been done earlier.

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## The Policy of Japan Concerning Natural Resources of Mengjiang: Legal Aspects

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### Abstract

With the beginning of military conformation against China in early 1930s, Japan began to consider its North-Eastern territories as part of the so-called "anti-Communist belt", but in terms of economy as a market for the export of capital, exclusive sale of goods and a source of natural resources such as coal, minerals and animal products, which is an important strategic military resources. Therefore, the aim of this article is to carry out a comprehensive analysis of the main legal acts regulating economic policy Mengjiang during the Japanese occupation of northeast China. The Central part of Inner Mongolia, known later under the name of Mengjiang, was a matter of special interest, which is manifested in the creation in the mid-1930s the independent Mongol state. The region had an extensive pastures and rich sources of livestock production, so Japan, feeling an acute need for strategic military resources, by using local authorities and the system of state regulation as a tool, has pursued a policy of control of the economy, trying to implement its strategy of "War feeds war". In addition, Menssen was a strategically important territory and was considered by the Japanese armed forces as a springboard for attacks on the Soviet Union.

**Keywords:** Mengjiang, Inner Mongolia, legal regulation, government economic policy, the law of the occupation forces of Japan.

### 1. Introduction

At the present stage for national science there is a need for large-scale studies in the public, political and legal systems of the leading countries of the world, with which Russia interacts, especially China: economic and military partner, a state with a long history of diplomatic relations, on the border space of which in the XX century there was a rapid processes of state building. Legal regulation of the economic policy of Japan in northeast China and Inner Mongolia is a little-studied topic and is of great interest for researchers. This is particularly important for the understanding of the official Japanese policy in China in the first half of the XX century and for the most complete understanding of contemporary international relations between Japan and China in the XXI century. The period of occupation of Chinese territories by Japan had an impact not only on its relations with China in the past, but continues to play a defining role in the system of international relations in the Far East, with including also the participation of Russia and in Russian foreign policy. The scientific relevance of the topic is also defined by a lack of knowledge of this period in the history of relations between Japan and China.

Materials, dedicated to the study and description of the processes of formation of statehood in Mongolian nation, are enough, but there are almost no works studying the subject of the state economic policy Mengjiang and Inner Mongolia and its legal consolidation. A separate source category consists of the memories of the participants of those events. Foreign printing produces the material, the author of which is Sechin Jagchid (Sechinbatt, Chinese name - Yu Bohan) who has published the material in English, Japanese, and later Chinese (Sechin, Jagchid, 1979; Hyer, P. and Sechin Jagchid 1983; and Sechin Jagchid 1999).

One of the first Russian explorers of Inner Asia was Nicholas Roerich (Roerich, Nicholas, 1936), who was personally acquainted with the leaders of Inner Mongolia of that period. His contemporary is representative of Harbin law school Valentine Ryazanovskiy, whose works (Ryazanovskiy, Valentine, 1931) about the Mongol and Chinese law and the state allow us to trace the evolution of the state and legal institutions available in Mengjiang: administrative divisions of banners of Inner Mongolia, powers and functions of the governing bodies. In the USSR scientific research was presented by a number of publications (Titov 1981; Theological, Moskalev 1984; and Contemporary history of China..., 1984) which affected Mongolian events contextually. In national science the material covering the Mongolian autonomist movement and further events associated with it, is extremely modest. G.F. Zakharova (Zakharova, G.F., 1990) and D.I. Goldberg (Goldberg, D.I., 1959) casually throw light upon some events and do not paying sufficient attention to the details and their further development, being confined to the statement of a number of generally accepted facts. There are no different variety and depth of the study of modern scientific research in the beginning of XXI.

57 Baoin Chaocat (Baoin, Chaocat, 2001; Din, Syeotze, 2007; Ray, Ciy, 2008; and Chai, Hongyuan, 1999) and other  
58 are the authors who consistently and closely to the topic work with the material on Mengjiang with the Chinese side. In  
59 addition, there are a few published archival material, including reviews of effecting at that time legislation (Review  
60 meetings..., 1940; and Review meetings...; 1941). It is important to note that both then and now this problem was  
61 engaged mainly universities of Inner Mongolia or Central institutions of Beijing, Tianjin and other major research centers.

62 In a series of modern scientists, it is necessary to allocate Sun Cunye, who in his works (Sun, Cunye, 2008; Sun,  
63 Cunye 2010; Sun, Cunye, 2010; and Sun, Cunye, 2011), using a considerable amount of archival material, statistical  
64 data, resulting in information that is contained in the Mongolian and Chinese press 1930-1940's, in details reveals the  
65 questions of law and legal regulation of social relations in Mengjiang, primarily concerning Economics and commerce.

66 Western literature of this period comes under the heading of the world's leading training centers: Oxford,  
67 Cambridge, Tokyo University, where some times ago rushed the flow of immigrants from Inner Mongolia. In their writings,  
68 (Beasley, William, 1987; Coble, Parks, 1991; Moise, Edwin 1986; Sarah, Paine, 2012; and Elliott, Marc, 2000) and others  
69 (Atwood, 2000; Black, Naby, 1997; and Narangoa, Cribb, 2003) do not learn exactly Mengjiang - in most books it is  
70 mentioned in the description of events in the North of China or in Inner Mongolia on the backdrop of the Japanese  
71 occupation. However, even this paltry amount of material allows to supplement the available data.

72 The economic side of the Mongolian events in the course of general study of the opium market in China is studied  
73 by Timothy Brook and Bob Tadashi Wakabayashi (Brook, Timothy and Wakabayashi Bob Tadashi, 2000). The materials  
74 of Japanese archives are used in the work published in the 1970s and 1980s, where regulatory framework trafficking of  
75 opium in the North of the country, created by the occupation forces is affected.

76 Among the works of the Mongolian authors such works are extremely rare, but here should be allocated the  
77 volume work of D. Zorigt "van De" (Zorigt, Dorgin, 2009), reprinted in 2011. Regardless of the increased volume of  
78 research material, which covers developments in Inner Mongolia in the first half of the XX century, actually complex  
79 works on Mengjiang, its legal system, the development of statehood and attempts to obtain state sovereignty up to the  
80 present time do not exist. Presented works have another subject for study, they are fragmented and often opportunistic,  
81 which suggest the need for research into this question.

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## 83 **2. Reasons for a Japanese Control Over the Central Regions of Inner Mongolia and the Creation Mengjiang**

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86 In order to have access to the rich natural resources of the Central regions of Inner Mongolia, in addition to the military  
87 forces, the Japanese military used a very wide range of legal instruments, from a clear and progressive tax policy to  
88 legalize drug trafficking and smuggling. Holding domestic and foreign policies of Mengjiang, the Japanese forced the  
89 government of this country to publish a series of laws and regulations that clearly define the methods of control of imports  
90 and exports, prices and production of goods. Measures of legal control of resources has seriously restricted the  
91 development of local manufacturers and merchants, and led to the devastation of rural livestock economy of the region  
92 and brought the population to many problems.

93 The primary task was to provide a guaranteed unlimited access to the rich resources of Mengjiang that could be  
94 implemented only through their complete control. First, it was about the need to avoid leakage of vital for Japan resources  
95 in areas controlled by the Kuomintang government or in the support areas of resistance to Japanese aggression on the  
96 part of the Communists. Around the Inner Mongolia geopolitical situation did not assume stability and uniformity: the  
97 Western territory was controlled by general Fu Tsoi, in the South-West was stationed ten thousandth Kuomintang army,  
98 the area at the junction of the province of Shanxi - Chahar - Hebei and Dazinhua was the military base of the Eighth field  
99 army. That is why without ensuring strict control of the flow of goods, especially for export, resources could be in a  
100 combat zone and along special channels go into areas controlled by the Japanese opponents.

101 Secondly, only by method of control over natural resources, it was possible to obtain the necessary further  
102 development of Mongolian resources funds, in connection with what Japan needed as soon as possible to begin their  
103 development. The rapid increase of productive forces, held since 1936, including with the participation of neighbouring  
104 Manchukuo, also demanded funds for expansion. Therefore, these countries have no excessive or free capital, which  
105 they could invest in land development. Moreover, in this period in Manchuria investors begin the process of regaining of  
106 the invested capitals. Thus, in conditions of lack of funding and lack of funds within the country, the value of Mengjiang as  
107 a platform for investments inevitably weakened. In this situation, the financial resources necessary for the development of  
108 natural resources to a greater is needed to find by proper authorities of Mengjiang. However, the economy of these  
109 nutritionpolicy areas was closely connected with the business circles of Beijing and Tianjin. According to statistics of the  
110 Bank of Mengjiang from 1938, in the structure of trade 93.7% of export shipments and 93.9 per cent import shipments  
were made by rail, mainly by rail Beijing-Baotou. Therefore, the lack of or poor implementation of control could lead to the

fact that capital could flow out together with the goods outside the sphere of Japanese influence.

Thirdly, only through an effective economic policy you could get necessary for development of the natural resources equipment. Although rich in resources, industry of Mengjiang was underdeveloped. Basically, with the money gained from the sale of raw materials, necessities - food, clothing, building materials, etc. was bought. In this situation, without strict control over material resources, including over imported products, to ensure the availability of production capacity necessary to develop the natural resources of Mengjiang was impossible. This aim served a Japanese policy to establish regulations - laws and regulations, which became the documentary basis, to create a working as a clock system of control over material resources.

### 3. The Legislative Policy of the Japanese Occupation Forces to Create a Joint Autonomous Government Mengjiang

To meet their own needs for food, wool and other resources in the occupied territory, Japan prevented the arrival of important goods in the occupied areas. Holding in northeast China's measures for the control of goods were transferred in Inner Mongolia. An effective instrument of such a control is right. As the legal system of mandatory rules of law is a powerful tool of not only public administration, but also the basis for the existence of the state, expressing its political nature, and was used by the Japanese military command, implementing legal regulation of economic policies.

In April 1938 in Mengjiang the law "About the general state mobilization of economic" was adopted. The economy, controlled by the Japanese government and military circles of Japan's, increasingly became systematized and managed.

In October 25, 1938, by decision of the Joint Council of the Autonomous provinces of Inner Mongolia was published the Law "On restriction of the export of wool" and the corresponding Decree "On implementation of the Law "On restriction of the export of wool"" (Boing, Chaocat, 2001), which created a system of administrative licensing for export of this product. Therefore, the person intending to engage in the export of wool, was obliged to submit to the Joint Council the application for permission to export, which indicated: the name of the product, the price, the exporter applying for and the buyer, address or legal address, the route of transportation of goods and other necessary information. These measures were the beginning of the system of control over the export of wool.

After the unification of Mengjiang, Chanani and Zigbee in September 1939, this law was abolished. When adopted the Law "On control over trade and the Law On the control of goods", they more tightened the control of the export of wool.

As for the export of cattle, in June 10, 1939 United Council the Law №22 "On the restriction of the export of cattle" was adopted. The law stated:

- "... Persons engaged in export of horses, sheep, goats, camels and cows outside of Mengjiang, must obtain a license from the chief of the General Committee of the Joint Council of Mengjiang";
- "...Under the age of twelve mares and have not attained the age of seven sheep should not be exported outside of Mengjiang, but mares older than 10 years and sheep over the age of 5 years can be readily disposed of in the state Manchukuo;
- "...A violation of this law is punishable by hard labour for a term of one year or by a fine in the amount of 2 thousand yuan. This penalty applies to persons who attempt to commit a crime. All livestock of offenders is confiscated" (Sun, Zunyi, 2011).

Therefore, there a system of licensing of any kind of activity, which was supposed to import cattle, introducing limitations on his age, which, however, did not touch the neighboring state of Manchukuo was established, which included penalties for violation of these standards that allow their implementation. After the adoption of the Law "On the control of goods" these norms do not find in it their fastening and were abolished, and they were replaced by other legal regulatory mechanisms.

### 4. The Legal Regulation of Economic Relations after the Proclamation of the State Egidono Mengjiang

Japan actively used the powers of local government to achieve its aim. After the merger on 1 September 1939 of three semi-Autonomous states of such formations, Mengjiang, Chanani and Zigbee, on the territory of the newly formed state was published laws and regulations designed to control the distribution of goods and other material resources. So in livestock sector on 1 October 1939, a Decree №11 "On the control of public pastures" was published, which stated that the organization engaged in the use of pastures, should be approved only by the decision of the State Administrative Yuan (Administrative department..., 1940). However, the key law should be the Law "On the control of trade", the Law

166 "On restriction of the export of livestock" and the Law "On control over material resources", and therefore they should be  
167 observed in greater detail.

168 These laws were the base of normative acts, which allowed Japan to build in Mengjiang a clear system, supplying  
169 almost uninterrupted Japanese war machine. Moreover, based on normative legal acts of the Mongolian government,  
170 Japan took in their hands the power of distribution of livestock products and in fact deprived the local population from the  
171 opportunity to use it for their own purposes, for the development of their country. After the founding of the United  
172 Autonomous government of Mengjiang, in October 10, 1939, a Law No. 3 "On the control of trade" was passed (Main  
173 administration..., 1941).

174 Article 1 of the Law stated:

- 175 1. The government is the guarantor of the value of material resources, but also regulates rates, supply and  
176 demand. To stabilize international payments, when it is considered necessary, it is possible according to the  
177 law, to restrict or prohibit the export and import of goods, or to promote their exports and imports.
- 178 2. In order to ensure the availability of necessary resources, to regulate the price of goods in accordance with  
179 international payments laws can be issued, on the basis of which the list of goods to restriction, prohibition to  
180 export or to stimulate their import and export is determined.
- 181 3. The government, as necessary, takes measures to limit, prohibit or encourage the export and import of goods,  
182 establishes a system of monitoring the activities of persons engaged in the importation and exportation of  
183 goods.
- 184 4. At the government's request, the responsible officials have the right to examine financial documents (Sun,  
185 Cunye, 2011).

186 Through this law, the government of Mengjiang had the right to determine the list of goods subject to export  
187 restrictions and import, to determine the list of participants of export-import operations, as well as procedures for  
188 monitoring and verification of transactions and operations undertaken by the participants of export-import operations.

189 At the end of 1939 there were new penalty: for violation of the Law "On the control of trade", or for violation of  
190 government orders could be imposed ban on economic activities, a fine of 1,000 yuan or conviction to imprisonment.

191 On August 26, 1940 in the Law "On the control of trade" was included a number of amendments. One of them said:  
192 "in order to ensure the availability of necessary resources, to regulate the price of goods in accordance with international  
193 payments, the directives of the Ministry of Finance were publishing, on the basis of which the list of goods subject to  
194 restriction, prohibition to export or Vice versa, to stimulate export was determined ". Thus, in the text of the law the word  
195 "decrees" was replaced by "Directive of the Ministry of Finance. The main reason for the editing of the law was that the  
196 law Manzana decree had much greater legal force than the Directive of the Ministry. Thus, in the text of the law the word  
197 "decrees" was replaced by "Directive of the Ministry of Finance". The main reason for the editing of the law was that in the  
198 law system of Mengjiang decree had much greater legal force than the Directive of the Ministry. In addition, the adoption  
199 of the decrees was a more complicated procedure that was not in the arm of the Japanese side, which was required  
200 quickly and timely to impose restrictions on the export of a particular type of goods. The second amendment was made in  
201 article 3 and in the original version sounded like "When carrying out control and the emergence of the need for the  
202 government of the relevant information, at the request of the responsible government officials can inspect financial and  
203 other documents". After the amendment the text was read as follows: "When carrying out control and the emergence of  
204 the need for the government of the relevant information, at the request of the responsible government officials may  
205 inspect the goods at the place of stay, as well as verification of financial and other documents" (Sun, Cunye, 2011). This  
206 amendment expanded the powers of the government in the field of inspection of the goods at any place and at any time,  
207 not limited to the verification of documents.

208 On 10 October 1939, based on the Law "On restriction of the export of cattle" the Law №4 "On the restriction of the  
209 export of livestock, which measures to control this sector of the economy found their specific legal consolidation and  
210 implementation was adopted. The Supervisory authority was changing. Instead of the Ministry of livestock for licensing for  
211 licensing was responsible the Management of livestock.

212 The law also stated: "...Persons engaged in export of horses, sheep, goats, camels, cows, mules, donkeys and  
213 pigs outside of Mengjiang must make written application for a permit export of cattle, which necessarily specify: type of  
214 livestock, the quantity, price and age, grazing, place and way of purchasing livestock, the place of export and the method  
215 of transportation, route, and other information. After that statement his resolution was putting the head of livestock. The  
216 severity of the punishment for breaking the law was changed, now the offender faced up to one year of prison work and a  
217 fine of 500 yuan (Sun, Cunye, 2011).

218 After approval, the applicant had obtained an export license, which he gave to the nearest bodies of the economic  
219 control of any employee of the Department of livestock of the respective aimak, after that when transporting cattle by rail

220 to the supporting documents it was needed to show a license.

221 On January 22 and may 6, 1940, the Law has been changed: it included items about the restriction of export  
222 asses, mules and pigs. On September 17, 1940, the new amendments significantly increased the punishment. In the new  
223 edition of the law the offender was subjected to prison labor for up to three years and fined 5 thousand yuan, and  
224 livestock violator of the law or of the person infringing the violation of the law, was the subject of forfeiture. If livestock fully  
225 or partially could not be confiscated, the violator has paid a penalty in the amount of livestock (Sun, Cunye, 2011). Thus,  
226 the control over the export of cattle became even tougher.

227 In order to control the production, movement and consumption of goods and other material resources, on October  
228 20, 1939, the Law №8 "On the control of goods" was adopted. It contained the following key statements:

- 229 1. In order to ensure the normal functioning of the state economy, the government considers it necessary to  
230 issue this law, which determines the production, recovery and distribution, as well as the use, consumption,  
231 and other goods movement.
- 232 2. In order to ensure the normal functioning of the state economy, the government considers it necessary that the  
233 cost, transportation costs, costs of insurance, the cost of renting and the cost of treatment was calculated on  
234 the basis of this law;
- 235 3. In order to ensure the normal functioning of the state economy, the government considers it necessary to  
236 create a special organization, which will operate in various sectors of the economy;
- 237 4. Before the establishment of organisations the government deems it necessary to create a legal basis for the  
238 activities of these organizations;
- 239 5. The government will select the data organization on the basis of material requirement and based on the  
240 provisions of this law;
- 241 6. The government has the right to establish, modify, or cancel the provisions of the regulations of the work of  
242 these organizations;
- 243 7. Any establishing, modifying of these provisions or decrees relating to these organizations, should be  
244 determined by the regulations of the organization;
- 245 8. During the execution of the laws on the control of goods and other material resources, the government  
246 receives reports on the work of the organizations, as well as the results of verification of financial documents;
- 247 9. At necessity of using restrictions by relevant departments in relation to the principal economic activities it's  
248 realization by this participant may be prohibited or suspended (Sun, Cunye 2011).

249 These provisions of the act clearly shows that the government of Mengjiang received a wide range of powers that  
250 allowed him to fully control the production and movement of goods into the territory of the country, failed to apply different  
251 measures of administrative regulation, including price fixing, the determination of the list of organizations involved in  
252 economic activities, to interfere in the work of participants of economic activities, monitor their work.

253 On November 20, 1939, in accordance with paragraph 2 of the Law "On the control of goods", the Law "On control  
254 over pricing" (Fudo, Wecan, 1943) and "Regulations restricting the price of repurchase of goods" were published. Group  
255 of officials, who were responsible for the verification of accounting records and related issues were determined.

256 On 14 June 1940, a Decision by the Ministry of civil Affairs No. 10 "Administrative and legal provisions for public  
257 granaries" was taken (Fudo Wecan..., 1941). In case of hunger and care for the poor citizens of the existing urban grain,  
258 the city granaries, county granaries, granary district, township granaries equally rename in public. Measures were taken  
259 to forcing people to stock up on food. Representatives of the Ministry of civil affairs had to collect a certain amount of food  
260 in the cities and counties, governors and district chiefs were responsible for collecting the population in the proper amount  
261 of food for the public store; if it was needed for collecting taxes in cash. Essentially, it was a form of gathering of food  
262 from the population in favor of military needs.

263 On December 1, 1940, the government of Mengjiang published a special act for the control of food - the Law "On  
264 the control of food" (Fudo Yuecan..., 1944) which regulated the control of grain. The resolving system was applied equally  
265 to each link of the food - buying, transport, transfer, trade, and price of food, processing, and costs associated with food.  
266 The farmer, besides the officially designated by the government purchaser, could not pass it to another person or to  
267 implement the food himself. Bought from the hands of the peasant food should refer to the designated person entitled to  
268 the export of the crop.

269 Food prices are set by the Ministry of economy. The manager of the processing and retail sale of food also had to  
270 get permission from the Ministry of economy.

271  
272  
273

## 5. Conclusion

After the start of the Pacific war, military spending in Japan have risen in multiply, and it advanced for the government of Mengjiang 3 new principles relating to the production: "the foodstuffs is ammunition, wool is gunpowder, people are a military force." The Japanese have increased even more control over the economy of Mengjiang. In order to meet the needs it was necessary to completely organize material resources, financial capacity and strengthen management. In order to satisfy their needs the control system of trade was again rebuilt and strengthened, it lasted until August 1945, when after the defeat of Japan Mengjiang was eliminated.

Thus, based on the adopted laws, Japan has created a system that allows for accurate and smooth control over such economic sectors as trade, production, movement and sale of goods and other material resources, pricing and food management. Each locality has performed a specific rate for the collection of food, which was passed to one appointed local exporter. The effectiveness of these measures has shown a sharp increase in financial and resource revenues, which went on military support of Japan. The creation of a single economic system, controlled by the occupying forces and unification of legislation actively contributed to this. In addition to well-coordinated work of all elements of the economy, a significant contribution was made by constantly adjusted legislation, which under the threat of serious punishment provided clear work of all the participants of this process.

Thus, the economic power of the region was not for the benefit of the population and development of the Mongolian state, it supplied the Japanese military system. Through effective economic policy Japan maintained its dominance and influence in the Mongolian lands, putting as its main purpose not the development of the state, but the receipt of a resource required to maintain the combat readiness and capability, which, in its turn, brought many disasters and suffering to the local population, increased in the given period of time to a state of extreme poverty.

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# The Transformation of Special Provincial Administration System in Turkey

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## Abstract

The Law No. 6360 on 'The Establishment of Fourteen Metropolitan Municipalities and Twenty-seven Districts and Amendments at Certain Law and Decree Laws' brings significant changes in Turkey's local government system. In this framework, the first objective of the article is examining the change and transformation of the Special Provincial Administrations (SPAs) at the historical perspective until the Law No. 6360 in Turkey. The second objective of the article is examining the new arrangements of Law No. 6360 in detail that entered into force in 2012 within the context of SPA. In that context, one of the new arrangements of that reference Law is the establishment of Investment, Monitoring and Coordination Directorates' (IMCDs) instead of the abolished SPAs at the provinces having metropolitan municipalities. At that scope, the IMCDs emergence, duties, powers and responsibilities are searched in detail in comparison with the SPAs in Turkey. Finally, it is seen that IMCDs and SPAs have lots of differences in terms of supervision authority, duties and responsibilities, financial, personnel and organizational structure.

**Keywords:** Special Provincial Administration, Law No. 6360, Investment, Monitoring and Coordination Directorate

## 1. Introduction

By the Law No. 6360 on 'The Establishment of Fourteen Metropolitan Municipalities and Twenty-seven Districts and Amendments At Certain Law and Decree Laws', the local government system<sup>1</sup> has undergone radical changes in Turkey in terms of administrative structure, distribution of the financial resources, at the provision of the local services and lastly, in the fields of development and planning schemes. In that context, the number of the metropolitan municipalities upgraded to 30, and SPAs were abrogated at those provinces having metropolitan municipalities and the villages turned to the neighborhoods and 27 new districts were established within the borders of the metropolitan municipalities by the Law No. 6360. One of the key features of that relevant Law was the abolition %36 of the SPAs, %53 of the municipalities and %47 of the villages in Turkey (Güler, 2012a:1). By the new Law, critical amendments were made at administrative structure (the removal of legal entities, the establishment of new corporate entities, the amendment at administrative commitment, the changes at borders and division of powers), financial system (redetermination of the shares of local governments and new distributional relations), political geography (the change at the dimension of representation and participation with the change at election zones), personnel structure, the provision of services/ service delivery ( the expansion of the service area with the expansion of the municipal borders to provincial borders) and development and planning order (Izci and Turan, 2013: 119). As it is seen from the clarifications, it is clear that the Law No. 6360 will lead to significant changes at the local government system in Turkey with its new arrangements. Within the framework of the article, that reference Law has been searched in detail in terms of its effect on SPAs administrative system in Turkey. In this study, the SPAs, one of the oldest local government unit of Turkish local administrative system, and Investment, Monitoring and Coordination Directorates (IMCDs) that are established instead of the SPAs at the provinces having metropolitan municipalities that are depended to the Governorate are selected for detailed examination. Furthermore, at

<sup>1</sup> There are four types of local government, including metropolitan municipal administrations in Turkey. Special provincial administration means a public entity having administrative and financial autonomy which is established to meet the common local needs of the people in the province and whose decision-making body is elected by voters; Municipality means a corporation established in the statute of public legal entity having powers of self-government (autonomous) both administratively and financially, to meet the local and common requirements of the county inhabitants and the decision maker of which is elected by the electors. Metropolitan municipalities means administratively and financially autonomous public legal entity of which decision making organs are elected by the voters and which comprises at least three district or first degree municipality; establishes coordination between the municipalities: undertakes the duties and responsibilities conferred upon by the laws: and uses its powers whenever deemed necessary, and the headman (mukhtar) and elected elders' council are governed the villages (Kapucu & Palabiyik, 2008: 137).

48 the study, a historical research design is used with starting from 'Regulation of Provinces' which was enacted in 1864 to  
49 the Law No. 6360 that was put into force in 2012, for examining the previous and current legal and administrative grounds  
50 of SPAs. Besides, by the historical research method, the reform efforts at the local government system in related with  
51 SPAs, the proposed solutions towards the problems of SPAs at the government reports and SPA Laws have been  
52 examined in detail up to the abrogation of public legal entities of SPAs at the provinces having metropolitan municipalities  
53 with the Law No. 6360 at Turkish administrative system.

54 Within the context of the article, the first objective is to put forth historical background to demonstrate the transition  
55 of SPAs' at Turkish administrative system. The examination of the historical perspective is significant for the study at  
56 indicating the previous and current problems of SPAs such as the insufficiency of organizational formation, service  
57 capacity, equipment and facilities, financial revenue, and human resource. The presence of SPAs and their necessity at  
58 the Turkish local government system started to be discussed since the 1960s, and those mentioned problems caused the  
59 discussion of the abrogation of SPAs at the local government system. Besides, the second objective of the study is  
60 related to the examination of the Law No. 6360 enacted in 2012 with its key provisions and aspects in relevant with the  
61 SPAs. That recent Law is noticeable for Turkey's local government system because it leads to the abolition of the SPAs  
62 in Turkey at the provinces having metropolitan municipalities. In that context, IMCDs' are established by the Law No.  
63 6360 instead of SPAs that their public legal entities removed in the provinces where metropolitan municipalities'  
64 established; however, there are significant differences between IMCD and SPA. Lastly, a comparison is tried to be made  
65 between the SPAs and the newly established IMCDs in Turkey with putting forth the main differences in terms of  
66 supervision authority, administrative tutelage, duties and responsibilities, finance, personnel structure and organizational  
67 formation.

## 68 2. Historical Background of Special Provincial Administrations in Turkey

69 SPAs are the local government units inherited from the Ottoman Empire. SPAs were established with the 'Regulation of  
70 Provinces' (*Vilayet Nizamnamesi*) in 1864 and those local government units had a local administrative formation inspired  
71 by the French administrative system during the Ottoman Empire period (Parlak & Sobacı, 2005: 79, Tortop *et al.*, 2014:  
72 165). One of the most striking aspects of 'Regulation of Provinces' was the provincial organization of the Ottoman Empire  
73 which was revised by that regulation and the provincial administrative system was set up to replace the existing states-  
74 *eyalet*- with new provincial-*vilayet*- system (Kapucu & Palabıyık, 2008: 138). By the 'Regulation of Provinces', a Provincial  
75 General Council (*Vilayet Umum Meclisi*) was established that composing from the councilors elected among local citizens  
76 under the leadership of the Governor. The duties and powers of Provincial General Council have been increased by the  
77 'General Administration of Provinces Law' dated 1870 (*İdare-i Umumiye-i Vilayet Nizamnamesi*) (Ortaylı, 1974: 79).

78 However, provinces peculiarity of being an autonomous decentralized administrative formation was firstly decided  
79 at the Constitution of 1876 (Kapucu & Palabıyık, 2008: 138). At the 11<sup>th</sup> section of the Kanun-u Esasi that consisting of 12  
80 parts; the principles and procedures of provinces were arranged between the items of 108-112. In that scope,  
81 deconcentration (*Tevsii mezuniyet*) and segregation of duties (*Tefriki vezail/ yetki genişliği/ görevler ayrılığı*) principles  
82 had been adopted at the provincial administration by the 108<sup>th</sup> item (Reyhan, 1982). Those principles which have been  
83 adopted in theoretical terms by the 'General Administration of Provinces Temporary Law' (*İdare-i Umumiye-i Vilayet*  
84 *Kanun-u Muvakkat*) in 26 March 1913 take the possibility to adjust at the application process (Kartal, 2010: 62).  
85 According to the General Administration of Provinces Temporary Law', the provinces are regulated not only as an  
86 extension of the central government but also as a local government unit having a public legal entity. As similar to the  
87 108<sup>th</sup> item of the 1876 Law of Kanun-u Esasi; it was determined that the provinces have been established as to the  
88 principles of deconcentration and segregation of duties (Kartal, 2010: 62).

89 By the 1921 Constitution (*Teşkilat-ı Esasiye Kanunu*), it was intended to give a new formation to the local  
90 administrative structure of SPAs. In this sense, the 1921 Constitution recognized autonomy to the local governments.  
91 That related Constitution had given special attention to the administration of the provinces and dedicated a special part  
92 towards the provinces (Nalbant, 1997: 167). According to that Constitution, provincial general council was called as  
93 'Provincial Council' (*Vilayet Şurası*) and councilors had been elected for two years by the citizens of the province and the  
94 councils meetings were convened twice a year. That related Constitution did not determine Governor as the head of the  
95 Provincial Council (*Vilayet Şurası*); whereas Governor had only the authority to intervene a dispute that may arise  
96 between the state's general affairs and local affairs. Within the framework of that Constitution, it is stipulated that  
97 Provincial Councils shall elect the chairman among the representatives of the provincial council, and this chairman will be  
98 the chief executive (Alpay, 1965: 27). On the contrary, by the 1924 Constitution, Turkish local government system again  
99 returned to the basis of deconcentration and segregation of powers (Ülkmen, 1960: 120-121). Furthermore, 1924 Turkish  
100

102 Constitution had a different context from the 1921 Constitution concerning the local governments, and that related  
103 Constitution revealed the basic principles that were founded by the 1876 Constitution. It is worth pointing out that 1921  
104 Constitution adopted the separation of state's general affairs and province local affairs; however, the term of province  
105 local affairs was not used in the 1924 Constitution and only the term of province affairs was expressed within the context  
106 of that Constitution. That related amendment is the indication of the adoption of a centralist tendency at the administration  
107 system (Nalbant, 1997: 171). Likewise, there was no provision in relevant with the provincial administration and local  
108 governments at the 1924 Constitution but there were expressions concerning SPAs and municipalities at the 85<sup>th</sup> Article  
109 of the Constitution (Güneş, 2013: 61). In that regard, within the years of 1920s and 1930s, many tasks of the SPAs were  
110 transferred to different administrative units (ministries and municipalities) at various laws enacted at that related period  
111 (Ateş & Es, 2008: 205-210). In that context, Kapucu and Palabıyık (2008: 138) clarified those words in relevant with that  
112 related period;

113 SPAs carried out important duties in the first years of Republic. However, many tasks belonging to these units  
114 were later undertaken by various ministries and central administrative organizations as the relevant organizational laws  
115 appeared on the statute books.

116 By the 'Provincial Administration Law' No. 1426 that was put into force in 1929, the first part of 1913 dated Law  
117 was abrogated in relevant with the provincial administration. By that reference Law, two administrative units at the  
118 provincial level-Governorate and SPA- separated at the legal dimension. By the 'Law on Provincial Administration' No.  
119 5442 that was put into force in 1949, the Law No. 1426 was subject to revision in terms of Turkish language<sup>2</sup>. In that  
120 context, Güler (2006: 219) puts forwards the view on the historical perspective in relevant with the provincial special  
121 administrations as follows;

122 SPAs have a more important place than the municipalities at the local government system in the period of 1930-  
123 1945. However, at the period of 1946-1960, the significant tasks of the SPAs were transferred to the central government.  
124 Therefore, the municipalities came to the front side instead of the SPAs.

125 Following that period, by the enactment of the 1961 Constitution; the local governments are formulated in the  
126 Article of the 116<sup>th</sup> as follows:

127 Local administrative bodies are public corporate entities created to meet the common local needs of the citizens of  
128 provinces, municipal districts, villages, whose policy-making organs are elected by the people. The elections of the local  
129 administrative bodies shall be held at such times as prescribed by law and subject to the provisions of Article 55 of this  
130 Constitution<sup>3</sup>.

131 In this regard, some of the tasks of the SPAs in time transferred to the regional directorate that incorporating more  
132 than one province. Thus, the SPAs turned to the local government units that cannot fulfill their responsibilities and  
133 launched to encounter with the problems of the insufficiency of organizational formation, service capacity, financial and  
134 human resource (Kaya, 2011: 30).

135 It is also noticeable that the presence of SPAs and their necessity within the Turkish administrative system have  
136 been started to be discussed since the 1960s. At that point, there was an ample support for the claim that SPAs lost its  
137 efficiency in the local government system and it should be abrogated at the local government system in Turkey (Keleş  
138 & Yavuz: 78; Güran, 1986: 74). The people who have the opinion of the abrogation of the SPAs have those justifications  
139 concerning the problems of SPAs which can be listed as follows (Keleş, 2006: 80; DPT, 1991: 125-126; Keleş & Yavuz,  
140 1983: 78-80):

- 142 • Many of the duties of SPAs that are not explicit, in time are undertaken by the central government  
143 organizations; however those related tasks are not removed from the responsibility area of the SPA.  
144 Therefore, SPAs have almost any responsibility and authorized service fields at the provision of the local  
145 services.
- 146 • The financial revenue, staff, equipment and facilities' of the SPAs are inadequate to fulfill their local tasks.
- 147 • The principles of democratization, autonomy, subsidiarity, and public participation are not settled at the local  
148 administrative system of SPAs that are required for being a local government unit.
- 149 • SPAs could not be an original local government unit; that local government unit is transformed into a structure  
150 that carrying the features of central government. SPAs are mostly remained under the influence of the central  
151 government. Therefore, a large proportion of the people in Turkey do not know that related local government

<sup>2</sup> By the Law No. 3360 that was put into force on 16 May 1987, which was issued with 19471 numbered Official Gazette, 1913 dated Law's name changed as 'SPA Law'.

<sup>3</sup> For details, see, <http://www.anayasa.gen.tr/1961constitution-text.pdf>, 'Constitution of Turkish Republic'.

152 or see it as a central government unit. Hence, the local services that are undertaken by the SPAs, perceived  
153 as central government oriented services (Kartal, 2010: 113).

154 In addition to that, there have been also dissenters to the abrogation of SPAs (Başsoy, 1976: 70-71, Güler, 1995:  
155 11, Gözübüyük, 1967: 100). The opponents demonstrate the most important reason for not abrogating the SPAs in  
156 Turkey at their being of constitutional institutions. Besides, another justification at that point is pertinent with financial  
157 resource and technical possibilities; that justification rests on the assumption that if the adequate financial resource and  
158 other possibilities have been given to the SPAs, those local governments can fulfill their assigned services; they also  
159 proved that related case in the past. In particular, another relevant aspect at that point is pertinent with the entailment of a  
160 more functional and strong SPAs at the rural field in the lacking of a management gap. In this scope, when SPAs are  
161 abrogated, there would be no administrative unit to provide services to the rural field and at that related field  
162 administrative and service unit weakness shall be occurred (Kartal, 2010: 114).

163 One of the other prominent features of the 1960s was relevant to the reform process, as well as the public  
164 administration, reform efforts at local governments started to be accelerated at the planned period in Turkey. The first and  
165 the most comprehensive restructuring study of the planned period was the MEHTAP (*Merkezi İdare Teşkilatı Araştırma*  
166 *Projesi* Central Government Organization Research Project) that was prepared by TODAİE<sup>4</sup>. In this research, central  
167 government and central government organization's provincial units, the distribution of responsibilities between local  
168 governments, powers of local governments, resources and organization issues represented an important area of  
169 investigation. At the result of this research, it was determined that those issues listed above should be examined and  
170 discussed one by one. Besides, it was also emphasized that the structural problems of the local governments and their  
171 relation with central government should be examined separately (Urhan, 2008: 70). Moreover, by the target of  
172 restructuring and developing local governments, "Ministry of Interior Restructuring of Service and Organization Project  
173 which was also called as 'Internal Regulation Project', in the years 1967-1971, was formed by the Ministry of Interior. In  
174 this scope, 'Internal Regulation Project' was the first research on Turkish Public Administration by a Ministry. At this  
175 Report, SPAs tasks evaluated one by one and later, it was expressed that many of those tasks have been fulfilled by  
176 central government (Şeyran, 1996: 52). By the 1971 onwards, the restructuring of administration issue came up again to  
177 the political agenda and a committee with the name of 'Administrative Reform Advisory Committee' established by the  
178 government for the determination of precautions on administrative system. That related Committee's works were  
179 presented to the public with the report titled 'Administrative Reform Advisory Committee Report: Restructuring of  
180 Administration Principles and Recommendations' in 1972<sup>5</sup>. At that report those following proposals have been expressed  
181 such as; to strengthen the local autonomy of local governments, to reduce the authorities of the public administrations  
182 that use the administrative tutelage and to make cooperation between them, to pay attention in gathering the authority at  
183 the sub-governor in the district level (Ökmen, 2003: 124). In accordance with the prepared Report, a determination was  
184 made concerning the SPAs as follows: the existing structure is away from the good-functioning of a healthy service  
185 provision and this case led to the disruption at the performing of education, health, and agriculture services especially in  
186 rural fields (Kaya, 2011: 30).

187 Furthermore, at the last period of the 1970s, the Ministry of Local Government was established in 1978 to resolve  
188 the administrative and financial bottlenecks of local governments and to make the arrangements for the effectiveness of  
189 the local governments in Turkey. At that point, it is noticeable that while that Ministry's name is called as the Ministry of  
190 Local Government, that related Ministry served as a Ministry of Municipalities and it did not contribute to the SPAs local  
191 administrative system. At last, that related Ministry was abrogated in November 1979 (Keleş, 2000: 369).

192 Besides, in Turkey, by the 1980s onwards, the existence of SPAs has been adopted by also the Constitution and  
193 that local government unit was determined as a public institution having public legal entity. At the 1982 Constitution at the  
194 Article 127<sup>th</sup>, it was determined that:

195 Local administrations are public corporate bodies established to meet the common local needs of the inhabitants of  
196 provinces, municipal districts and villages, whose principles of constitution and decision-making organs elected by the  
197 electorate are determined by law. The formation, duties and powers of the local administrations shall be regulated by law  
198 in accordance with the principle of local administration<sup>6</sup>.

199 In addition to that, by the 3360 Numbered Law, dated 26 May 1987, 'Provincial Administration Law' No. 1426 dated  
200 1929 name has been changed to 'SPA Law'. In this context, while the Law No. 3360 brought new provisions to the SPAs

<sup>4</sup> For Details, see, MEHTAP Projesi, [www.todaie.gov.tr](http://www.todaie.gov.tr) (10.11.2014).

<sup>5</sup> For Details, see, Talat Bayraktar, "Türkiye'de İdareyi Geliştirme Çalışmalarının Tarihsel Gelişimi", <http://www.igb.gov.tr/Forms/p/GecmisDonemCalismalari.aspx> (10.01.2015).

<sup>6</sup> For details, see, [http://global.tbmm.gov.tr/docs/constitution\\_en.pdf](http://global.tbmm.gov.tr/docs/constitution_en.pdf), 'Constitution of the Republic of Turkey'.

and made some amendments in some articles, it did not touch on most of the provisions of 'Provincial Administration Law' No. 1426 (Keleş, 1994: 113). By the Law No. 3360, significant responsibilities have been given to the SPAs such as education, health, agriculture, and animal husbandry. On the contrary, those listed services have been undertaken by the central government that it led to authority conflict between central and local governments, and those local government units turned to dysfunctional and ineffective institutions (Ulusoy & Akdemir, 2008: 159; TOBB, 1996: 114). Furthermore, SPAs also faced with the problem of the staff in terms of its decreasing number and quality owing to the fact that the negligence of the central government (Tortop, 2006: 130).

On the other hand, by the 1990s onwards, a new approach that perceived a new distribution of power between the local and central government was observed in the prepared draft laws, development plans, and at KAYA (Public Administration Research Project) Report. However, the local government reform planning to be made within the framework of that new responsibility and power distribution would result in the restructuring of social relation and this kind of manner entails not only a strong common will and but also an effective and decisive political will that this new understanding could not find the possibility of realization (Güler, 2001: 7).

In addition to that, Turkey was introduced with 'Public Administration Basic Draft Law', and Turkey quickly and deeply felt the results of that draft Law that composed of 73 items by the 2000s onwards (Güler, 2005: 161). In this scope, 58<sup>th</sup> Government perceived a new responsibility and authority distribution between central and local governments with that related Law draft. In that context, most of the duties and responsibilities that have been carried out by the central government are declared to be transferred to the SPAs as a necessity (Coşkun & Uzun, 2005: 157). In this regard, 'Basic Law of Public Administration' that has been presented to the Grand National Assembly on 15 July 2004 was enacted by the Law No. 5227 on 'Basic Principles of Public Administration and Its Restructuring'. In that context, the Law No. 5227 dated 3 August 2004 was returned by the 10<sup>th</sup> President of Ahmet Necdet Sezer with finding most of the items of the Law unconstitutional and it was returned to the Grand National Assembly for reconsideration and it could not find the possibility of legalization (Kaya, 2011: 31). In that scope, while the Law text was not adopted that formed the legal framework of the reform of public administration, the Law of Public Finance Management, Metropolitan Municipality Law and Special Provincial Law that complement the reform process entered into force by one by one in Turkey (Kapucu & Palabıyık, 2008: 195).

In that context, the process of restructuring of public administration that was launched in 2003 in Turkey resulted in the SPA Law within the framework of searching solutions to the problems of SPAs (Parlak & Ökmen, 2008: 135). Afterward, the reform expectations and suggestions have continued to increase in the local government field. Until the SPA Law No. 5302, many draft laws and drafts have been prepared by the governments coming to the power, but those reform-making efforts could not find the chance of realization (Kartal, 2010: 89). Finally, the SPA Law No. 5302 discussed at the Grand National Assembly on 22 February 2005 and entered into force with the published Official Gazette dated 4 March 2005 (Tortop *et al.*, 2014: 165-166). Within the framework of the article, the most significant issue concerning SPAs is its abrogation of the public legal entity at the provinces having metropolitan municipality by the Law No. 6360 that was enacted in 2012. Within the scope of the Law No 6360, 'Investment, Monitoring and Coordination Directorates' have been established instead of the SPAs in the provinces having metropolitan municipality.

### **3. The Law No. 6360 on 'The Establishment of Fourteen Metropolitan Municipalities and Twenty-Seven Districts and Amendments at Certain Law and Decree Laws'**

The Municipal Law No. 6360 on 'The Establishment of Fourteen Metropolitan Municipalities and Twenty-seven Districts and Amendments at Certain Law and Decree Laws' entered into force with the published Official Gazette dated 06.12.2012 and numbered 28489. By that Law, the metropolitan municipality numbers upgraded from 16 to 30, and all metropolitan municipality borders were expanded to the provincial borders up to the end of the mentioned year (Zengin, 2013: 543).

In this regard, the new metropolitan system leads to structural changes in terms of administrative, financial, zoning, and planning order. By the new Law, critical amendments were made at administrative structure (the removal of public legal personalities, the establishment of new public legal personalities, the amendment at administrative commitment, the changes at borders and division of powers), financial system (redetermination of the shares of local governments and new distributional relations), political geography (the change in the dimension of representation and participation with the change at election zones), personnel structure, the provision of services/ service delivery (the expansion of the service area with the expansion of the municipal borders to provincial borders) and development and planning order (Izci & Turan, 2013: 119).

The Law No. 6360 that came into force after 30 March 2014 General Elections for Local Governments put forth

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those following issues listed below;

- SPAs' were removed from the cities where metropolitan municipalities were established and IMCDs were established instead of the closed SPAs at 30 provinces.
- Metropolitan municipality borders were expanded to provincial borders.
- 14 new metropolitan municipality were established.
- The villages turned to neighborhood at the cities where metropolitan municipalities were established, and 500 population criterion was introduced at the establishment of neighborhood within the borders of municipalities<sup>7</sup>.
- 25 new districts established within the borders of the metropolitan municipalities.
- Local government unions were abolished in the cities where metropolitan municipalities were established.
- The shares transferred to the municipalities from the general budget tax revenue were rearranged (Genç, 2014: 4-5).

As it is seen from the above clarifications, the SPAs were abrogated at thirty provinces having metropolitan municipalities by the Law No. 6360 in Turkey. At that reference Law, it was expressed that all types of movable and immovable property, rights, receivable, and debts of SPAs by a commission to be formed shall be shared among the public institutions (Temporary Item 1/5). Additionally, the provisions concerning IMCD are stipulated in the Article 34<sup>th</sup> of Law No. 6360 to fulfill the administrative gap that is stemmed from the abrogation of the SPAs. In that scope, by the Law No. 6447 dated 14.03.2013, SPAs were abrogated at 14 provinces that were turned into metropolitan municipality status and other 16 provinces having metropolitan municipality status, and IMCDs set up that are tied to Governorates at those related provinces. The target of the IMCD is determined at the Article 34<sup>th</sup> of the Law No. 6360 as follows;

To increase the effectiveness and efficiency of the services concerning the central government affairs carrying at the local level, to ensure the financial resources in an efficient way, to carry out disaster and emergency services, to prevent the disruption of services, to fill the gap in relevant with supervision and guide to it<sup>8</sup>.

It is possible to clarify that IMCDs take over the duties of SPAs aside from the sending of the report to the Prime Minister and the affiliated or related Ministry of those institutions (Zengin, 2014: 102-103). Likewise, Güler (2012b: 104) also clarified that when the listed tasks, powers, and responsibilities have been examined at the Law No. 6360, it can be stated that the newly established administrative unit is the 'alternative province general administration' enabling the provincial general administration. Additionally, at the Ministry of Interior Directive, at the Article 7<sup>th</sup> /1-a, it is expressed that the Ministries and other central government agencies with the provision of the transferring resources can make any investment, construction, and maintenance, and repair affairs through this Directorate (Güngör, 2012: 28). As it is seen from those clarifications, as contrary to the decentralization approach, SPAs were closed at 30 metropolitan municipality and Investment, Monitoring, and Coordination Directorates tied to the Governorships.

#### 4. The Main Differences between SPAs and IMCDs

##### 4.1 Within the Scope of Supervision Authority and Administrative Tutelage:

In Turkey, local governments have public legal entity and they are established to meet the common local needs of the inhabitants of provinces, municipal districts and villages, whose principles of constitution and decision-making organs elected by the electorate are determined by law. The principle of decentralization applies to them, and they are autonomous from the central government in terms financial and administrative autonomy that does not involve an unlimited freedom<sup>9</sup>. In that framework, at the Turkish Constitution dated 1982, at the Article 127<sup>th</sup>, local administrations have been stipulated with those expressions as follows:

Local administrations are public corporate bodies established to meet the common local needs of the inhabitants of provinces, municipal districts and villages, whose principles of constitution and decision-making organs elected by the electorate are determined by law. The formation, duties and powers of the local administrations shall be regulated by law in accordance with the principle of local administration. The central administration has the power of administrative tutelage over the local administrations in the framework of principles and procedures set forth by law with the objective of ensuring the functioning of local services in conformity with the principle of the integrity of the administration, securing

<sup>7</sup> For detail, see, Article 15 of Law No. 6360.

<sup>8</sup> For details, see, <http://www.tbmm.gov.tr/kanunlar/k6360.html>, 'On Üç İlde Büyükşehir Belediyesi ve Yirmi altı İlçe Kurulması ile Bazı Kanun ve Kanun Hükmünde Kararnamelerde Değişiklik Yapılmasına Dair Kanun'.

<sup>9</sup> For Details, see, <http://www.migm.gov.tr/en/PDF/GeneralInformation.pdf>, 'Local Governments in Turkey', pp.10-19.p.15.

303 uniform public service, safeguarding the public interest and meeting local needs properly<sup>10</sup>.

304 As it was seen from the Article, the central government has the power of administrative tutelage over the local  
305 governments in the framework of principles and procedures set forth by law. In that regard, the new local government  
306 laws that are regulating the central and local government relations have the objective to constraint the central  
307 government's administrative tutelage over local governments<sup>11</sup>. In Turkey, administrative and financial decentralization  
308 supported with the major Laws such as Public Financial Management and Control Law No. 5018, Metropolitan  
309 Municipality Law No. 5216, SPA Law No. 5302, Law of Unions of Local Governments. In this sense, the general objective  
310 of those Laws focused on reducing the administrative tutelage on local governments, and expanding the local autonomy  
311 of local governments. At that point, it is noticeable that local autonomy is a tool at the realization of effectiveness and  
312 efficiency at the local services that the whole reforms and local regulations intended to provide the effectiveness and  
313 efficiency are consistent with autonomy (Pirler *et al.*, 1995: 32). The autonomy in terms of local government means the  
314 provision of the significant proportion of public services that are determined by the Constitution and the Laws under the  
315 responsibility of the local governments for the benefit of the local citizens<sup>12</sup>. In that context, the most important issue  
316 concerning the autonomy of the local administrations is pertinent with the using of right of management by the decision-  
317 making organs composed of elected representatives (Arıkboğa, 2007: 56). According to Bilgiç (2007: 12), the  
318 administrative tutelage at the SPAs was eased by the SPA Law No. 5302. Besides, the budget of the SPAs has been  
319 approved with the opinion of Provincial Executive Committee, and the procedure of the approval of the budget of the  
320 SPAs to the Ministry of Interior application was removed with that related Law. This case is a striking development in  
321 terms of the autonomy of the SPAs and the alleviation of the administrative tutelage on those local government units  
322 (Sobacı, 2005: 48). In the light of those clarifications, by that reference Law, at the finalization of the Council resolutions  
323 and their application process, the governor and the central government will are not the only determiner; the examination  
324 to be conducted on council decisions degraded to only the legal audit (Günday, 2005: 166). Moreover, the provincial  
325 general council launched to be convened at each month instead of twice a year that this procedure is a positive  
326 development in terms of accountability and transparency of the local administration (Kızılboğa & Özasan, 2013: 13). That  
327 related provision can be seen at the Article 12<sup>th</sup> of the SPA Law No 5302; the general provincial council meetings have  
328 been determined in detail;

329 The general provincial council shall meet in its usual venue in the first week of every month, excluding the one-  
330 month vacation to be determined by the general provincial council, on the date determined in advance by the general  
331 provincial council<sup>13</sup>.

332 However, while on the one hand positive steps have been taken in the development of the local autonomy, on the  
333 other side the local government's relation with the local community have been negatively affected by the abolition of the  
334 decision-making organ of the general provincial councils of SPAs with the Law No. 6360 (Arıkboğa, 2007: 45). By the  
335 abolition of the legal entities of SPAs, first-tier municipalities and villages; provincial general directorates, municipal  
336 councils, and village elderly councils' decision-making organs are also closed. Thus, the citizens' participation in the  
337 decision-making mechanisms would be decreased to a certain extent (Adıgüzel, 2012: 172).

338 In that context, IMCDs' are established by the Law No. 6360 instead of SPAs that their public legal entities  
339 removed in the provinces where metropolitan municipalities established; however, there are significant differences  
340 between IMCD and SPA. First of all, one of the most prominent differences is focused on their administrative formations;  
341 SPAs are local government institutions, whereas IMCDs' have been stipulated as a local unit of the central government at  
342 the Metropolitan Municipality Law No. 6360. Furthermore, the internal and external supervision has been perceived for  
343 SPAs with the Law No. 5018, however, internal supervision has not been foreseen for IMCD (Karaaslan *et al.*, 2012:  
344 126). At the Law No. 5302 of SPA under the title of scope and types of supervision at the Article 38; it was determined  
345 that;

346 Special provincial administrations shall be subject to internal and external supervision. Supervision shall cover the  
347 legal compliance of acts, and financial and performance auditing. Internal and external supervision shall be conducted in  
348 accordance with the provisions of the Law No. 5018 on Public Fiscal Administration and Control. Furthermore, the  
349 administrative acts of the SPA other than the financial transactions shall also be audited by the Ministry of Interior, by the  
350 governor or by the staff members to be assigned duty by the governor, in terms of compliance with the integrity of

<sup>10</sup> For details, see, [http://global.tbmm.gov.tr/docs/constitution\\_en.pdf](http://global.tbmm.gov.tr/docs/constitution_en.pdf), 'Constitution of the Republic of Turkey'.

<sup>11</sup> For Details, see, <http://www.migm.gov.tr/en/PDF/GeneralInformation.pdf>, 'Local Governments in Turkey', pp.10-19.p.15.

<sup>12</sup> For Details, see, <http://www.anayasa.gov.tr/eskisite/KARARLAR/IPTALITIRAZ/K1988/K1988-23.htm>.

<sup>13</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.



administration as well as with the development plan and strategies. Affiliated entities and enterprises of the special provincial administrations shall be audited in accordance with the principles mentioned above. The outcome of audits shall be made public, and communicated to the general provincial council<sup>14</sup>.

At the Law No. 6360, there are no provisions concerning the supervision of IMCD. Moreover, General Provincial Council of SPA has the authority to supervise the SPA that can be seen on the Article 17<sup>th</sup> of the Law No 5302. At the Article 17; it was determined that;

The general provincial council shall, at each January meeting, form by balloting an audit commission of three to five persons from among its own members to audit the revenues and expenditures and related accounting records and transactions of the SPA for the previous year. The commission shall be formed according to the ratio of the number of members of each political party group and the number of independent members in the general provincial council to the total number of members of the council<sup>15</sup>.

In that scope, at the Law No. 5302, under the title of Council's means to obtain information and exercise supervision, the activities of the SPAs can be monitored by the local representatives that were expressed in the Article 18, as follows;

The general provincial council shall exercise its powers to obtain information and supervise through questions, general debates and its assessment of the activity report. In the March meeting, the governor shall present the activity report of the previous year to the council. If a majority of three-quarters of the full membership of the council considers that the explanations given in the activity report are unsatisfactory, the resolution on the report's being unsatisfactory and the record of the debates shall be communicated to the Ministry of Interior for action<sup>16</sup>.

In this regard, IMCD is a part of the central government that IMCD is not subject to supervision by a local council. Besides, SPAs have no authority in the supervision of the other public institutions and organizations. However, IMCD has the supervision power in the public institutions and organizations in the province via the Report which will be prepared by IMCD concerning the effectiveness and efficiency of the services and activities and the institutions compliance with the strategic plan and performance program of the all units at the local level excluding the judicial and military organization of central government (Karaaslan *et al.*, 2012: 125). In that framework, while at one side decentralization has been advocated by the local laws to improve the local autonomy fields of the local governments, from the other side with the establishment of the IMCDs with the Law No. 6360, the using of the administrative tutelage by the governor has been facilitated on local government units in Turkey.

#### 4.2 Within the Scope of Duties and Responsibilities:

At the Law No. 5302 of SPA in the Article 3<sup>th</sup> that was put into force on 22 February 2005; SPA is determined with those clarifications;

Special provincial administration means a public entity having administrative and financial autonomy which is established to meet the common local needs of the people in the province and whose decision-making body is elected by voters<sup>17</sup>.

It is apparent from the above determination that SPAs are the local government units established to carry out local services at their respective provinces beyond the boundaries of the municipal administration. In this sense, according to SPA Law No. 5302, Article 4, it is illuminated that "SPA shall be established by the law concerning the establishment of a province and its legal personality shall cease to exist when the province is abolished"<sup>18</sup>. Furthermore, the duties and responsibilities of the SPAs have been stipulated in the Law No. 5302 of SPA in the Article 6<sup>th</sup> as follows; Provided that such services be of local and common nature, the SPA shall be mandated and authorized to provide:

- a) Services that are related to youth and sports, health, agriculture, industry and trade; except for those metropolitan municipalities whose boundaries are the boundaries of the province, provincial environmental

<sup>14</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

<sup>15</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

<sup>16</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

<sup>17</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

<sup>18</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

395 plan, public works and settlement, conservation of soil, prevention of erosion, culture, arts, tourism, social  
396 services and aids, provision of micro credits to the poor, day care centres and orphanages; provision of land  
397 lots to primary and secondary education institutions, construction, maintenance, and repair work of the  
398 buildings, as well as services to respond to other needs within the boundaries of the province;  
399 b) Services that are related to land development planning and control, road, water, sewer, solid waste,  
400 environment, emergency aid and rescue; supporting the forest villages, forestation, establishment of parks and  
401 gardens outside the municipal boundaries. (Supplementary paragraph: 3/7/2005-5393/85 Art.; Amended  
402 second paragraph: 24/7/2008-5793/42 Art.) Ministries and other central government agencies may realize the  
403 investments relating to such services as construction, maintenance and repair works, state and provincial  
404 roads, potable water, irrigation water, sewer, power transmission lines, health, education, culture, tourism,  
405 environment, land development planning and control, public works, settlement, youth and sports, and other  
406 investments within the purview of ministries and other central government agencies by transferring the  
407 appropriations in their budgets earmarked for such services to the special provincial administrations<sup>19</sup>.

408 Furthermore, at the Law No. 6360 at the item 28/ A; the responsibilities and duties of IMCD at the provinces having  
409 metropolitan municipalities have been expressed as follows;

- 410 • Making the investment and the services of the public institutions in an effective way, its monitoring and  
411 coordination,
- 412 • Coordinating and functioning of emergency call, disaster, and emergency assistance services,
- 413 • The publicity of the city,
- 414 • Coordinating and making the investments of the central government in the locality when necessary,
- 415 • Performing the representation, ceremony; rewarding and protocol services,
- 416 • Providing the guidance to public authorities and institutions in the city and realizing their audit,
- 417 • Guiding the public institutions and organizations at the city and realizing their audit<sup>20</sup>.

418 In the light of those clarifications, it is apparent that one of the most prominent differences between SPAs and  
419 IMCDs sourced from their duties and powers that are expressed in their reference Laws and directives. In that regard, as  
420 it is seen from the above clarifications, SPAs' duties and powers have been determined in detail at the Law No. 5302 of  
421 SPA. IMCDs duties and powers have been counted in general, and the details are left to directives issued by the Ministry  
422 of Interior (Karaaslan *et al.*, 2012: 126).

423 In addition to that, at the Article 10<sup>th</sup> of the Law No. 6360, it was determined that 'The Ministry of Interior is  
424 authorized to remove the hesitations and to make the regulatory and the guidance process'<sup>21</sup>. By the provision of the Law  
425 No. 6360 that is described above, the task distribution between the central and local government is made, but that task  
426 distribution is left to the directives and regulation of the Ministry of Interior. At that point, one of the other striking  
427 differences lies in their legal functioning mechanisms. In this sense, SPAs are established by law and fulfill their duties  
428 and responsibilities under that law. At that point, the establishment of IMCD reached on its legal basis with the Law No.  
429 6360, but it was determined that any regulations related to IMCD are included in the Directive to be issued by the Ministry  
430 of Interior. At this context, at the comparison of the IMCD and SPA, it seen that the SPAs are the local government units  
431 having public legal entity, however IMCDs are the central government organization tied to Governor which are organized  
432 at the provincial level. In this scope, the SPAs are local government units that can prepare their regulation and budget,  
433 and they can employ staff with having a public legal personality; in contrast, the IMCDs have no public legal personality  
434 and they have no authority to make their directive and to prepare their budget.

#### 435 436 4.3 Within the Scope of Financial Structure:

437  
438 At the Law No. 5302, at the Article 45<sup>th</sup> under the title of the preparation and adoption of the budget, it was determined  
439 that:

440 The draft budget drawn up by the governor shall be submitted to the executive committee. The executive  
441 committee shall examine the budget and submit it to the general provincial council, together with its opinion, by the first

<sup>19</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

<sup>20</sup> For details, see, <http://www.tbmm.gov.tr/kanunlar/k6360.html>, 'On Üç İlde Büyükşehir Belediyesi ve Yirmi altı İlçe Kurulması ile Bazı Kanun ve Kanun Hükmünde Kararnamelerde Değişiklik Yapılmasına Dair Kanun'.

<sup>21</sup> For details, see, <http://www.tbmm.gov.tr/kanunlar/k6360.html>, 'On Üç İlde Büyükşehir Belediyesi ve Yirmi altı İlçe Kurulması ile Bazı Kanun ve Kanun Hükmünde Kararnamelerde Değişiklik Yapılmasına Dair Kanun'.

442 day of November. The general provincial council shall adopt the draft budget, unchanged or with amendments, before the  
443 beginning of the year. However, the council may not make amendments increasing expenditures and reducing revenues  
444 in such a manner as to impair budgetary balance<sup>22</sup>.

445 The approval of the budget of the SPAs to the Ministry of Interior application was removed by the Law No. 5302  
446 (Coşkun &Uzun, 2005: 171). According to that, the draft budget of the SPAs prepared by the Governor and adopted by  
447 the Provincial General Council in accordance with the opinion of the Provincial Executive Committee.

448 On the other hand, at the Law No. 6360 at the Article 34<sup>th</sup>, it is determined that adequate appropriation has been  
449 allocated to the Ministry of Interior for the realization of duties and responsibilities of IMCD. Besides, at the Article 34<sup>th</sup> of  
450 the Law No 6360; it was clarified that;

451 The Ministries and other central government institutions with the provision of the transition of the required financial  
452 resource, those related institutions can make any investment, construction, maintenance, and repair affairs through the  
453 IMCD. The financial resource transfer that will be made by the public institutions within the context of the general budget  
454 is realized with appropriation transfer and the financial resource transfer that will be made by the other public institutions  
455 is performed by accrual procedures<sup>23</sup>.

456 As it is seen from the above clarification, IMCD has gained the possibility of using the resources of the municipality.  
457 Within the framework of the decentralization concept, which is generally referred as the transfer of powers from central  
458 government to lower levels in a political-administrative and territorial hierarchy (Crook &Manor 1998, Agrawal &Ribot  
459 1999), it is seen that the central government is tried to be active in the whole administrative process at the evaluation of  
460 the financial formation of IMCD (Özer &Sipahi, 2003: 56).

#### 4.4 Within the Scope of Organization and Personnel Structure:

461 At the Law No. 5302, at the article 35<sup>th</sup> with the title organization of the SPA, it is determined that;

462 The organization of the SPA shall consist of the general secretariat, units of financial affairs, health, agriculture,  
463 land development planning and control, human resources and legal affairs. Such units shall be established as divisions  
464 and branches in provinces having a metropolitan municipality and as branches in other provinces<sup>24</sup>.

465 On the other hand, at the Law No. 6360, it was determined that IMCD shall consist of disaster assistance,  
466 emergency call, investment monitoring, guidance and supervision, strategy and coordination, and administrative  
467 directives and, it is also clarified at the Directives that if it is entailed, temporary units can establish. It is also worth noting  
468 that at the Law No. 5302, the possibility of contract staff employment has been provided in addition to the officials  
469 (Supplementary third paragraph: 3/7/2005-5393/85 Art.). Article 49<sup>th</sup> of the Law on Municipality shall apply to the  
470 employment of contracted personnel and part-time contracted personnel in SPAs. Besides, at the Law No. 6360, it is  
471 determined that the Governorate has the authority to appoint specialist, contractual staff and officials in necessary  
472 conditions regardless of cadre, status, and title. In this context, the criteria of that requirement are not included in the text  
473 of the law No. 6360 (Karaaslan *et al.*, 2012: 128; Coşkun &Uzun, 2005: 172).

## 5. Conclusion

474 By the Law No. 6360 on 'The Establishment of Fourteen Metropolitan Municipalities and Twenty-seven Districts and  
475 Amendments At Certain Law and Decree Laws', the local government system has undergone radical changes in Turkey.  
476 In that context, the number of the metropolitan municipalities upgraded to 30, and SPAs were abrogated at those  
477 provinces having metropolitan municipalities. At that point, Gözübüyük (1967: 99-100) clarifications are worth to mention,  
478 the scholar puts forwards the view concerning the SPAs as follows: "to benefit from that organization with making some  
479 amendments to its organization and duties would be better rather than removing an existing organization, and those  
480 institutions should not be abrogated unless a major necessity. The benefits and the significance will emerge automatically  
481 by finding out the flaws and correcting them. In that framework, the tasks that are assigned to the SPAs should be clearly  
482 demonstrated, and adequate financial resource should be provided to respond to those local services". The SPAs that

<sup>22</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

<sup>23</sup> For details, see, <http://www.tbmm.gov.tr/kanunlar/k6360.html>, 'On Üç İlde Büyükşehir Belediyesi ve Yirmi altı İlçe Kurulması ile Bazı Kanun ve Kanun Hükmünde Kararnamelerde Değişiklik Yapılmasına Dair Kanun'.

<sup>24</sup> For Details, see, [http://www.migm.gov.tr/en/Laws/Law5302\\_SpecialProvincialAdmin\\_2010-12-31\\_EN\\_rev01.pdf](http://www.migm.gov.tr/en/Laws/Law5302_SpecialProvincialAdmin_2010-12-31_EN_rev01.pdf) 'Law on Special Provincial Administration'.

489 are one of the oldest local government units of Turkish local government system should be supported in terms of finance  
490 and staff for increasing the effectiveness of SPAs at the provision of services.

491 In that context, IMCDs' are established by the Law No. 6360 instead of SPAs that their public legal entities  
492 removed at the provinces where metropolitan municipalities established; however, there are significant differences  
493 between IMCD and SPA. First of all, one of the most prominent differences is focused on their administrative formations;  
494 SPAs are local government institutions, whereas IMCDs' have been stipulated as a local unit of the central government at  
495 the Metropolitan Municipality Law No. 6360. Furthermore, the internal and external supervision has been perceived for  
496 SPAs with the Law No. 5018; however, internal supervision has not been foreseen for IMCD. In this regard, IMCD is a  
497 part of the central government that IMCD is not subject to supervision by a local council. Besides, SPAs have no authority  
498 in the supervision of the other public institutions and organizations. However, IMCD has the supervision power in the  
499 public institutions and organizations in the province via the Report that will be prepared by IMCD. Moreover, as it was  
500 mentioned before, SPAs' duties and powers have been determined in detail at the Law No. 5302 of SPA. IMCDs duties  
501 and powers have been counted in general, and the details are left to directives issued by the Ministry of Interior. Besides,  
502 IMCD has gained the possibility of using the resources of the other local government units. Lastly, the organizational  
503 structure differs from SPA with consisting of disaster assistance, emergency call, investment monitoring, guidance and  
504 supervision, strategy and coordination and administrative directives. Consequently, the functioning of IMCDs should be  
505 analyzed from the administrative dimension at putting forth the possible strengths and the weaknesses in Turkey. There  
506 has been relatively little research on that newly established administrative formation; it's worth to increase the researches  
507 by case studies in a comparative perspective in Turkey.

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# Mapping Impacts of Crude Oil theft and Illegal Refineries on Mangrove of the Niger Delta of Nigeria with Remote Sensing Technology

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## Abstract

Niger Delta is the oil rich region of Nigeria where extensive mangrove form one of the most important ecosystems of coastal and marine areas. It is a fragile ecosystem rich in biodiversity. The mangrove is exposed to the activities of crude oil bunkering and illegal refinery. This study aims at mapping the impacts of the crude oil theft and illegal refineries on the creeks and mangroves of the Niger Delta. Worldview-2 2013 satellite image was processed using supervised classification methods and Normalized Difference Vegetation Index (NDVI). Oil on the waterways covering estimated area of 9.2 km<sup>2</sup> and stressed mangrove vegetation covering estimated area of 37.6 km<sup>2</sup> were detected. Result of NDVI shows positive correlation with photosynthetic activities as areas with stressed vegetation around the illegal refineries had low vegetation index of -0.39 while areas with healthier vegetation had higher index of 0.55. Since illegal refineries and crude oil theft is rampant in the region, the paper recommends a regional study of the state of the mangrove in the Niger Delta.

**Keywords:** Bunkering, sabotage, environmental sensitivity index, remediation, mangrove recovery

## 1. Introduction

Nigeria is the largest producer of petroleum in Africa and the 5<sup>th</sup> among the Organization of Petroleum Exporting Countries (OPEC). In the first quarter of the year in 2013 the daily crude oil production in Nigeria fluctuated between 1.86 and 2.1 million barrels per day as against the estimated 2.48 mbpd. This drop was linked to the incessant crude oil theft and vandalisation of pipelines. Though oil bunkering started as far back as 2003 when it was done as an act of vandalism to make the oil company pay compensation for oil spill it later graduated to stealing and selling/ processed and sell. Oil theft and illegal refinery became escalated and full blown in 2012 after the militants were granted amnesty. In the first half of the year 2012, the Nigerian government estimated as many as 400,000 barrels of crude oil being stolen each day, costing the nation up to \$1 billion per month in lost revenues. Baird(2010) observed that oil siphoning has become a big business, with the stolen oil quickly making its way into the black market . Some of the oil is delivered to small scale rudimentary refineries in the creeks and mangroves. Here it is boiled to produce low grade diesel fuel.

According to Anderson (2005) sabotage is performed primarily through what is known as "bunkering", whereby the saboteur attempts to tap the pipeline. Oil spills occur at every stage of the bunkering process. In the process of extraction sometimes the pipeline is damaged or destroyed. Damaged lines may go unnoticed for days, and repair of the damaged pipes takes even longer. Attah, (2012) noted that the activities of the saboteur is more than Nigeria losing money from lost production, costly repairs and clean-up and facility downtime. It is a sad story of consistent pollution of farm lands and rivers by people who are not bothered by the effects of their actions on the environment.

The Joint Task Force (the Niger Delta-focused security unit) set up by the government reported that in the first quarter of the year 2013, it destroyed 3,778 illegal refineries and seized eight vessels, 120 barges, 878 boats, 178 fuel pumps, 5238 surface tanks, 606 pumping machines and 626 outbound engines allegedly belonging to oil thieves (Africappractice, 2012). In spite of these efforts the crude theft has not abated. Crude theft is not only economic loss to the government and the people but also environmentally detrimental. This study looks at the impacts of crude oil theft on the mangrove environment.

## 2. Literature Review

Nigeria is blessed with a large expanse of mangrove forests estimated to cover approximately 5,000 to 8,580 km<sup>2</sup> of land of the Niger Delta. The mangroves belong to a fragile ecosystem and are exposed to oil spill due to oil exploration either

56 through accident or sabotage which usually results into environmental degradation. Blasco et al. (1996) observed that if  
57 oil directly affects any organism within an ecosystem, it can indirectly affect a host of other organisms. Mangrove  
58 ecosystems support aquatic food chains and form habitats for marine fauna, such as juvenile crabs, prawns, offshore  
59 fish, reef fish, and larvae (Manson, et al, 2005; Mumby, et al 2004; Nagelkerken, et al, 2008; Naylor et al, 2000).  
60 Terrestrial fauna, such as birds, insects, mammals, and reptiles, and associated flora, such as fungi, algae, and sea  
61 grass, build rich communities within mangroves (Kathiresan, et al, 2001, Mumby, et al 2004; Nagelkerken, et al, 2008,  
62 Cannicci et al, 2008). Mangroves are important for the carbon balance of the coastal zone (Boullion, et al, (2008);  
63 Kristensen, (2008). According to Kuenzer (2011) mangrove ecosystems provide various ecological and economical  
64 ecosystem services contributing to coastal erosion protection, water filtration, provision of areas for fish and shrimp  
65 breeding, provision of building material and medicinal ingredients, and the attraction of tourists, amongst many other  
66 factors. The effects of oil spills on mangroves are known to acidify the soils, halt cellular respiration, and starve roots of  
67 vital oxygen.

68 As important as mangroves ecosystem is, it belong to the most threatened and vulnerable ecosystems worldwide.  
69 In order of increasing vulnerability, the mangroves and intertidal shores of the Niger Delta fall under categories 8 to 10 on  
70 the environmental sensitivity index (ESI) scale, which predisposes the areas to serious long-term effects and clean-up  
71 complexity (Osuji, Erondu and Ogali, 2010). Physiographic types of mangroves, oil type and length of mangrove's  
72 exposure all combine in different permutations to determine the impacts of oil spill on the mangrove. In terms of  
73 physiographic types, of mangroves and length of mangrove's exposure to spilled oil, Lewis (1979) opines defoliation and  
74 death of small (< 1m) mangrove coupled with loss of aerial root community (*bostrychietum*) within 15 to 30 days of  
75 exposure. Chan (1977) and Lewis (1980) observed defoliation and death of medium (< 3m) mangrove coupled with  
76 damage of aerial roots' tissue within 30 days to 1 year of exposure. Snedaker et al (1981) suggests death of larger (<3 m)  
77 mangroves and loss of impacted aerial roots within 1 and 5 years of exposure to spilled oil. Mangrove mortality tends to  
78 be highest among propagules, seedlings, and juvenile trees. An area of mangroves that has been destroyed by  
79 petroleum may be susceptible to other problems. The area may not be suitable for any native plant growth until bacteria  
80 and microorganisms can remediate the conditions. Boyer (1982) observed that the impact of environmental stress on the  
81 physiological processes of a plant defines a crop's overall productivity. Unfavorable environmental conditions can reduce  
82 yields by more than 70%. Basso (2004) also observed that the consequence of stressful growing conditions is a decline  
83 in leaf chlorophyll concentrations, a decrease in incident light absorbance, and a reduction in overall plant productivity  
84 (Carter et al., 2001; Zhao et al., 2003).

85 The destruction of mangrove ecosystems can reduce production of coastal fisheries, because mangrove forests  
86 serve as breeding and nursery grounds for many commercial species of fish, crustaceans and mollusks (Boyd and  
87 Tucker, 1998; Ramachandran et al, 1998). In the Delta Mangrove wood is a source of fuel, either as charcoal or firewood,  
88 and is a primary material for the construction of boats, houses, furniture, etc. Timber resources and particularly non-  
89 timber forest product (NTRFs) are critical sources of income for many rural household. In River State alone, the estimated  
90 value of NTRFs may exceed USD 100 million annually (Ruitenbeck, 1990).

91 According to Lewis (1983) mangrove forest complete recovery period from oil spill impacts takes 10 to 50 years. As  
92 he noted, the pattern of damage and recovery of mangrove vegetation from oil spill impact is a function of a number of  
93 factors in time. He identified four determinants: type of spilled oil, the amount of spilled oil reaching the mangroves, the  
94 amount remaining after any cleanup effort and the various physiographic types of mangroves affected. Other factors  
95 identified by other authors are length of mangrove's exposure to spilled oil (Shigenaka, 2002), site conditions (Jacobi and  
96 Schaeffer-Novelli, 1990) and the type of remediation technique employed (Proffitt et al., 1996).

97 Since the mangrove is important to the indigenous people of Nigeria as well as to the various organisms that  
98 inhabit these ecosystems thus up-to-date information with regard to the extent and condition of mangrove ecosystems is  
99 an essential aid to management and policy- and decision-making processes. Hence Kuenzer, (2011) noted that the goal  
100 of all remote-sensing-based mangrove mapping and monitoring activities should be the protection of these unique  
101 ecosystems, whose value cannot be overestimated.

### 102 3. Research Methodology

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104  
105 Awoba and Krakrama are major settlements in Degema Local Government Area in Rivers State of Nigeria. The Local  
106 government is located within the mangrove forest. Traditional field survey are not effective to acquire vegetation condition  
107 over a large, impenetrable and unsecured area because it is unsaved, time consuming and expensive. According to  
108 Langley et al, (2001) the technology of remote sensing offers a practical and economical means to carry out mangrove  
109 study especially over a large area. Two remote sensing methods were adopted in this study: Supervised image

classification and Normalized Difference Vegetation Index (NDVI).

Worldview-2 image acquired in 9<sup>th</sup> January 2013 was geometrically corrected, rectified to the true ground positions and projected to the Transverse Mercator Nigeria Mid-Belt (WGS-1984) and referenced to the Minna Datum. The georeferenced image was processed with Erdas Imagine 2010 version. False color composite was created to aid image interpretation and processing because it gives a better visual impression of the reality on the ground. False color composite scheme allows vegetation to be detected readily in the image as vegetation appears in different shades of red depending on the types and conditions of the vegetation, since it has a high reflectance in the NIR band. In interpreting the image, proxy that could be used to determine the presence/impact of oil spill in the image was used. Direct method based on texture and spectral signature was also utilized. Elements of image interpretation such as shape, hue, pattern and texture also aided in the interpretation. These elements were used in the selection of the training sites. Supervised classification method and Maximum Likelihood Classification (MLC) Algorithm were carried out on the image.

### 3.1 Normalized Difference Vegetation Index (NDVI)

Ajibola (2009) noted that assessment and modeling of oil spill impact would yield more reliable result if approached from NDVI perspective than from vegetal cover area. NDVI is a mapping technique used to show the behavior of vegetal cover in relation to the environmental condition. This spatial behavior/variability is useful to assess vegetal cover. It is often directly related to other ground parameters such as percent of ground cover, photosynthetic activity of the plant, surface water, leaf area index and the amount of biomass. Healthy vegetation has a low reflectance within the visible light range (from 0.4 to 0.7 $\mu$ m), since it is strongly absorbed by the leaf pigments (chlorophyll) for photosynthesis, and high reflectance in the near-infrared light range (from 0.7 to 1.1 $\mu$ m) a dying or scensening leaf has less photosynthetic activity and the cell structure of the leaf collapses resulting in an increase of reflected visible light and a decrease of reflected near-infrared light.

Generally, healthy vegetation will absorb most of the visible light that falls on it, and reflects a large portion of the near-infrared light. Unhealthy or sparse vegetation reflects more visible light and less near-infrared light. Bare soils on the other hand reflect moderately in both the red and infrared portion of the electromagnetic spectrum (Holme *et al* 1987). This spectral behavior is useful to assess plant vigor and to separate canopy from bare soil. The spectral behavior of the leaf changes during senescence and in plants subjected to stress (e.g. disease, pest, and Nitrogen shortage) by reflecting more Red lights and absorbing more NIR. Opposite behavior is shown in healthy plants with high values of reflectance in the NIR region and low values in Red portion (Pinter *et al.*, 2003). The normalized difference vegetation index (NDVI) is often used to monitor vegetation dynamics (Julien, Sobrino, & Verhoef, 2006; and Zhou *et al.*, 2001). It has been shown to be highly correlated with plant health, vegetation density, and cover (Ormsby, Choudhury, & Owe, 1987). The NDVI algorithm subtracts the red reflectance values from the near-infrared and divides it by the sum of near-infrared and red bands. NDVI is calculated by the formula:

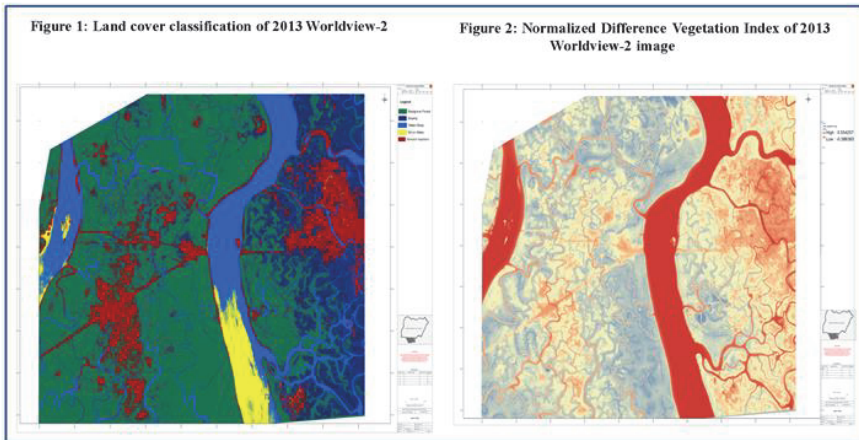
$$NDVI = (NIR - RED) / (NIR + RED)$$

Applying the concept of normalization, the comparison of absorbed incident light to reflected can be placed in a simple ratio that exists on a scale varying between -1.0 and 1.0 making evaluation of environmental responses comparable (Crippen, 1990). The higher the index, the more vigorous the vegetation of the observed area. Very low values (0.1 and below) correspond to barren areas of rock, sand and snow or areas that have been burnt. Moderate values (0.2 to 0.3) usually indicate shrub and grassland, while temperate and tropical rainforests are represented by very high NDVI values (0.6 to 0.8) (Crippen, 1990). Vegetation index has a direct relation with the quantity, quality and development of vegetation and it correlates well with the yield of a given field. Vegetated areas will generally yield high values because of their relatively high near-infrared reflectance and low visible reflectance.

## 4. Findings and Discussion

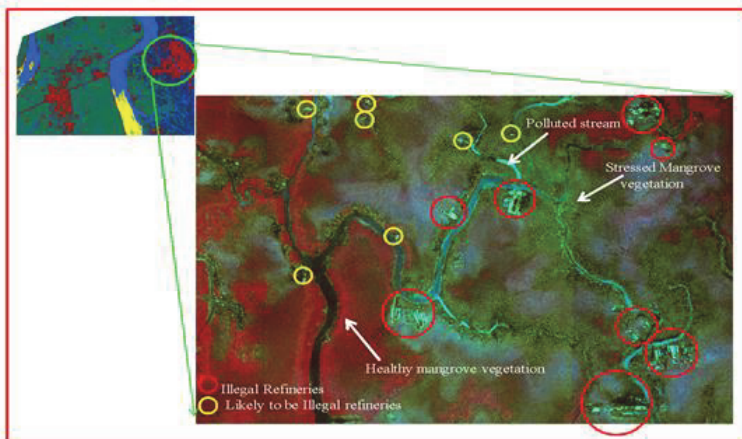
The result of the supervised classified worldview 2 image of 2013 is shown in figure 1 while Figure 2 is the Normalized Difference Vegetation Index of the same image. Figure 1 reveals stressed mangrove vegetation which covers about 37.6 km<sup>2</sup> and also oil on water covering 9.2 km<sup>2</sup> in area. Figure 2, the NDVI of 2013 Worldview-2 image gave index that ranges between -0.39 and 0.55. More area show low photosynthetic activity especially the disturbed areas. Areas with stressed vegetation have an index of -0.39 indicating that the mangrove vegetations are dead. Consequently, this indicates reduction in mangrove cover. Area with oil on water did not show on the NDVI because oil only reflects in the blue band. Note that the NDVI was generated using red and Near Infrared.





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When zoomed in on the area with stressed vegetation in the worldview-2 raw image it reveals structures that the author interpreted as illegal refineries. Elements of photo- interpretation and other collateral information aerial photographs were used to verify this. Figure 3 shows that the illegal refineries are co-located with the impacted areas. It is observed that these illegal refineries clustered around a major oil pipeline which has been reported to have suffered illegal bunkering several times in 2012 and 2013. This may tend to suggest that illegal refineries activities could have been responsible for the observed mangrove stressed.



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The study demonstrated that it is possible to assess the condition of the mangrove ecosystem using remote sensing data. On the land, mangrove condition is detectable using the reflectance characteristic of the stress vegetation as proxy. The affected area reflects in the optical image (2013 Worldview-2) differently and was also well captured in the NDVI. The NDVI prove to be a useful tool that corroborates the result of the processed image. The study reveals that some areas which were previously covered by swamps and mangroves are experiencing disturbance from crude oil spill. The amount of oil theft going on in the Niger Delta region according to report would suggest that there exist many of these illegal refineries within the mangroves. This being the case more area outside the study area might have been impacted. That would be a major threat to mangrove forest in the Niger Delta.

## 5. Conclusion

The study demonstrated the potentials of remote sensing method in detecting and mapping the impacts oil spill in the mangrove. It also reveals that the mangrove is experiencing some significant changes due to oil spillages arising majorly from oil bunkering and illegal refinery. The loss of mangrove forests is not only degrading life for plants and animals, but for humans as well since the mangrove products are critical source of income to the people. Oil bunkering and illegal refining activities taking place within the creeks and environs are a challenge and threat to the nation economy and environment. Due to the increasing waves of crude oil theft and illegal refineries in the region and its impacts on the mangroves and on those who depend on the mangrove products for their sustenance this study suggests a regional survey of the mangrove in the Niger Delta using optical remote sensing method.

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# Strategic Management Role on Contemporary Emerging Market – The Female Economy

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## Abstract

Economic power of women in today's is surging solidly whereas creating positive climate on businesses worldwide. Business people make long term plans and tend having bright vision about the future, commonly they look closely about market trends, it's movement and positive changes. Literally, they are pretty aware of female purchasing power, hence, they identify the opportunity of newly emerged market- the females market towards which market responding wisely to their demands and request is prerequisite for survivor. Doing so, strategic management is the best decision being applied getting good chunk of this market that provides high return for every single investment done. Since female make almost half global population converting into the money meaning they make almost 85% of all purchases made in the world. Taking this fact into account, businesses must make a leap ahead reaching this market and women as main actor in it. Additionally, women are ongoing growing working force, academically and highly educated, in some occasions are better paid than men, have own money for personal and family spending, and unstopably search for life and work balance achievement. Aforementioned facts strengthens consciousness to whom businesses should focus their managerial and business strategy - straight forward the new market having known that the global biggest market – female market, is everywhere around us. Every strategic movement of businesses having females on focus must move swiftly and prepare business operation upon high and firm demands that in return make businesses more lucrative and give strength for further succeeding. Strategic management consists of actions and organizations to create sustain and highly competitive advantage for businesses, pursuing contemporary trends is an operation engagement and venture that facilitate seizing share into the arising market powered by women.

**Keywords:** Women, Strategic, Management, Businesses, Market.

## 1. Introduction

Rising power of women as primary international consumer is becoming reality. Her power derives from many sources- worth to be mentioned is as well her role on managing and leading business positions where she put her private purchasing experience into the action by expressing the way she feels and needs as woman consumer. Contemporary living styles bestowed her at head role of a family which she tries to manage given position by completing professional work, care giving for her children, her husband and other family members, meantime completing the rest of family duties such are chores, for instance. Almost entire spending and family purchases goes thru her hands, so she, woman, is maturing with or without her wish into the position of a major decision maker in a family.

Women are most powerful customers on the planet, influencing or purchasing 85% of everything businesses make, sell, or offer (Quinlan, Drexler, Chapman, 2010).

Women now earn one trillion dollars a year and their incomes over the past three decades have increased a dramatic 63% after inflation. This increase in earning power is not result of one big event but has been fueled by a series of important changes in the working place, family and personal lives of women. Women account for roughly 80% of all consumers buying. The Center for Women's Business Research indicates that businesswomen (working women and female entrepreneurs) are the primary decision makers in households, making 95% of the purchase decisions. Women now bring more of the household income in the majority of U.S households. In the 55% of U.S households made up of married couples, Census Bureau survey data indicated that 48% of the working wives provide at least half of household income. Today they comprise a significant majority of customers for most businesses. So focusing on their preferences is literally big businesses that can dramatically affect a company's sales, make share and profits (Johnson & Learned, 2004).

Therefore, its power and strong position on market is seemingly obvious which makes woman being targeted as main customer widely from businesses around the globe. Accordingly, vast majority of businesses began shaping management strategies leaning towards main decision maker in order to obtain higher turnover and revenues,

57 consequently.

58 Some reliable and useful tips for businesses about picking the right strategy while it come choosing being focused  
59 on female as most important target customer:

60 Creating products for women isn't about sacrificing one gender to gain the business of another. Ideally, it's about  
61 broadening your reach and increasing your revenues by adding more products that appeal to the world's primary  
62 shoppers. Once you've got the product right, the next critical step comes into play: make it women want it.

- 63 a. Women can help grow flat economy - If you are in a product category or industry that's hit a plateau, focusing  
64 on women may help bring in new customers and revenues.
- 65 b. Women are key customers to the next generation of customers – if you want children and teenagers to  
66 participate in an activity, get their mothers excited about it.
- 67 c. Women's participation has a multiplier effect in terms of people and purchases – not only do women bring their  
68 friends and family members to companies activities that they're thrilled with, they spend money differently and  
69 often more of it, on accoutrements (Brennan, 2011).

70 Significance of paper relies on strong facts and figures displaying ongoing rising purchasing power of women on  
71 markets all around the world - even, from many is referred as newly emerging markets along other existing ones.  
72 Obviously, women most recently are counted as core drive on many businesses. Many of businesses initiated strategy  
73 alignment towards demands coming from women. Besides, many businesses did not cease just on women demands for  
74 goods and services, being aware of their power they spurred and gave chances to many women toping on leading  
75 managerial positions in many eminent companies and corporations. Data provided are result for proper and original  
76 description of outcomes part of qualitative methods used for completion and representation of this valuable research  
77 paper useful for readers who are willing to gain comprehensive knowledge on management strategy and its impact in  
78 businesses and economy, as well.

## 80 2. Business Strategy Alignment towards the Female Economy

81 Seeing long term opportunities, businesses must search for new and markets. Not always markets abroad or on  
82 distanced countries may be counted as thriving ones. The emergence of the female economy holds the potential for  
83 creation of vast wealth- the \$ 20trillion of consumer spending now controlled by women could climb to as high as \$ 28  
84 trillion in the next several years. Women's trillion in total earning could grow to as much as \$ 18 trillion on the same  
85 period. Women find themselves caught in an upward spiral. If they and their families are to continue to achieve higher  
86 levels of prosperity, health, education, and accumulated wealth, they have virtually no choice but to work full-time.  
87 Although the status of women has changed, much of the world seems not to have noticed or adjusted the new reality. For  
88 example, the great majority participates in the workforce, but these women still do most of households' chores. What's  
89 more, although women control the spending in most categories of consumers goods- including food, clothing, personal  
90 care, households goods and services, travel, healthcare, financial services and education- too many companies  
91 continues to make poorly conceived products, offer services that up way too much for women's precious time, and serve  
92 up outdated marketing narratives women as stereotypes. Further the female economy will challenge corporate leaders  
93 and managers to reexamine their human resources practices-how they recruit, select, develop, integrate, retain, and  
94 provide support to their people and how they help nurture and facilitate healthy work-life balance.(Silverstein & Sayre,  
95 2009).

96 A fact drawn from the research of market which makes businesses being aware of new demands is the plus size  
97 women as target market in US, as a sample. The average woman is a size fourteen and the number isn't expected to  
98 change anytime soon. Women of all sizes want beautiful clothes, elegant bridal gowns, lovely pro dresses, fashionable  
99 shoes, and cool workout gear (Brennan, 2011). Merely, as businesses get deeper into the women analyses figures out  
100 that number of plus sized women are those that hold purses of economy whose earnings are solid and their buying  
101 decisions are also huge; consequently strategy alignment towards these category of buyers brings higher revenues with  
102 little changes of shifting the supply according to demands.

## 105 3. Leading Strategy - Women on Top of Business a New Leadership Model

106 It's often been said that women are the most underutilized asset in the world studies have shown that the economic  
107 inclusion of women is fundamental to reducing gender inequality and spurring overall growth. Women's economic  
108 participation has been shown to have a multiplier effect: the economic empowerment of one women ripples meaningfully  
109 to her children and family-even to entire communities and nations (Blomqvist, Chastain, Thickett, Unnikrishnan, Woods,  
110

111 2014).

112 In a business environment where competition, employees, and teams are becoming more global and stakeholders  
113 group are becoming more global, and stakeholder groups are more diverse, what are the characteristics of an effective  
114 business leader in the 21<sup>st</sup> century and where do women fit into this picture-some raise the question? Anyway, it has been  
115 shown that despite the fact that some archaic thoughts still retain on the assumptions of adage effected stories that  
116 business should and could be led mainly by men which in practice proved to be not totally right. Nowadays in many  
117 companies engagement of women in leading positions and their participation on decisive decision making on multiple  
118 field of various businesses is proof of abilities expressed from women on leading businesses. Today female executives  
119 from range of multinational companies are taking adaptive approach in order to sustain performance and, in turn being as  
120 adaptive as they could in new leadership roles. The model represented from leading woman is identified the  
121 differentiating characteristics of those leaders who will thrive in a 21<sup>st</sup> century world: navigate-embrace global uncertainty  
122 and chart a clear course: empathize – achieve influence and authority through networking: self-correct- unlearn outmoded  
123 success models: and win and win – deliver sustainable success to company and stakeholders. Above all as soon as a  
124 company appoints a woman on top of a company- highly educated and experienced as well, one thing is clear –  
125 companies will have to profoundly reshape the way they manage their talent and develop their leaders. (Torres & Caye,  
126 2011).

127 Despite numerous cases well known internationally where women successfully direct and manage companies and  
128 corporate in billion and trillion revenues, there are some even argue and slightly suspect about that young women may  
129 face unique challenges in asserting and developing a leadership style. Some struggle with managing style, some may  
130 perceive them as not acting feminine enough, but if they act in stereotypically feminine way they aren't seen as strong  
131 leaders. Leadership coaches encourage women to take charge of their office image by showcasing their workplace  
132 activities in thoughtful ways, such as leading presentations at meetings. When the company has new project in the works,  
133 women should suggest how their research and skills contribute on nurturing the ideas for further achievements since they  
134 ought to unveil knowledge of being part of heading staff which expectances for goals set to be achieved are on their hand  
135 to put them in practice. (The Wall Street Journal, 2009).

136 In many circumstances women attempt to reveal leadership abilities and knowledge even though are seen or  
137 perceived that lag behind the men on leading positions. Achieving success and being on top, they should doubtlessly be  
138 encouraged and pushed forward in one way or another. In despite perception or culture the way women are seen, there  
139 is opportunity for plenty of business which can surely positively change the course of operation selecting a woman  
140 heading the company, while it's been attested a brilliant choice practiced in many corporation around the globe, i.e. Pepsi  
141 Co, Revlon, Wal-Mart Stores, Intel, General Motors, Morgan Chase, Hewlett-Packards, Oracle, DuPont, Procter &  
142 Gamble are just some of the prosperous international companies and corporations samples of roles models head from  
143 women.

144 Women have made great progress in business. They make up more than half the workforce and are increasingly  
145 occupying management and senior leadership positions. The "playing field" has become more level in many industries  
146 and countries and women are able to compete directly as never before. Some companies are actively recruiting women  
147 for their boards. They are building programmers to move more women into the management ranks and leadership  
148 pipeline. But there is still progress to be made.

149 A few facts to consider:

- 150 • Companies and some governments are increasingly interested in setting gender balance quotas,
- 151 • Many companies want more diversity in the decision-making, or a more participative style of leadership,
- 152 • Customers are increasingly female and expect to be able to deal with other women,
- 153 • There is a shortage of qualified management talent to move into management roles for the future,
- 154 • Women are an "untapped resource",
- 155 • Female university graduates outnumber males in most countries<sup>1</sup>.

156 Moreover, throughout Europe countries are passed legislations about improving representation of women on  
157 corporate boards. Recently the German legislation requires improving representation of women on board of corporation  
158 giving them rights holding 30% of supervisory seats, which law will be enforced starting from next year. Currently, fewer  
159 than 20 percent of the seats on corporate boards in Germany are held by women, while some of the biggest multinational  
160 companies in the world are based here, including Volkswagen, BMW and Daimler — the maker of Mercedes-Benz  
161 vehicles — as well as Siemens, Deutsche Bank, BASF, Bayer and Merck. Norway was the first in Europe to legislate

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<sup>1</sup> "Women in Leadership and Management" <http://www.mce-ama.com/strategy-execution-expertise/women-managers/>

boardroom quotas, joined by Spain, France and Iceland, which all set their minimums at 40 %. Italy has a quota of one-third, Belgium of 30 percent and the Netherlands a 30 percent nonbinding target. Britain has not legislated boardroom quotas, but a voluntary effort, known as the 30% Club, has helped to substantially increase women's representation. The group, founded by Helena Morrissey, a money manager, has used persuasion to help double the percentage of women on the boards of major British companies since 2010, to 23 % (Smale & Miller, 2015).

#### 4. Long Term Strategy – Focus on Power of Women in Business and Economy

Aforementioned role of women on top of corporations and companies could be counted as a step further leaping ahead towards higher achievements and competition advantages; moreover it's one among many management strategies picked which build company or business prosperity at the same time. Range of management strategies where female is main target to be pursued and whose power can be divulged in business and economy, as whole, can be built on long term –strategies which can rely mainly on the female as crucial factor on contemporary business world which is driven from.

Since purpose of businesses is retaining some profit out of operation, surviving amidst competition should be found a path to run on. Finding a proper way not just to survive but also to make some extra profit and being as lucrative as possible, focusing on newly, as some call it, emerging market – in which women conducts majority of this economy. Shifting one business strategy to something new, isn't easy pattern as it seem. Prior to making decision doing so, getting aligned with market demands, deep research about is highly necessary. Data and information collection will easy attempts getting straightforward reaching target market. Power of women into the global economy market is firmly rising day in day out.

In the United States, women make 80 percent of discretionary purchases, including 90 percent of food and 55 percent of consumer electronic purchases<sup>2</sup>. Women may be the primary purchasers for their households. Far more women than men are worried about their economic security. The competing tension between saving and spending is not unique to women, but because women are the primary consumers in America any signs of increasing confidence among women may signal a strengthening economy. The role that women have played in the economy has dramatically changed in the last 50 years. Having once provided what was viewed as supplementary income, today, women earn 45 percent of all household income and over seven million families rely mainly or solely on the woman's income to survive (Keil, 2009).

A research conducted from Index of Women's Economic Opportunity in the 2012, "women are the key driver of economic growth." research has shown that in the United States alone, women have added 2 percentage points per year to the overall economic growth. Similar or even better numbers have been seen in numerous countries all around the world. These studies only account for women in developed countries. However, the same improvements can be seen in developing countries with education and empowerment for every single female. Tapping into the most prominent unused workforce in the world would have undoubtedly huge, positive impacts on the global economy. The WEO is a great way to see clear and positive results on how improving our global economy can become a reality. (Yongs).



If women hadn't dramatically increased how much time they spend working for pay outside the home since the late 1970s, gross domestic product (GDP) would have been about 11 percent lower in 2012, according to a new report from the Center for American Progress (CAP). That's nearly twice the contribution to GDP from information, communications, and technology-producing industries that year. Women's contribution to GDP also translates to more than \$1.7 trillion in greater output, "roughly equivalent to combined U.S. spending on Social Security, Medicare, and Medicaid in 2012," the report notes (Covert, 2014).

But there's another trend that has led to sharply higher economic output, and one that goes largely overlooked.

<sup>2</sup> The Economist : "Hello Girls" <http://www.economist.com/node/13278440>

<sup>3</sup> <http://notenoughgood.com/2012/04/womens-economic-opportunity/>

208 That is the flood of women into the full-time workforce: Since 1979, the proportion of working-age women with a full-time  
209 job has surged to 40.7 percent from 28.6 percent. For mothers, the effect is even more striking: The proportion has  
210 climbed to 44.1 percent from 27.3 percent (Lowrey, 2015).

211 On basis of data and information gathered from research done as part of qualitative analyses methods used for  
212 completion of paper, I conclude that extraction of important values are foundation of facts that businesses should turn  
213 head and businesses strategy towards women aligning product and service providing based on demands targeting the  
214 high demands as main potential for market segmentation.

## 215 216 **5. Recommendation**

217  
218 Businesses in general in some cases unintentionally may omit the women from not appointing or selecting her in crucial  
219 positions. Aware that this is not a mere justification but the "masculine" culture reign or it's inherited in many countries  
220 wide. Topic of women and her accurate brain potential is topic of discussions in many conferences and economic journals  
221 - meanwhile it was a topic which took place and comprehensively discussed at The Wall Street Journal dedicated to  
222 Women in Economy. Among other topics was also the one talking about moving forwards the industry with women on top  
223 of it, so from this debate five golden recommendations derived as result. Recommendation obtained below indisputably  
224 show that every company can improve his market position and even gain more market share with little efforts of making  
225 slightly changes which could be characterized as wise management strategies for future goal attainments.

226 After each individual industry-focused group presented its priorities, the full task force ranked all the priorities, in  
227 order of their relative urgency and importance. Here's a look at the top five priorities, as voted by the entire task force.

### 228 229 *5.1 P&L Leadership*

230  
231 Companies should establish a program to train and encourage women to take leadership positions that involve profit-and  
232 loss expertise specifically, and enable them to transition into these roles. Companies should establish specific targets and  
233 incentives to this end.

### 234 235 *5.2 Leverage C-Suite Power*

236  
237 Hold the CEO accountable for hiring women in the top jobs with equal pay. Use metrics and scorecards to track women's  
238 promotions and positions, and if women aren't promoted, explain why not. Require a diverse slate of candidates for high-  
239 level jobs. Expect a balance of men and women at the decision-making table, including the board.

### 240 241 *5.3 Promote Women on Potential*

242  
243 Women should be equally considered for promotion on their potential as are men. Companies need to identify talented  
244 women early and nurture them. Employers should create incentives for female sponsorship, tying success to  
245 mechanisms such as compensation, goal achievement and performance evaluation.

### 246 247 *5.4 Mentors and Sponsors*

248  
249 Develop more industry wide and company-specific programs for both mentorship and sponsorship. Tie sponsorship goals  
250 to pay or career advancement. Such programs should include succession planning and "co-mentoring," which allows  
251 advice to flow from junior to senior levels. Involve men and women.

### 252 253 *5.5 Strong Talent-Management Programs*

254  
255 Recruit outside normal channels and leverage diverse networks. Take risks on high-potential women by rotating them  
256 through different positions and giving them exposure to senior leadership. Provide training in effective communication and  
257 strategic thinking. Foster entrepreneurial culture, including a more flexible work/life environment. (The Wall Street  
258 Journal, 2011).

259  
260  
261



## 6. Conclusion

Women's influence on market, as seen from many marketers, creates a frame that comprises purchasing power, decision making, personal earnings and control over household wallet which literally means control upon almost entire family spending. Woman is also considered a witty manager of household economy whilst many businesses based on this issue are appointing her on top of companies to manage and led businesses in many cases some big corporations as she does manage her family.

Increasing power of women is distinguished worldwide. Her role on world economy is incremental. Most of the companies try to get closer and study behavior of female aiming to align and shift business strategy according to her requests and demands being knowledgeable the rise which can experience those businesses in case of make women likable products and services. In sum, picture of women can be framed allegedly as: powerful, decision makers, wallet keepers, big spender and key factor on economy, hence, clue for business success should easily get – let pursue her.

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## An ECM Analysis of Thai Tourism Demand in Malaysia

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### Abstract

*Tourism industry is one of the important service industries that play a crucial role in the development of Malaysian economy. Thailand has been ranked among the top five tourist generating countries for Malaysia since the last decade. This paper intends to determine factors affecting Thai tourism demand in Malaysia from the macroeconomic perspective by utilizing quarterly data from 2000Q1 to 2013Q4. The Thai tourism demand model is estimated using the error-correction model and a battery of diagnostic tests were carried out to ensure the robustness of the model. The empirical results indicate that there is a long-run equilibrium relationship between Thai tourism demand and the specified explanatory variables, which are Thai real income, real travel cost and exchange rate. Specifically, higher Thai real income will reduce Thai tourist to Malaysia, while higher real travel cost and stronger currency attract more Thai visitor to Malaysia. As a conclusion, this paper has achieved its aim to determine the factors affecting Thai tourism demand in Malaysia.*

**Keywords:** Tourism demand, error-correction model, macroeconomic

### 1. Introduction

Malaysian government has given attention to its tourism industry following the poor performances of Malaysia's primary commodities and manufacturing industry, which were resulted by the oil price drop and economic recession in the mid-1980s. The Ministry of Culture, Arts and Tourism was established by Malaysian government in 1987, and was upgraded to Ministry of Tourism in 2004.

In order to promote Malaysia to tourists around the globe, a series of promotion campaign was implemented since 1990s. The famous Visit Malaysia Year programme was carried out in 1990, 1994, 2000 and 2007. At the same time, Malaysia also organizes annual events such as the World Amateur Inter-team Golf Championship, the Rainforest World Music Festival and the Borneo International Jazz Festival, which attract mass arrival of international tourist.

According to World Travel and Tourism Council (WTTC) (2014), Malaysia's tourism industry contributed 16.1 percent (RM 158.2 billion) to its GDP in 2013. WTTC (2014) forecasted this contribution to increase further to 16.4 percent of GDP (RM 168.9 billion) in 2014. Furthermore, Malaysian tourism industry contributed 14.1 percent (1.86 million jobs) of total employment in 2013 and is projected to contribute to 14.5 percent (1.95 million jobs) of total employment in 2014.

In addition, the role of tourism industry is highlighted in the Economic Transformation Programme (ETP), which is introduced to lead Malaysian economy towards achieving the status of high income nation by 2020. A successful ETP will

58 divert Malaysia into service-based economy in which service sector will contribute to 65 percent of GDP. Under ETP, 12  
59 National Key Economic Areas (NKEAs) are identified as the key engines of growth and tourism industry is included in the  
60 list.

61 Malaysia has a strong position for its tourism industry as it was ranked in top 10 for both the most visited country  
62 and tourist arrival in the world, as well as ranked in top 15 in terms of global receipts (PEMANDU, 2010). Therefore, it is  
63 important to study the factors affecting tourism demand in Malaysia as this particular industry will play an important role in  
64 the future development of Malaysian economy.

65 Thailand was ranked second in tourist generating countries for Malaysia from 2000 until 2006. Nevertheless,  
66 Thailand's ranking has dropped to be the fifth tourist generating country for Malaysia starting from 2012. Despite this, the  
67 average annual growth for Thai visitor arriving into Malaysia is 2.43 percent for the period 2000 to 2013. Table 1 shows  
68 the number of Thai tourist arrival into Malaysia, their market share and annual growth from 2000 to 2013.

70 **Table 1:** Thai Market Analysis in Malaysia's Tourism Industry

71

Year	Tourist Arrival (Person)	Market Share (Percentage)	Annual Growth (Percentage)
2000	940,215	9.2	88.6
2001	1,018,797	8.0	8.4
2002	1,166,937	8.8	14.5
2003	1,152,296	10.9	-1.3
2004	1,518,452	9.7	31.8
2005	1,900,839	11.6	25.2
2006	1,891,921	10.8	-0.5
2007	1,625,698	7.8	-14.1
2008	1,493,789	6.8	-8.1
2009	1,449,262	6.1	-3.0
2010	1,458,678	5.9	0.6
2011	1,442,048	5.8	-1.1
2012	1,263,024	5.0	-12.4
2013	1,156,452	4.5	-8.4

Source: Tourism Malaysia (2014).

72  
73 As depicted in Table 1, Thai tourist arrival has shown an upward trend from 2000 to 2005, with the highest tourist arrival  
74 in 2005 (accounted for 11.6 percent of total tourist arrival in Malaysia). However, since 2006, Thai tourist arrival has  
75 shown a downward trend until 2013 with the highest negative annual growth of 14.1 percent in 2007. The decreasing Thai  
76 tourist arrival in recent years has raised the needs to study the factors affecting Thai tourist arrival into Malaysia. The  
77 main objective of this paper is to empirically examine the Thai tourism demand in Malaysia from a macroeconomic  
78 perspective.

## 80 2. Literature Review

81  
82 In the study of tourism demand, tourist arrival has been utilized by a number of studies such as Dritsakis (2004), Garin-  
83 Munoz and Montero-Martin (2007), Ouerfelli (2008), Habibi et al. (2009), Kusni et al. (2013) and Kadir et al. (2013) to  
84 represent tourism demand. In Dritsakis' (2004) study, the author found that the real income of origin country is significant  
85 and elastic for both German and UK tourists visiting Greece.

86 Other researchers such as Ouerfelli (2008), Botti et al. (2007) and Brida et al. (2008) also obtained results  
87 supporting elastic coefficient for income in the cases of France, Mexico and Tunisia, respectively. The elastic income  
88 coefficient indicates that tourism is a luxury good given that demand increases more than proportionate to a change in  
89 income.

90 On the other hand, Garin-Munoz (2006) pointed out that transportation cost or travel cost is also an important  
91 explanatory variable to be included in tourism demand study. This variable measures the travel expenditure of tourist to  
92 travel from their origin country to the tourism destination and this expenditure makes up a considerable part of total  
93 expenditure of their trip. Dritsakis (2004) and Nelson et al. (2011) are among the researchers who have included travel  
94 cost in examining tourism demand. Both authors utilized the airfare to measure the travel cost in their study.

95 Nev ertheless, Mohd Salleh et al. (2007) revealed that difficulty exists in determining the exact flight that tourist  
96 bought and hence the amount of airfare paid. As such, Mohd Salleh et al. (2007) suggested to proxy travel cost using

97 crude oil price. This proxy is also used in number of studies such as Garin-Munoz and Montero-Martin (2007), Garin-  
98 Munoz (2006), Mohd Salleh et al. (2008) and Habibi and Abdul Rahim (2009).

99 In addition, exchange rate is evidenced to be a significant variable to explain tourism demand as revealed in the  
100 studies by Dritsakis (2004), Ouerfelli (2008), Mohd Salleh et al. (2007) and Mohd Salleh et al. (2008), to name a few. The  
101 appreciation of origin country's currency against the destination's currency will encourage tourists to travel as their  
102 spending power has increased and they are able to purchase more goods and services in tourist destination.

103 According to Purchasing Power Parity, the depreciation or appreciation of the exchange rate also reflects the  
104 difference in the rate of prices (or the difference in inflation rates) in origin country and destination country. Thus,  
105 exchange rate variable carries the information of both price levels in tourist origin country and tourism destination. The  
106 price levels carry information of cost of living in the destination as compared to the country of origin.

### 108 3. Model, Data and Methodology

109 The following function is used in examining Thai demand for tourism in Malaysia:

$$110 \quad TA = F(Y, TC, EX) \quad (1)$$

111 where TA represents Thai tourist arrival to Malaysia, Y proxies the real income of Thai, TC is the real travel cost  
112 and EX is the exchange rate between Thailand and Malaysia.

113 A positive relationship is expected to exist between Thai real income and tourism demand in Malaysia. This  
114 indicates that an increase in Thai real income will encourage more Thai tourist to visit Malaysia and vice versa, a decline  
115 in Thai real income subsequently will reduce the Thai tourist visiting Malaysia. Thai real income is computed by deflating  
116 Thai GDP with its consumer price index (CPI).

117 Meanwhile, real travel cost is expected to have a negative relationship with Thai tourist inflow to Malaysia. Higher  
118 real travel cost would increase the total cost of the trip and reduce the visiting Thai tourist to Malaysia. The real travel cost  
119 proxy used in this study is real crude oil price. Real crude oil price is calculated by deflating crude oil price with the CPI of  
120 the US.

121 The existence of a positive relationship between exchange rate and tourism demand is expected, which in  
122 particular, the appreciation of Thai Baht will encourage more Thai visitors travelling to Malaysia and vice versa, Thai Baht  
123 depreciation will decrease the number of Thai tourists visiting Malaysia. The exchange rate variable used in this study is  
124 the ratio of currency between Malaysia and Thailand.

125 The tourism demand model to be examined in this study is expressed as follow:

$$126 \quad LTA = \beta_0 + \beta_1 LY_t + \beta_2 LTC_t + \beta_3 LEX_t + \varepsilon_t \quad (2)$$

127 The data for Thai tourist arrival were collected from Tourism Malaysia<sup>1</sup>, while the data used to compute Thai real  
128 income and exchange rate were collected from International Financial Statistics (IFS) published under International  
129 Monetary Fund (IMF) and for travel cost, crude oil price data were obtained from Global Economic Monitor published by  
130 World Bank. All variables were transformed into natural logarithm form before conducting any estimation. The period  
131 covered in this study is from 2000Q1 to 2013Q4, utilizing quarterly observation.

132 The empirical testing procedures started off by examining the time series properties of the variables utilizing the  
133 Augmented Dickey-Fuller test (ADF) unit root test (Dickey and Fuller, 1979; 1981). The next step after identifying the time  
134 series properties of the variables was to test for long-run relationship among the variables by implementing the Johansen  
135 and Juselius multivariate cointegration test (Johansen and Juselius, 1990).

136 Once the long-run cointegration relationship was established, Error-Correction Model (ECM) was carried out to  
137 determine the interaction among the variables. ECM is also able to investigate the speed of adjustment of the dependant  
138 variable back to equilibrium when there are changes in explanatory variables. Short-run Granger causality test result was  
139 obtained from ECM before running a series of diagnostic tests to ensure that the model is robust.

### 142 4. Empirical Results

#### 143 4.1 Unit root test results

144 This study utilized ADF unit root test to determine the time series properties of variables. Table 2 shows the results of  
145 ADF unit root test. The null hypothesis of unit root is not rejected at the level, but it is rejected after first differencing.

<sup>1</sup> Data of tourist arrival from Thailand is downloaded and compiled from [http://corporate.tourism.gov.my/research.asp?page=facts\\_figures](http://corporate.tourism.gov.my/research.asp?page=facts_figures).

Hence, all variables were integrated of order one or  $I(1)$  as illustrated in Table 2.

**Table 2:** ADF Unit Root Test Results

Variable	Level	First Difference
LTA	-1.137 (3)	-5.096 (3)***
LY	-1.218 (3)	-4.376 (3)***
LTC	-2.471 (3)	-4.388 (3)***
LEX	-2.706 (3)	-5.482 (3)***

Notes: LTA = natural log of tourist arrival, LY = natural log of real income, LTC = natural log of real travel cost, and LEX = natural log of exchange rate. Asterisk (\*\*\*) indicates significant at 1 percent level. The lag selection criteria is based on on Schwert (1987) criteria.

#### 4.2 Multivariate cointegration test results

Once the variables were identified to be integrated of order one, Johansen and Juselius multivariate cointegration test was implemented to determine the number of cointegrating vector(s) in the model. The null hypothesis of zero cointegration ( $r = 0$ ) is rejected by both maximum eigenvalue and trace statistics at 5 percent level of significance as shown in Table 3. However, we are not able to reject the null hypothesis of at most one cointegrating vector. Thus, the existence of a single cointegrating vector in the model lead us to presume that there is a long-run relationship among the variables in the model.

**Table 3:** Johansen and Juselius Cointegration Test Results

$H_0$	$H_1$	$\lambda_{max}$	$\lambda_{trace}$
Variable: LTA, LY, LTC, LEX			
$r = 0$	$r = 1$	35.510**	57.165**
$r \leq 1$	$r = 2$	15.057	21.654
$r \leq 2$	$r = 3$	4.354	6.597
$r \leq 3$	$r = 4$	2.242	2.242

Notes:  $r$  is the number of cointegrating vectors. Asterisk (\*\*) indicates significant at 5 percent level. The optimal lag length for VAR model is three, which is selected based on Schwert (1987) criteria.

#### 4.3 Normalized cointegrating vector estimates

The evidence of long-run equilibrium relationship found in the cointegration test allows us to normalize the obtained cointegrating vector with respect to the dependant variable (LTA) in order to obtain the long-run estimates of the independent variables. The following equation shows the estimated results acquired from vector error correction estimates:

$$LTA = -50.145 - 5.813 LY + 1.473 LTC + 8.028 LEX \quad (3)$$

(-5.45)
(4.60)
(4.32)

The  $t$ -statistic is reported in the parentheses and indicates that all the estimated coefficients are statistically significant at 1 percent level. The estimated sign of real income is negative, which contradicts the theory. Higher Thai real income in this case will lead to the decrease in Thai tourist arrival to Malaysia. The possible explanation behind this phenomenon is that Thai tourist with higher income seek for alternate tourism destinations in other countries rather than their neighbouring countries. The increase in income will encourage Thai tourist to travel to other tourism destinations which previously may be perceived as expensive and unaffordable for them.

Real travel cost is identified to have a positive relationship with Thai tourist arrival into Malaysia. In other words, increase in real travel cost will increase visiting Thai tourist to Malaysia. This positive relationship can be explained by considering the possibility that higher real travel cost will subsequently increases airfare, which discourages Thai visitors to travel via airline services. Therefore, as an alternative, they tend to use their own transportations to travel to Malaysia, their neighbouring country.

In relation to that, Thai visitors are also more probable to travel to Malaysia using their own transport as they can

184 take the advantage to buy petrol in Malaysia, which is cheaper due to the subsidies provided by Malaysian government. A  
 185 trip to Malaysia using their own transportation would be pleasant for Thai tourists as they can enjoy their travelling trip in  
 186 Malaysia and return home purchasing cheaper petrol at the same time.

187 Finally, exchange rate has a plausible sign and in line with past literature. The positive relationship between  
 188 exchange rate and tourism demand implies that appreciation of Thai Baht will increase Thai tourist travelling to Malaysia.  
 189 Thai visitor will perceive that they are wealthier when their currency appreciates as more unit of Malaysian Ringgit can be  
 190 exchange by a unit of Thai Baht. This situation will lead Thai to perceive that travelling and spending in Malaysia is  
 191 cheaper than before.

192  
 193 **4.4 Estimation of error-correction model**  
 194

195 In Table 4, the summarized estimation of ECM for Thai tourism demand in Malaysia is presented. The model passes all  
 196 the diagnostic tests. The estimated residuals are normally distributed with constant variances, free from serial correlation  
 197 and misspecification. In addition, the CUSUM and CUSUM of squares stability tests indicate that the model is stable  
 198 within the period of study.

200 **Table 4:** Estimation of Error-Correction Model

Variable	Coefficient	t-statistic	p-value
Constant	0.006	0.216	0.829
$\Delta LY_{t-1}$	1.812	2.575	0.013
$\Delta LTC_{t-2}$	-0.275	-1.772	0.082
Dum2001Q4	-0.630	-3.181	0.002
ECT(-1)	-0.246	-3.157	0.002
Diagnostic Tests:			
$R^2$	0.341	ARCH[1]	1.068 [0.306]
$\bar{R}^2$	0.286	RESET	0.189 [0.665]
JB	3.297 [0.192]	CUSUM	Stable
AR[2]	3.189 [0.050]	CUSUM <sup>2</sup>	Stable

Notes: JB is the Jarque-Bera statistic for testing normality, AR[2] and ARCH[1] are the Langrange Multiplier tests for 2nd order serial correlation and ARCH effects, respectively. RESET refers to the Ramsey RESET specification test while CUSUM and CUSUM2 refer to CUSUM and CUSUM of squares stability tests.

202  
 203 The estimated error-correction term (ECT) is statistically significant and has the correct negative sign for its coefficient,  
 204 which implies that the variables in the system are cointegrated in long-run (Kueh et al, 2009). As suggested by the ECT  
 205 value, approximately 24.6 percent of short-run deviations of tourism demand will be adjusted in quarterly basis towards  
 206 the long-run equilibrium state<sup>2</sup>.

207 Table 5 demonstrates the short-run causality test results obtained from the ECM. The null hypothesis of no causal  
 208 relationship is rejected for real income and real travel cost at 5 and 10 percent significant levels, respectively. This implies  
 209 that tourism demand is influenced by both variables in the short-run. This also suggests that Thai visitors are influenced  
 210 by the wealth effect, where they perceive they are wealthier when their real income increases and travel more often to  
 211 Malaysia in the short-run. Moreover, Thai travellers are also responsive to the changes in travel costs, where they have  
 212 the alternative to travel to Malaysia using their own transports when travel cost increases in the short-run.

214 **Table 5:** Short-run Granger Causality Test Results

H <sub>0</sub>	p-value	Causal Inference
LY does not Granger cause LTA	0.013	Reject H <sub>0</sub>
LTC does not Granger cause LTA	0.082	Reject H <sub>0</sub>

216  
 217  
 218  
 219

<sup>2</sup> A dummy variable (Dum2001Q4) is included in the ECM to capture the impact of terrorist attack in September 2011.

## 5. Summary and Conclusion

This study examines the factors affecting Thai tourist arrival into Malaysia from the macroeconomic point of view. The independent variables utilized in this study are real income, real travel cost and exchange rate. First of all, time series properties of the variables were identified to be  $I(1)$  by the ADF unit root test. Next, Johansen and Juselius multivariate cointegration test confirmed the existence of long-run equilibrium relationship among the variables under studied.

The normalized equation shows that two of the variables have reversal sign and one with plausible sign. The reversal sign of real income is possible considering Thai visitor may travel to other countries in the long-run when their real income increases. They feel that they afford to travel to other countries rather than only their neighbouring country.

On the other hand, the positive sign of real travel cost is viewed with the possibility that an increase in real crude oil price (proxy for real travel cost) will increase airfare and subsequently, Thai visitors may choose to travel to Malaysia using their own transportation. Another probable explanation is the airfares travelling to Malaysia are relatively cheaper as compared with airfares to other countries, although both airfares may have increased.

Exchange rate is the only variable with plausible sign in line with past literature. In the long-run, appreciation of Thai Baht will increase Thai tourist to Malaysia as one unit of Thai Baht can be exchanges for more units of Malaysian Ringgit. In other words, goods and services in Malaysia are relatively cheaper and this will attract more Thai tourists into Malaysia.

ECM was performed to determine the interaction between the variables of study. Results obtained from the ECM once again confirmed the existence of long-run equilibrium relationship among the variables in the model. Short-run deviations will be adjusted back towards the long-run equilibrium. In addition, Granger causality test was carried out and the results indicated that real income and real travel cost could be used to predict the future movement of Thai tourist.

Policy implications that can be suggested in this study are to improve the attractions of Malaysia's tourism, and to increase the promotion of Malaysia's tourism in Thailand. In the long run, less Thai tourists will travel to Malaysia because as their real income increases, they start to travel to other countries. Therefore, tourism authorities in Malaysia should increase the attractiveness of their tourism destinations to ensure that Thai visitors revisit Malaysia because of these attractions. These attractions may exist in the form of uniqueness of its cultures, products and the environment in the destinations.

Also, Thai visitors who are satisfied of their trip to Malaysia or, are attracted by the uniqueness of Malaysia's tourism will share their experiences with their friends and families. Therefore, increasing promotion of Malaysia's tourism is parallel with the spread of information about Malaysia's tourism to attract potential Thai visitors. The spread of information together with the timely promotion of Malaysia's tourism is able to grasp Thai tourists as such pertinent information will ease the concern regarding safety of the destination.

Additionally, by knowing that Thai tourists are likely to travel to Malaysia when the travel cost increases, Malaysia should prepare to welcome Thai tourists when an increase in the real crude oil price (the proxy for real travel cost) is observed. Once again, a timely promotion campaigns in Thailand during the period of increasing travel cost is expected to attract more Thai tourist arrival.

In short, tourism sector in Malaysia plays an important role in developing its economy, not only in the past but in the future as well. Since WTTC has pointed out that tourism industry has a wider impact on an economy via its direct and also indirect or induced contributions, it is essential to study the factors affecting tourist arrival to Malaysia. This study focused on determining the factors affecting tourist arrival to Malaysia for the case of Thailand, which ranked fifth in the tourist generating countries for Malaysia. With the knowledge of factors affecting tourist arrival to Malaysia, Malaysia tourism authorities can design appropriate policies to attract more international visitors.

## 6. Acknowledgement

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## Acts of Corporations as the Main Factor in the Lapse of the Right of Participation in Corporations

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### Abstract

The article is devoted to acts of corporations as the main factor in the lapse of the right of participation in corporations. In recent years corporate relations in general were the object of scrutiny. The main discussion was expanded in the field of explanations of their nature and place in the system of civil law. The priority was the concept of special and not contractual nature of corporate relations. The result of developed dispute was large-scale changes in the legislation of the Russian Federation on legal entities. The changes affected not only the Civil code of the Russian Federation (hereinafter - the CC), but the Federal law of 08.02.1998 No. 14-FL "On limited liability companies", the Federal law dated 26.12.1995 No. 208-FL "On joint stock companies". The lapse of the right of participation is associated primarily with the disappearance of one of the parties of the membership relationship. It is either a liquidation of the corporation, the output of member of the corporation, or conclusion of disposing civil transactions. Liquidation is considered as a corporate procedure, resulting in the termination of a legal entity. Liquidation is considered as a corporate procedure, resulting in the lapse of a legal entity. The output of member of the economic society is carried out on the basis of his act. Thus, such an act would be in itself a ground for lapse of the participation rights as since its implementation the legal status of the participant is lapsed. Participation right is lapsed by one partner and begins with another. For a business entity any effect does not occur, because the identity of a particular participant does not matter, there are no changes in the structure of the corporation. Only the subject is changing in the membership relationship.

**Keywords:** participation in the corporation, the corporation, the right to participate, a business company.

### 1. Introduction

Any business company exercises the rights and acquires responsibilities through its bodies. Acts of bodies of the legal entity are legal facts (Bevzenko, R.S. Theory of legal facts, 2007.). There is generally accepted scientific classification of bodies of a legal entity:

- a) individual;
- b) collegial.

The first group is the individual executive body. The collegial include: the general meeting of members of the corporation, the board of directors (supervisory council), the collegial executive body.

58 In our opinion the most controversial category of corporate law are the acts of the collegial executive bodies. It is  
59 written very much about the decisions of general meetings in foreign and domestic literature. For example, R. S.  
60 Bevenko identifies the following approaches to the legal nature of decisions of the general meeting of members of  
61 corporations:

- 62 a) the theory of normative local act;
- 63 b) the theory of dealing;
- 64 c) the theory of special legal fact;
- 65 d) the theory of non-normative legal act (Berle, Adolf A., 1991; Berle F.F., 1991 and civil Code of Russia,  
66 <http://base.consultant.ru/cons/cgi/online.cgi?base=LAW;n=156206;req=doc>).

67 Normative theory ranks the solutions to sources of objective right. One of the varieties of normative theory was the  
68 theory of socio-legal act (Vilkin, S. S., 2009; and Cahn, Andreas, 2010), in which the decision was perceived as a  
69 normative act for persons involved in the corporation.

70 The following approach is the most common and significant in the Russian scientific literature, it is the transaction  
71 theory of decisions of the general meeting of the members of the corporation. In favor of the transaction theory of  
72 decisions of the general meeting of participants with arguments indicates, that:

- 73 a) the solution is directed will of the legal person, which has a legal character, being a rule of conduct, defined by  
74 individuals vested power in body of the legal entity (Rubenko, G. L., 2015);
- 75 b) the solution entails legal consequences, which aims such will, such as creating obligations for the participants  
76 of the legal entity and its bodies, changes in the organizational unit of a legal entity, the occurrence of  
77 contractual rights requirements, authorizing of any action or other consequences. (Rubenko, G.L., 2015).

78 Furthermore, in his researches Stepanov D. I. in particular notes that the decision of the general meeting of  
79 participants of the corporation has initially lawful character and definitely is a legal fact, because that creates, modifies  
80 and terminates civil matters. (Kuzmin, A.I., 2014; Clark, Robert C., 1986; and Orts, E., 1992).

81 The priority was the concept of special and not contractual nature of corporate relations (Drury, R., 2007;  
82 Parkinson, J., 1993.; and Robert, A.G., 1995). The result of permitted dispute became large-scale changes in the  
83 legislation of the Russian Federation on legal entities. The changes affected not only the Civil code of the Russian  
84 Federation (hereinafter - the CC), but also the Federal law of 08.02.1998 No. 14-FL "On limited liability companies" (Civil  
85 code of the Russian Federation (hereinafter - the CC) and Federal law from 08.02.1998 No. 14-FL,  
86 <http://base.consultant.ru/cons/cgi/online.cgi?base=LAW;n=156206;req=doc>), the Federal law dated 26.12.1995 No. 208-  
87 FZ "On joint stock companies" (Civil code of the Russian Federation, part two from 26.01.1996 No. 14-FL,  
88 <http://www.consultant.ru/popular/gkrf2/>).

## 90 2. Materials and Methods

91  
92 The decision of the general meeting of participants is recognized the special legal fact, which does not apply to  
93 transactions. The total resolution of the meeting of participants of the economic entity, with the purposes of the acquisition  
94 of property of a legal fact, should go through the procedure stipulated by the law that provides the decision in accordance  
95 with the competence of the authority. These factors contribute to the interests of the corporation and its members in  
96 particular, ensure the will of the voting persons and fixation of this desire.

97 The will of the participants is one-sided binding transactions that do not have a counter character. The decision of  
98 the general meeting, usually do not consider an act of will, because there is no formation of any joint will. In the basis of  
99 decisions of the General Assembly lies volitional activity, as the will manifests itself in the voting procedure and its defect  
100 should be evaluated only in the study of voting. Therefore, the acts of corporations include acts of bodies of legal entities,  
101 aimed at the movement of internal relations (Ashtaeva, S. S., 2013; Cohen, M. S., 2008; and Kraakman, Renier, 2009).

102 It should be noted that the classification, considering from the point of view of civil law, depends on which the body  
103 of the legal entity made the decision:

- 104 a) collegial;
- 105 b) individual.

106 So, the acts of the individual executive body, in the framework of corporate relations, must be qualified as legal  
107 actions. And acts of collegial bodies can be classified as collegial volitional acts, a special group of legal facts. A process  
108 procedure of their adoption, the grounds of invalidity and legal consequences that they entail unite these acts. The  
109 procedure for the lapse of the right of participation may occur when:

- 110 a) liquidation of the company;
- 111 b) exit from company;

112 c) exclusion of partner.

113 In accordance with the Art. 62 CC the decision on liquidation should contain not only the decision to dissolve the  
114 corporation (Gabov, A.V., 2011), but must also be specified the time and manner of carrying out this enterprise  
115 procedures. After the decision on liquidation the corporation ceases to exist (Gabov, A.V., 2011), as a consequence the  
116 corporate legal relations break up and all rights of participation in society is redeemed. To the legal forms of liquidation of  
117 the legal entity can be attributed the circumstances:

- 118 a) grounds for liquidation (Gabov, A.V., 2011). That is, those legal facts, with which the legislation relates the  
119 beginning of the liquidation procedure;
- 120 b) the order of liquidation. That is, the set of legal facts necessary for any legal purpose of liquidation (laose of a  
121 legal entity);
- 122 c) consequences liquidation. An important consequence is the lapse of a legal entity. An important feature of the  
123 solution is its real, enforceable nature.

124 Information letter of the Presidium of the Supreme Arbitration Court of the Russian Federation of 13.01.2000 No.  
125 50 (Arbitration procedural code of the Russian Federation dated 24.07.2002 No. 95-FL, [http://www.consultant.ru/  
126 popular/apkrfl/](http://www.consultant.ru/popular/apkrfl/)) when resolving disputes related to the liquidation of commercial organizations, proposes to apply the rule,  
127 when the decision on voluntary liquidation of a legal entity does not exclude the possibility of recourse to the court for its  
128 compulsory liquidation, if the above solution fails and there are grounds provided for n. 2 Art. 61 of the CC of RF.

129 Gabov A. V. in his works believes that inane decision on liquidation cannot be without the appointment of a  
130 liquidation Commission, the detailed definition of the order of liquidation and its specific term (Ashtaeva, S.S., 2013). For  
131 its purpose the decision on reorganization of the company and the decision on liquidation is similar in many points. For  
132 example, the liquidation decision also establishes the procedure, rules of conduct, the liquidation procedure, however, is  
133 not grounds for lapse of the participation rights. However, in terms of violations of established by the corporation and the  
134 law liquidation procedure shall entail the invalidity of the entire liquidation.

135 The decision of the general meeting of commercial companies runs, and most importantly regulates the legal  
136 structure of the liquidation of the company. At the same time, the separate corporate acts of the parties or of the  
137 individual executive body do not have any independent value. It happens because this procedure affects the rights of  
138 third parties, as well as to the participation rights of all members of the corporation.

139 In connection with the disappearance of one of the parties the membership of legal relations terminates and as a  
140 consequence cease participation rights.

141 The main feature of the procedure of lapse of the right of participation is the widespread use of acts of members of  
142 corporations. So, in joint stock companies often used the right of the participant (shareholder) on redemption of shares  
143 (Glushetski, A.A., 2013., <http://base.garant.ru/70109900/1/>). For example, in accordance with Art. 75 of the Law on joint  
144 stock companies the right of a shareholder to require the compulsory redemption of his shares by the company is  
145 established. The redemption of shares by a person who has acquired more than 95% of the shares, at the request of  
146 other shareholders regulates Art. 84.7. Article 84.8 of the Law on corporations establishe reverse obligation of the  
147 shareholders to sell their shares upon request of the person who has acquired more than 95 % of the shares in the  
148 authorized capital of the company. In addition there are the shareholders ' request for redemption of shares - in this case,  
149 there are also grounds for lapse of the participation rights (Glushetski, A.A., 2013., <http://base.garant.ru/70109900/1/>). In  
150 each of these cases happens the lapse of the participation rights in the society and these sample requirements, as stated  
151 above, are unilaterally binding transactions. There is no need for any other transactions for the ensuing consequences. It  
152 can be stated that the corporations the right of participation may be terminated unilaterally. The position of some authors  
153 runs that this requirement constitutes an offer to the buyer, and is not true.

154 The offer implies a further conclusion of a civil contract. At purchase of shares there is no agreement, the  
155 obligation arises by virtue of the application requirements, conditions are determined in the order prescribed by law and  
156 are objective (Glushetski, A.A., 2013.). From this it can be concluded that in this case tere is no existence of a civil  
157 contract (Vilkin, S.S., 2009, <http://base.garant.ru/70109900/1/>).

158 The coercive and unilateral nature of corporate relations appears, after the lapse of membership relations at the  
159 company's property duty on paymentof the value of the shares occurs.

160 Identical is the situation with the output member of the LLC (limited liability Company: the Federal law from  
161 08.02.1998 No. 14-FL, <http://www.consultant.ru/popular/ooo/>). This transaction, in itself, is ground for lapse of the right of  
162 participation. Under part 7 of article 23 of the Law on LLC the share proceeds to the company from the date of receipt by  
163 the company of the participant's application to withdraw from the society or the requirements of this share repurchase.

164 And in this case, this situation cannot speak about signing any civil contract (The Concept of development of civil  
165 legislation of the Russian Federation, appr. by the decision of the Council under the President of RF

166 <http://base.consultant.ru/cons/cgi/online.cgi?base=LAW;n=95075;req=doc>).

167 It can be stated that in the conditions of lapse of the right of participation unilaterally require the existence of  
168 regulatory bodies and legal relation prerequisites.

169 That is, the appropriate legal relations related to participants' votes on certain issues are necessary, when the  
170 direction of requirements connected with making certain decisions. Regulatory prerequisites are the provisions of the  
171 legislation of the Russian Federation, the company Charter, decisions of the General shareholders meeting, which will  
172 regulate the ability and the exercise of the powers of the output. In law prerequisites must be included General civil legal  
173 personality.

174 Thus, taking into account both the presence of conditions for lapse of the right of participation and expression in  
175 accordance with the legislation of the Russian Federation there is a right to lapse the participation rights. It should be  
176 noted that the will must be made on the form prescribed by the legislation of the Russian Federation. The ability of a party  
177 to unilaterally lapse membership in the society confirms the importance of the sign of the membership relationship. The  
178 emergence of a contractual relationship arises from the moment of lapse of the relationship, and the termination of the  
179 right of participation (Kuzmin, A.I., 2014).

180 The multiplicity of acts of application of corporate companies, aimed at the lapse of the right of participation in  
181 societies that create a protective legal framework, providing opportunities for participants to leave the corporation on their  
182 own. In contrast, the acquisition of the right of participation in the corporation and its members are virtually non-existent  
183 due to the fact that joining the ranks of the members of the corporation may be made only as a result of a civil law  
184 transaction, either as a result of changes in the structure of society.

185 The emergence and lapse of the right to participate in corporate companies is always associated with the  
186 origination and lapse of membership, the membership relationship. Share or shares does not pass to the company and  
187 back to the participants (Kuzmin, A. I., 2014). They arise at one party membership relationship and are lapsed in  
188 connection with its disappearance. The reason for accrual of the right of participation is the fact of establishment of the  
189 corporation, or its contribution to the authorized capital of the corporation. Ground for lapse of the right of participation is  
190 the termination of the corporation, the participant unilaterally. (Berle, F.F. and Means G.C., 1991)

191 Changing participation rights can be quantitative and qualitative. Quantitative changes associated with changes in  
192 the ratio of the company shares, and quality due to volume changes in rights participation rights or the manner of their  
193 implementation.

194 The basis for quantitative changes is the investment in the assets of the corporation, or the acquisition of shares by  
195 the member of the corporation, if such actions involve a change in the ratio of shares in the company.

196 Qualitative changes associated with the existence of the new edition of the Charter of the Corporation or its internal  
197 documents. Qualitative changes associates with the existence of the new edition of the Charter of the corporation or its  
198 internal documents.

199 Collective volitions are not legal basis for the emergence, change and lapse of participation rights. Such acts are  
200 installing only the rules of procedure, which may occur in the movement of the participation rights are preconditions of  
201 such motion. (Kuzmin, A.I., 2014).

202 The acts of a member of the corporation are not the basis of the origin and changes of the right of participation,  
203 however, may constitute ground for lapse of the participation rights. The lapse of the right of participation is possible in  
204 the unilateral action of the party the corporation aimed at the exit of the corporation.

### 206 3. Conclusion

207  
208 At the conclusion of accurate civil transactions there is a change in the membership of the legal side of the member of  
209 corporation, then as a meaningful relationship does not change. As the result of this transaction, the party always ends  
210 the right to participate and it occurs in another subject (side of deal). For corporations, this action has no legal  
211 significance because it does not change its structure, the share capital remains fully paid. (Berle, F.F. and Means G.C.,  
212 1991).

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# Russian New Industrialisation Policy as a Change-Over Method to the Postindustrial Economics

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## Abstract

Hydrocarbon export-focus, step-by-step degradation and critical situation in the industrial branch, native goods displacement by the import, high energy dependence and attachment to the world raw prices make the Russian Economics ineffective, noncompetitive and unstable to crisis. The key point of this research is to show the aspects that are necessary for creation country postindustrial development. Developed and developing GDP structure and growth analysis has led to the definite conclusions as for the necessity of competitive industrial sector with high percentage of innovative product creation. In the article also presented the consequences of the highly developed countries' actions relative to the productions transfer in the countries with the lowest economic costs. There is shown that Russia's postindustrial economic development change-over is impossible without creation of the effective competitive industrial sector based on state-private partnership.

**Keywords:** new industrialization, postindustrial economics, innovative activity, industrial sector, state-private partnership.

## 1. Introduction

More than twenty years ago Russia changed socialistic development way on liberal, chose market economy instead of command-planned economy. In the 1990s Russian Federation after realizing economic reforms faced with several social-economic problems such as hyperinflation, economics barter, decreasing country GDP, brain drain, cutoff scores industrial productions, criminality increasing, decreasing real population's salary [Kara-Murza, 2008]. For instance, GDP increasing tempo decreased by 15 percentage. In the post socialistic countries recovering period took in average 3-4 years. Russia at the same time was able to rehabilitate the pre-crisis level of GDP of the 1989 year, only by 2007 thanks to costs conditions on the world raw and energy market of the 1999-2000s [RFSS, 2014].

Liberalization of the foreign commerce and costs, and also new taxation policy have led the production to the critical point in all industrial spheres: construction engineering, mechanical engineering, shipbuilding, consumer goods, foodstuff and manufacturing industries reduced the country size production of more than two, moreover lots of factories lost almost all the circulating assets because of hyperinflation.

As a consequence of the hyperinflation the population salaries, savings and incomes depreciated, salary payments became irregular, barter took place in the economics [Esipov, 2007].

These consequences of the created so-called quasimarket economy, characterized as imperfect and incomplete, with obvious presence of the populism and lobbying of the modern class property owners after privatization, nowadays have strong influence [Lopatnikov, 2006].

Critical situation in the industrial sector generate a chain of interconnected social-economic problems. Statistic data and comparative characteristic of the industrial cluster of the 2010 and 1990s are declarative of a serious disruption in the basic spheres of the Russian industry after USSR disintegration. In order to determine post-soviet period market economy results we go over several facts. Definitely, in order to take into account common territorial factor and only industrial sector, we should compare only Russia and RSFSR.

Industrial production coefficient decreased more than by 50 percentage in comparison with the level of 1991. Since 2000s this index in Russian Federation is increasing, but is not able to reach pre-reform period rates.

Steel production in the RSFSR in 1971 amounted 66,8 million ton, in the crisis 1991 were produced 77,1 million ton, and in 2012 there were 70,4 million ton. It means that production rates in this period still have not reached twenty years ago rates, that automatically pushes the country twenty years back as for the steel production [RFSS, 2014]. The similar situation is in the steel tubs production.

The key coefficient for industrial developed country is the machine and equipment production index. Last twenty years in the mechanical engineering takes place gradual native goods displacement by the import.

Machine and equipment production index in Russia decreased more than 70% in 1998 in comparison with 1991. In

59 2007 machine production was seriously strengthened, but still the best rates are 30% lower than in 1991. Black metals  
60 roll stock was in 2012 61,8 million tons, in 2010 – 57,8 million tons, in 1990 – 63,7 million tons, in 1978 – 60,1 million tons  
61 [RFSSS, 2014].

62 Agrocultural machines production decreased in modern Russia 28 times and variety of products were totally  
63 displaced by the import. This type production degradation, exactly agricultural tractors, was gradual: 1991 – 178 thousand  
64 ones, 1994 – 27 thousand ones, 1999 - 15,4 thousand ones, in 2010 - 6,2 thousand ones, in 2012 – 17,8 thousand ones  
65 [RFSSS, 2014]. It seems impossible to catch up with last years rates, despite active agriculture subsidizing by the  
66 government.

67 Construction-highway machines production also has strong cutoff. The following data about excavator production  
68 is observed: 1984 – 27,1 thousand ones, 1991 – 21,1 thousand ones, 2010 – 2,1 thousand ones, 2012 – 1,9 thousand  
69 ones. Stable regress took place in production and practically total machines displacement by the import ones.

70 Vehicles production is characterized by decreasing rates: 1970 – 445 thousand ones, 1991 – 616 thousand ones,  
71 2010 – 153 thousand ones [RFSSS, 2014].

72 So, there can be obviously observed gradual degradation in the industrial sector in Russian Federation. The main  
73 problems that the country faced with are the loss of working capacity in the end market and the replacement by the  
74 import. [Kara-Murza, 2008] Russia has not managed to achieve twenty-years-old rates in the production sector, it has not  
75 succeed in renewal of the industrial cluster and in looking on new markets. Russian Economy oriented on the  
76 hydrocarbon export last twenty years turned to the pre-industrial age. High country energy and also economy world costs  
77 dependence, native goods displacement by the import and high level of commerce in sectorial structure – it's far not  
78 complete list of standard points turned out in the economic state of Russian Federation. This way of development will not  
79 let the country be the leader in some economic statistics.

80 The industrial sector for developed countries is the basis for stable, effective economy; consequently, its absence  
81 may turn out unbearable obstacle in crisis periods [Dabrowski, 2009]. The 2008-2009s world economic crisis is the  
82 proving for this. It demonstrated that the countries with small industrial sector had bigger GDP decrease than in any  
83 industrial country. Poland is the country oriented on the export in the developed EU countries, that is why its GDP  
84 continued increasing, but at the same time Russian GDP lost 9%. High participation in industrial sector, based on  
85 competitiveness and innovative development that is what definitely guarantee stable and qualitative growth of the most  
86 important economic rates is the Russian Federation economic structure. It will create more stable and less world costs  
87 dependent economy [Tatarin, 2014].  
88

## 89 2. Method

90  
91 Nowadays there exist several approaches to postindustrial economic development of different countries. One of the  
92 intendings: "Developed countries do without industrial cluster". Actually, given excess takes place to be, that is rare to be  
93 come across though, in comparison with blanket situation. For example, participation of the manufacturing industry in  
94 postindustrial England amounts 20,8%, in Germany – 30,5%, in USA – 19,2%. China, India, Brazil are the most promptly  
95 developing countries, thanks industrial sector they provide GDP increase.  
96

97 **Table 1 – Developed and developing countries GDP structure**

Country	GDP sectors		
	Agriculture	Industry	Human-services
Developed countries			
USA	1,1	19,2	79,7
Germany	0,8	30,5	68,6
Great Britain	0,7	20,8	78,5
Japan	1,1	26,1	72,8
Canada	1,7	28,5	69,8
Biggest promptly developing countries			
China	10,1	45,3	44,6
India	17,4	17,6	65,0
Pakistan	24,4	22,0	53,6
Brazil	5,2	26,8	68,5
Russia	4,2	37,5	58,4

98 **Source:** World Fact Book [Electronic resource]. URL: <https://www.cia.gov/library/publications/the-world-factbook/geos/pk.html>  
99 [date of referring: 14.03.2014]

So, the leader in the industrial sector is China, its participation in industry amounts 45,3% of all GDP. It is not just coincident that this country is known as “world workshop.” In the sphere of human-services USA (79,75%), Great Britain (78,5%) and Japan (72,8%) are the leaders, and thanks exactly to these countries World Economy turned out to be financially inflated and virtual, unable to react to the world economic crisis. World crisis appeared very strong in the USA and Europe, also showing state debt increase. For example in 2007-2012 period, state debt in Germany increased from 65% to 82% of GDP volume, USA debt increased from 66% to 107%.

**Table 2** – GDP increase in developed and developing countries in 2001-2012, number of multiplies

Developed countries		Developing countries	
USA	1,2	China	2,9
Germany	1,1	India	2,2
Great Britain	1,2	Pakistan	1,7
Japan	1,1	Brazil	1,5
Canada	1,2	Russia	1.6

**Source:** World Fact Book [Electronic resource]. URL: <https://www.cia.gov/library/publications/the-world-factbook/geos/pk.html> [date of referring: 10.04.2014]

Last time in there is a tendency in the World Economy of decreasing of developed countries growth dynamics and increasing of developing ones, that definitely leads to change the world periphery correlation and world developing center, moreover lodgment of some countries with uncharacteristic for them economic power and geopolitical influence.

### 3. Results

Lop-sided vision of the Russian Economy in postindustrial spheres development is not able become a break of economic growth of Russian Federation. Postindustrial economy is unable to develop separately from industrial sector, as a primary consumer of innovative product. Postindustrial development of Russian Federation economy should be based on the priority of innovative sector with high-productive industry and realizing structural and institutional reforms, directed on economy flexibility increase.

Differential factors of postindustrial economy from industrial one are human capital, high level of life quality, venture business, developed innovative sector with hi-tech production. The main idea of postindustrial economy comes to increase of human-services and consequently decrease of industrial cluster participation in GDP at the expense of innovative hi-tech productions development. However, low participation or its decrease in not the index of postindustrial economy. For example, in Russian Federation human-services participation in 2010 amounted 62,7%, industry participation – 27,5% of GDP. In Ukraine Economy human-services participation amounted 56%, industry participation – 23,2%. However, significant human-services predominance does not mean that above-listed countries economy is postindustrial. Russian economy is characterized as raw, with noncompetitive industrial sector and high level of native goods replacement by the import. That is far not characteristic of postindustrial economy. Absolutely contrary situation is in Belorussia, human-services participation in its GDP amounts 44,4%, industrial participation – 46,2%. But economy is industrial with low participation of raw economy.

In 2012 the United States of America formerly exported productions in countries with cheap forces of production and minimal economic expenses thanks to invisible hand of market economy, started to return the industrial sector back into the country. American production transferring process in countries with the less economical expenses has led to increase of unemployment, decrease of a real salary in the given country [Vedomosti, 2013]. In 2010 in Detroit was organized the meeting of the White House officials, states governors and Congressmen with the heads of automobile corporations for the purpose of returning work-places and productions transferring back into the United States of America. The USA government actively support the companies working on the US territory, rendering benefits and subsidy for employees retraining [Stiglitz, 2011]. According to the BCG rating productions returning and export increase will let by the end of decade create in the USA industrial sector 0,6-1,2 million work-places, and taking into account multiplicative effect and employment growth human-services with productions enlarging — 2,5-5 million workplaces. Insourcing process goes rapidly not only in the USA, but also in Canada and Great Britain [KM, 2012]. According to the prognosis since 2014-2018 an average World Economy growth tempo will accelerate and will be on the level of 4% [GEP, 2014]. It will be thanks to returning of the industrialization policy in the developed countries [Rodnik, 2010].



Innovative activity cannot be created in an empty place, some technological basis in the industrial sector is necessary for the creation of new appreciation as an innovative product, having a potential interest of the consumer. At the same time even the novelty created in laboratories of innovative parks cannot to become relevant, because in Russia practically absent the technological basis, which could apply and use given elaborations and also to produce on their basis competitive hi-tech production. Because of these reasons created in recent time technologies became the innovation source of other countries or devaluated, not finding application and losing their actuality The participation of the shipped innovative production amounts only 5,5%, however, for the reasons of economic safety this index should be on the level of 15% and more. In order to achieve this level by 2019 it is necessary to increase the participation of innovative product 2% per year [Nekipelov, 2013]. It is necessary to create working programs, but not national projects which are called upon depicting their decisions [Biryukov, 2011].

#### 4. Discussion

As the result of everything said, we consider that it is necessary to improve partner relations system between state and business. State-private partnership proved its budget and social-economic effectiveness in the world practice. Effective realization of new innovative industrial policy is impossible without partnership of state and private sector. The government should determine development priorities, create profitable legal framework and stimulate involvement for the realization investment projects financial resources, hi-tech technologies, innovative decisions and employee potential of the private partner.

On Moscow economic forum, which took place in MSU in March 2014, the thesis: "Russian industrial policy: private-state or state-private partnership?" had been actively discussed by Russian economists, theoreticians and experts, and also by the representatives of the world community [MEF, 2014]. This topic actuality is connected with the increase of government participation in financial mobilization and first of all investment resources. In 2009 on the first Russian economic congress by the author of the article was done the report, in which state-private partnership (SPP) was examined as the modern universal mechanism of economic development, which gives an opportunity through the cooperation of state and business, focused on all society development, to achieve economic effect. However, state-private partnership realization is complicated by several problems legal, economic and administrative character [Vaslavskaya I., 2014].

State-private partnership is defined as the system of economical, organizational, lawful and social relationships arising between the government and the private sector of the national economic.

State-private partnership organization allows to cope with difficult social-economic problems by involvement of government and private sector resources. As the result of such partnership relations state innovative and investment programs are put into effect more effective and resulting [Tatarin, 2009]. State-private partnership acquires a particular significance while realizing of large-scale innovative projects. Let us view exactly the state-private partnership while realizing of large-scale innovative projects in the national economy system.

State-private partnership organization by the state and private sectors interaction concerned with the necessity of working up of useful for this particular case law base, tax stimulation extents accordance, organizational preferences usage, normative and law base introduction, institutional structure reforming by negotiated relationships creating, and also the ownership definition on the activity results.

Theoretical basis of the state-private organization concerned with economically reasonable business offers formulating , which reflects tendencies of developing and increasing of a country economic competitiveness from the point of view of the business and financing effectiveness increasing, management and economical activity increasing in the national economy from the position of the state.

State-private partnership should be based on parity relationships among innovative projects participants [Makarov, 2010]. De facto state-private partnership supposes important social services specter definition from the position of the state power, but from the position of private entrepreneurs - all possible variants of formulated problem solution definition. However, it does not say anything about the primary and essential initiative from the state position, but only defines the direction of vector in the social-economic development directions.

It's necessary to note that the state-private partnership while realizing projects bases on voluntary partnership from both sides, state structures and business for cooperative work on the achieving of the formulated point.

Examining advantages and disadvantages of state-private partnership usage as the large-scale innovative projects mean, it is necessary to define:

- significant financial resources attraction from the side of commercial sector participants, and also timely and sufficient large-scale innovative projects;

- 202 - financial costs decrease from the side of state on the support of effective managing and objects;
- 203 - effective risks distribution between private and state large-scale innovative projects participants;
- 204 - infrastructure improvement and approach application to infrastructure objects managing;
- 205 - increasing of investment attractiveness of various national economy sectors;
- 206 - transferring of objects managing to the definite private individuals for financial effectiveness increasing.

207 It is also possible to examine advantages of state-private partnership organization as large-scale innovative  
208 projects realization mean separately for the each participant of the given project. There are plenty of advantages for  
209 business, methodical and resource state support exactly, investments rendering for large-scale innovative projects  
210 realization with definite financial guarantees, decrease of the project risks level, project-financing rendering. There are  
211 also advantages for state while using state-private partnership as the large-scale innovative projects realization mean:  
212 increasing of budget matriculation volumes, qualitative work and service rendering from the private sector, increase of the  
213 innovative and investment activity level in the national economy branches, support of a high level economical activity and  
214 competition in the national economy branches, high level of structures managing effectiveness of large-scale innovative  
215 projects [Kireyeva, 2012].

216 However, there are also disadvantages as for the state-private partnership as large-scale innovative projects  
217 realization means:

- 218 - possibility of asymmetrical information streams forming because of the state employees competitiveness lack  
219 in the arriving investment opportunities examination;
- 220 - not always fair intentions of the private sector participants, willing to use various administrative and financial  
221 resources, provided by the state sector without any;
- 222 - transferring of arriving risks of large-scale innovative projects to the state and consequently on.

223 Let us examine disadvantages of using of state-private partnership for the state and the private sector separately  
224 as the given projects participants.

225 While using state-private partnership as large-scale innovative projects realization mean there arrive the following  
226 disadvantages for the private sector: significant political and juridical risks rise, concerned with change of strategic goals  
227 and priorities of the state policy, increasing private sector dependence from state tactical objectives, lesser loyalty and  
228 increasing terms of large-scale innovative project realization by means of coordination necessity with the state sector,  
229 significant technical risks rise, concerned with building and effective infrastructure objects using, especially in the case of  
230 indefinite formed environment conditions for large-scale innovative projects realization, limited private sector activity  
231 freedom because of joint solutions with the state sector [Grebennikov A.V., 2010].

232 For the state using of state-private partnership leads to the following disadvantages: democratically participation  
233 and state controlling absence of large-scale innovative projects results, financial burden increasing on citizens as for the  
234 working up and realization of innovative projects, following privatization of intellectual labor results by the private sector.

235 Large-scale innovative projects grow up, as a common, from small ideas which appear as small innovative  
236 business. Let us examine small innovative business as one of the forms of innovative national economy activity  
237 existence.

238 Small innovative business is an independent organization that deals with working up and commercialization of  
239 intellectual labor results of the budget organizations, predominantly higher education institutes. The main reason of small  
240 innovative business appearance has become the necessity in commercialization of scientific elaborations of the higher  
241 education institutes, that before the application in August, 2009 of the federal law 17. #217-FL «About the entry of  
242 changes in separate law acts of the Russian Federation as for the questions of creation by budget scientific and  
243 educational institutes economic associations for practical using (entry) of intellectual activity results, contradicted with the  
244 principle of prohibition on the commercial activity for higher education institutes. Consequently, a small innovative  
245 organization by the higher education institutes appealed to commercial activity.

246 Innovative country development strategy should be created by the state and worked up for all participants of the  
247 given process. Firstly, for small innovative business development by the higher education institutes as the subject of  
248 intellectual resources concentration. Large-scale organizations, if they generate innovative elaborations, most probably,  
249 they will be probated and of the foreign high quality production, such activity can difficultly be called innovative. It is also  
250 necessary to pay significant attention in the innovative activity to cooperation of offer and demand of innovative  
251 technologies. State eagerly develop offer on the innovation, but pays very little attention to demand forming. There exists  
252 discrepancy of clause and demand on the modern innovation market. Innovative offers are in the non-demanded areas,  
253 but demand on innovation in areas which are weakly developed on the country, exactly laser and informative-  
254 communicative. The demand on innovative activity results has not been discovered yet, potential consumers have not  
255 been revealed, it is quite difficult to define prospective directions of the small business development, to define innovative

potential. It is necessary to stimulate the demand on innovative technologies, elaborations by the state, it is possible by means of strict requirements to the ecology, energy effectiveness [Vertakova, 2013]. The given methods are able to stimulate only insignificant rise of activity in innovative work, that is not capable to cause long-term, stable economic rise. Also the history of the Russian Federation has led to creation of large number of companies of monopolistic character, which do not put high competitiveness on the head position, and consequently do not stimulate innovative elaborations. Requirement in innovations can appear only in condition of absolute competitiveness in each economic sector. In the last decade Russian market becomes more competitive, cutting activity of monopolies, creating condition for good competitiveness, that became the main reason for creation of innovative-technological potential, transferring to innovative economy with activation, as the main subjects, small innovative organizations.

Small organizations analysis in innovative sphere shows the following peculiarities: narrow specialized direction of the scientific elaborations; producing of the small parcel production. Small organizations activity analysis discovered the following specialization: more than a half of small innovative organizations are busy with projecting of new techniques, the second place takes working up of program support, and the third – elaboration of nanotechnologies and new materials. Small firms, for example, create many innovations: microprocessor, personal computer, various program support. It is definitely possible to say, that small innovative organizations takes a significant place in the development of scientific-technological progress.

## 5. Conclusion

Industrial policy is the conception which was rejected during long years by liberal economists, but obtaining bigger importance and ponderability in modern world. So, the key moment in the change-over process from industrial to postindustrial Russian development way is not decrease of industrial production and services participation increase, but creation of competitive production on the basis of state-private partnership, with the help of which industrial volumes increase slower thanks to absolute demand satisfaction than volumes of increasing services demand. Consequently, Russian Federation should enlarge the participation of industry in GDP, create competitive industrial sector, what in the future will lead to postindustrial economy with the help of innovative activity development. According to our point of view, the country cannot examine the opportunity of change-over to the postindustrial development with stable economy without creating effective industrial sector.

As the result, there exist critical necessity in development of sector of small innovative business, which will have significant social-economic effect in the national economy, and also strictly built system of state-private partnership as large-scale innovative projects realization. The main forming factors of innovative economy will be: rise of the scientific works and fundamental theoretical knowledge role; enlarging the sector of service; widening of the education role; predominance of the hi-tech goods, created in small innovative organizations. Cooperation of the main institutes of innovative activity is the main cause for creation and functioning of the innovative system of the country economy.

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## Islamic Banking and Finance: Traders not Mere Financial Intermediary

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### Abstract

Although Islamic Banking and Finance has been in existence since 40 years ago, the subject of Islamic banking and finance continues to be at the forefront of economic and financial discourses all over the world. The issue of Islamic banking and finance losing its credibility, its apparent inability to respond decisively to the need of its clients and accusation that Islamic banking and finance is mere replication of the conventional system are but some of the pressing issues that need to be addressed before they can ruin the legitimacy of Islamic banking as a viable alternative system. Using qualitative research method by utilising document analysis, this paper attempts to critically investigate the role and function of Islamic banking and finance as a financial intermediary and trader in the course of discharging its fiduciary function as bank and financial institution. This article also addresses the major role of Islamic bank as a financial intermediary as well as at the same time trader of goods for sale to the customers.

**Keywords:** Islamic Banking and Finance, Financial Intermediary Function, Trader.

### 1. Introduction

Islamic banking and finance has been in the financial market for over four decades offering banking services, mobilizing funds from the surplus sector to the deficit sectors of the economy just like its conventional counterparts. While the basic functions of both these institutions are similar in nature, the methodology of transmission and deliverance of its services are in stark contrast between the Islamic banking and that of the conventional banking institutions. Islamic banking and finance operates within the purview of the Shari'ah laws governing financial transactions. It embraces a wide scope of human economic activities ranging from investments, development and trading. This has led the Islamic scholars to regard Islamic banking and finance as commercial undertakings based on the law of Shari'ah where *riba* and *gharar* are its primary philosophy of non-participation but focusing on trade transactions on the basis of sharing profit and loss (Taqī 'Uṣmānī, 1998). This broad definition of Islamic banking brought to the forefront of the basic understanding that Islamic banking is a financial institution that does not indulge in any usurious activities, undertaking business transactions as partners rather than lenders and sharing profits or loss arising from the activities.

Compared to its conventional counterparts, the Islamic banking and finance in its present forms is relatively a recent phenomenon. It first emerged in the Arab Republic of Egypt with the setting up of a saving and cooperative institutions offering services that comply with the law of Shari'ah in the district of Mit Ghamar by Dr Mohammad Al-Nagger in 1963 (Abdul-Rahman, 2009). Then in 1975 the Islamic development Bank was established in Jeddah, Saudi Arabia by the Organisation of Islamic Countries. The bank modelled the World Bank in its set up but adhering strictly to the law of *Shari'ah* in its dealings. Its main function is to help its poor member countries in their effort to eradicate poverty through

57 extension of soft loan and other facilities. In Malaysia, the call for setting up Islamic bank was preceded by the  
58 establishment of a saving institution to help Muslim saving their funds for the Hajj. Being an Islamic institution, Lembaga  
59 Tabung Haji need to invest the money collected from the Muslim in investment avenues that are not against the religion  
60 of Islam. Underpinning the government effort to provide Muslim with banking facilities that conform to the Shari'ah, Bank  
61 Islam Malaysia Bhd (BIMB) was then established in 1983 after the passage of the Islamic Banking Act 1983 which paved  
62 the way for the operations of banking institution in line with the law of Shari'ah (BNM, 2007, Venardos, 2012: 118).  
63 Moreover, it is also estimated that the assets of Islamic banks may reach US\$5.5 trillion by 2020.

64 To date, the growth and development of Islamic banking and finance has been phenomenal in term of number of  
65 institutions and its volume of business. According to Ernst & Young's Report in 2013 the Islamic banking assets grew at  
66 an annual rate of 17.6% and the volume of business of Islamic banking and finance is estimated to reach a total of  
67 US\$4.4t by 2018 with more than 500 institutions offering Islamic banking services in more than 75 countries (Dusuki and  
68 ISRA, 2011, Young, 2013). Interestingly, the advent of Islamic banking and finance is not confined within the Muslim  
69 countries but it has swept to the shore of non-Muslim countries in the world from the United State of America to the Great  
70 Britain and other European countries.

71 After more than 40 years of existence, the subject of Islamic banking and finance continues to be at the forefront of  
72 economic and financial discourses all over the world. The issue of Islamic banking and finance losing its credibility, its  
73 apparent inability to respond decisively to the need of its clients and accusation that Islamic banking and finance is mere  
74 replication of the conventional system are but some of the pressing issues that need to be addressed before they can ruin  
75 the legitimacy of Islamic banking as a viable alternative system (Ahmed, 2014).

76 This paper attempts to investigate the role and function of Islamic banking and finance as a financial intermediary  
77 and trader in the course of discharging its fiduciary function as bank and financial institution.

## 79 2. Islamic Banking and Finance Fundamental Frameworks

81 The establishment of Islamic banking is primarily to fulfil the aspiration and desire of Muslims all over the world to conduct  
82 banking transactions that conform to the law of Shari'ah. The role of Islamic banking is substantively similar to the  
83 conventional system. They are the mobiliser of funds from the surplus sector to the deficit sector of the economy,  
84 providing financing facilities to stimulate business and trading activities of the community it serves. However, while  
85 conventional banking has established itself as a reliable and efficient financial system, the Islamic banking is still at its  
86 relatively infant stage and still searching for its rightful position in the economy. In addition, while the conventional  
87 banking is a debt-based financial institution, the Islamic banking is not allowed to receive or pay interest on all its  
88 transactions because Islam provides a different doctrine to its followers for setting up a system that is entirely different  
89 from the western conventional system (Hassan and Lewis, 2007a: 2).

90 The Islamic banking according to Dusuki (2011) was founded on the three basic principles. First it strives for just,  
91 fair and balanced society as envisioned by the Islamic economics. Second Islamic banking is constructed upon the  
92 principle of brotherhood and cooperation which denotes for equity sharing, risk sharing and stake taking. Third a system  
93 grounded on ethical and moral frameworks of the law of Shari'ah. From these foundations, Islamic banking is defined as  
94 a financial institution which conducts all its operations conforming to the divine of Shari'ah, without involving itself and its  
95 clients in Riba and other usurious transactions but based on real economic activities and sharing the profit and loss  
96 (Aḥmad, 1993, Taqī 'Uṣmānī, 1998, Ayub, 2007, Dusuki and ISRA, 2011: ). The Islamic Banking Act 1983 (the act was  
97 then replaced by The Islamic Financial Services Act 2103) has defined Islamic banking in its Article of IBA as a company  
98 which carries on Islamic banking business where its objectives and operations do not involve any elements which are not  
99 approved by the religion of Islam. Theoretically, therefore, Islamic banking revolves around replacing interest in bank  
100 lending by the profit sharing thus changing the status of financial intermediation making the fund owners as well as  
101 financial intermediaries shares the risk enterprise often encounter while utilizing funds for its investments (Siddiqi, 2006).  
102 In short it can be said that Islamic banking is a system that is consistent with Islamic (*Shari'ah*) principles in particular it  
103 prohibits usurious activities, indulging only in a lawful business or investments, and avoidance of *mysir* and *gharar* in its  
104 transactions.

105 Prohibition of *riba* is central upon all Islamic trade transactions. *Riba* is not restricted to loan transaction as in the  
106 conventional banking but *riba* can occurs even in the trade transaction. As long as it is in excess over and above and  
107 beyond the original capital or price be it in lending or in trading it is *riba* and it is prohibited in Islam (Suruhanjaya Sekuriti  
108 Malaysia, 2009). The prohibition of *riba* is made clear gradually in the Al-Quran through various revelations as in Surah  
109 Al-Rum verse 39 in which Allah said that *riba* deprives wealth of Allah blessings. Then in Surah Al-Nisa verse 162 where  
110 Allah condemns interest, placing it at the juxtaposition with wrongful appropriation of properties belonging to others.

111 Finally, Allah s.w.t. revealed an all-encompassing injunction on Riba in Surah Al-Baqarah verse 275 in which Allah said  
112 "Those who devour riba will not stand except as stand one whom the evil one by his touch has driven to madness. That is  
113 because they say: "Trade is like usury," But verily Allah has permitted trade and forbidden Riba. Those after receiving  
114 Direction from their Lord, Desist, shall be forgiven for the past; their case is for Allah (to judge); But those who repeat (the  
115 offence), are Companion of the Fire; they will Abide therein (forever)" (Ali, 1994). While prohibition of riba is made in  
116 general in the Al-Quran, the detail and clear reference as to what constitutes riba is found in the Saying of our Prophet  
117 Mohammad s.a.w. In His prominent Hadith reported by Abu Said Al-Qudri the Prophet s.a.w. said "Gold for gold, silver for  
118 silver, wheat for wheat, barley for barley, slat for slat, like for like, equal for equal and hand to hand, if the commodities  
119 differs then you may sell as you wish provided that the exchange is hand to hand (Narrated by Ahmad and Muslim).

120 In the above hadith, there are two major criteria in which any transaction can give rise to Riba. First is the  
121 deferment of the time of exchange and second, the difference in counter value in the exchange of ribawi items mentioned  
122 in the Hadith of the Prophet s.a.w. In order to avoid any usurious transaction, all ribawi items must be transacted on the  
123 spot and of equal counter value. It can be concluded therefore, that riba can be categorized into two categories namely,  
124 riba al-dayn which can arise from delay in payment which usually involve monetary transactions. The other is riba Al-  
125 Buyu' due to the non-compliance of the two conditions mentioned in the Hadith involving commodities transactions.

126 Against the backdrop of a clear and all-encompassing injunction of riba in Islamic jurisprudence. Islamic banking  
127 and finance therefore, is to avoid at all costs, riba or any transaction that has in it elements of riba. Instead Islamic  
128 banking should focus its entire activities on doing trading, buying and selling of commodities with its clients and  
129 undertaking investments on the principles of sharing profit and loss. In other words Islamic banking and finance is a faith-  
130 based and socially responsible brand of community banking and its aim is to eliminate Riba and how to reconstruct its  
131 products in order to comply with the law of Shari'ah (Abdul-Rahman, 2009).

### 132 3. Practice of Islamic Banking and Finance

133 The establishment of Islamic bank and finance was intended to become a financial institution for the Muslims to enable  
134 them to do business in accordance with the divine Shari'ah. Its role as financial institutions is substantially similar to the  
135 conventional banking; mobilizing funds from the surplus sectors to the deficit sectors of the economy and providing  
136 financing facilities to the society enabling them to conduct their businesses. In short Islamic banking and finance is the  
137 financial intermediaries between these two contrasting sectors of the economy. This is because financial intermediation  
138 enhances the efficiency of saving/investment process by eliminating the mismatch inherent in the need of surplus and  
139 deficit unit with respect to size, duration, liquidity and risk profiles (Iqbal, 2011). Financial intermediaries are also in a  
140 better position to gather information about the economic conditions and business opportunities which is crucial for  
141 efficient allocation and transmission of society's resources.

142 Like its conventional counterpart, Islamic banking and finance uses people's money as deposit for its liquidity  
143 requirements and also to fund its investment's activities and its financing operations. However, being an Islamic  
144 institution, the manner in which Islamic banking and finance conduct its operations differs greatly from the conventional  
145 banking. Islamic banking and finance is not based on the notion of a predetermined fixed return on capital but through  
146 direct undertaking of trade activities assuming risk before it can reap any potential profits. According to Hanif (2011).  
147 Islamic financial transactions have two distinct features that are totally absent in the conventional system. First is the  
148 linkage between financial and real sector of the economy as Islamic financial institution cannot extend credit facilities  
149 without having support from real sector. Secondly, the concept of *Mudharabah* plays greater role as catalyst for  
150 transforming the society into prosperity by extending capital facility to skilful person but lacking in capital. This is because  
151 under the *Mudharabah*, partnership between capital and skill is formed which can be used to provide self-employment to  
152 jobless skilful citizens.

153 In Islamic transaction, capital must be employed into the productive use before it can gain return. Therefore, the  
154 basic principle of Islamic transaction is based on risk/profit sharing as return for entrepreneurial efforts and financial  
155 capital (Iqbal, 2011). In practice there are verities of Islamic contracts which can be used to conduct business. According  
156 to Lewis and Algaoud (Lewis and Algaoud, 2001) three types of contracts are the most widely used in Islamic finance  
157 namely Trustee contracts (*Al-Mudharabah*), Equity contract (*Al-Musharakah*) and Debts-based contracts.

158 *Al-Mudharabah* is a contract between provider of capital (*rab al-mal*) and the entrepreneur (*Al-mudharib*) whereby  
159 skill and money are brought together to conduct business. Profit is shared according to the agreement usually based of  
160 agreed ratio while loss is born entirely by the *rab al-mal*. The concept of *al-Mudharabah* is also applicable in the collection  
161 of deposit by Islamic banking worldwide. *Al-mudharabah* can be restricted or unrestricted and no one party in the contract  
162 can claim a lump sum profit but must be based on actual outcome of the business undertaking (Qudamah, 1972, Taqī

165 'Usmānī, 1999).

166 *Al-Musharakah* or *Shirkah* is literally sharing or partnership. It means a joint partnership formed to conduct  
167 business undertaking in which all partners share the profit according to the agreed ratio while loss is shared based of capital  
168 contribution. For *Al-Musharakah* to be valid it must fulfil certain conditions (Hanif, 2011);

- 169 1. There must be written agreement among all partners stating clearly the terms and conditions including  
170 management, capital contribution, profit and loss sharing among partners.

171 Capital can be contributed in cash as well as in kind.

172 Profit is to be distributed according to the agreement of partnership. Sleeping partners cannot claim more than his  
173 proportionate share in equity.

174 Debts-based contract is a mode of financing involving deferred payment arrangement whereby the clients are  
175 allowed to pay the purchased good on periodical instalments within a specified future period. Included under this mode of  
176 financing is *al-Bai' Bithaman Ajil (BBA)*, *Al-Murabaha* (cost plus sale), *Bai'al-inah*, *Ijarah* or leasing. The debt-based  
177 contracts as practiced by most Islamic banking and finance invariably involve the purchase and sale transaction whereby  
178 the financial institutions purchase commodities on cash term to be sold later to its clients on a deferred payment (Anwar,  
179 2003).

180 Between the three types of contracts mentioned above, most of the Islamic scholars agree that the most preferable  
181 and acceptable mode of financing are *Al-Mudharabah* and *Al-Musharakah* financing because these transactions are  
182 asset-based and entail real economic activities while simultaneously undertaking liabilities associated with them (Taqī  
183 'Usmānī, 1998, Ayub, 2007, Dusuki and ISRA, 2011). However, despite the acknowledgement of the Islamic scholars  
184 about the validity of *Al-Mudharabah* and *Al-Musharakah* as the preferred mode of financing under Islamic banking and  
185 finance, most Islamic banking and finance in reality prefer to engage in the debt-based deferred payment contracts of  
186 BBA, *al-Murabahah*, *Ijarah* and *Inah*. For instance, in the context of Islamic bank in Malaysia, these forms of financing  
187 constitute more than 80% of the total assets held by Islamic banks (Dusuki and ISRA, 2011). The trend is similar in other  
188 Islamic banking and finance where these financing modes comprise between 60% and 80% of the total asset holdings.

189 The Islamic banking and finance preference and overconcentration on the debt-based contracts over the profit -  
190 sharing contract is due chiefly to the fact that Profit Sharing concept entails more risk and uncertainty as it is hard to  
191 ascertain that the *mudharib* is capable of undertaking the business and it takes longer gestation period before business  
192 produce any profits. As the bank is responsible to its deposits which are relatively short term in nature it is therefore,  
193 untenable to the bank when it cannot give return to the depositors due to the fault of the *mudharib*. On the other hand,  
194 under the debt-based transaction, the profit is predetermined and repayments are assured thus enabling the bank to  
195 distribute its profits to the depositors (Dusuki and Abozaid, 2007, Dusuki and Mokhtar, 2010, Dusuki and ISRA, 2011).

#### 196 4. Trader and Financial Intermediaries

197  
198 The Islamic banking and finance is indeed a financial intermediary acting as a go-between in the financial market and  
199 undertaking transaction that is in line with Shari'ah. Financial intermediation does not violate Shari'ah as long as it is  
200 undertaken based on the rules and procedures prescribed by Islamic jurisprudence. Financial intermediation in the  
201 Islamic economy is crucial in today's global economy because as a fast growing economy it is unimaginable in a society  
202 without intermediaries, depriving the society the opportunity to undertake business based on Islamic banking principles. It  
203 will expose the society to the evil and manipulation of conventional system which is obviously unacceptable from the  
204 Islamic religion view point. However, Islamic bank and finance is not an ordinary intermediary but whose activities are  
205 strictly undertaken in compliance with the law of Shari'ah. Unlike conventional banking, Islamic banking cannot lend  
206 money with interest but focus its activities on trading. It is in this area therefore, that Islamic banking must demonstrate its  
207 capabilities to mobilise fund for the genuine and real economic activities and not just providing financing.

208  
209 Islam emphasises trade transaction and prohibit lending with interest because *riba* is prohibited by Allah s.w.t. as it  
210 is not only associated with ephemeral wealth that can increase or decrease through receiving or paying of interest without  
211 undertaking actual activities but also due to the serious ramification of *riba* that can cause to mankind. However, as the  
212 Islamic banking is still relatively at its infant stage, it was not in the best position to introduce *Mudharabah* or *Musharakah*  
213 contracts with its clients when it first open its door to the customers. Thus conventional financing facilities such as home  
214 financing, trade finance and consumer lending were reconstructed to comply with Shari'ah and offered to the Islamic  
215 banking clientele. Indeed these are amongst the first few contracts used by Islamic banking because they are  
216 straightforward contracts and consist of sales and purchase transactions which are the cornerstone of Islamic *muamalat*.  
217 Overtime these forms of financing has become the backbone of Islamic banking business and incur criticism from many  
218 scholars as they are akin to the interest-based lending operations of the conventional banking (Dusuki and Abozaid,



219 2007, Soualhi, 2012, Ahmed, 2014).

220 The debt-based financing methods should rightly become the flagship product of Islamic banking as they  
221 demonstrate the true nature of trading activities. However, Islamic banking and finance failed to seize this golden  
222 opportunity of becoming real trader because they are more concerned of being financial intermediaries rather than  
223 traders. Under the BBA, *Murabaha* or *Ijarah* contract, one of the most important conditions is that Islamic banking must  
224 assume ownership of the property before they are sold to the customers. By assuming ownership bank face ownership  
225 risk which can occurs in three different stages (Ahmed, 2011);

- 226 1. Beginning of transaction: Bank buys property based on promise from the buyer. However, promise is not  
227 binding and if customer refuse to honour his promise the bank may get stuck with the asset and may run a  
228 loss if price fluctuate. Such a loss is borne entirely by the bank.

229 During transaction period: once assets is transferred to the client bank may still face with credit risk. This is  
230 especially so if the asset is sold on deferred payment and customer were to default his obligation. To mitigate this risk,  
231 bank may request that the asset be collateralised to guarantee performance of the contract.

232 End of period: Upon expiry of the agreement bank may still face with potential problem when customer fails to  
233 satisfy his obligation under the contract. In this instance bank may initiate legal proceeding to compel customer to settle  
234 the purchase price of the assets failing which bank may demand court order to dispose of the asset.

235 It is precisely this potential risk bank as trader may suffer that entitle the bank to impose higher price on the asset  
236 sold. However, the practice of Islamic bank in Malaysia is that bank transferred all its risk under the contract to the client  
237 leaving the bank with no risk but assured of its profits. This has diminished the role of Islamic banking as trader and thus  
238 renders Islamic banking and finance as mere replication of conventional banking institutions (Hassan and Lewis, 2007b,  
239 Ahmed, 2014).

240 As an Islamic financial institution, its function as financial intermediaries is different from the conventional bank.  
241 The key difference is that while conventional banking is using its fund for its lending operations and collecting rent in the  
242 form of interest the Islamic banking utilize *Mudharabah* as the cornerstone of its financial intermediation. This means that  
243 the concept of fund mobilisation and the employment of funds for business activities are based on profit sharing among  
244 depositors and the bank after the business undertaking for which fund is used to finance has yielded profits. It follows that  
245 even under the *Mudharabah* contract, Islamic bank is also acting as trader taking an active role in the business  
246 undertaking with the customer and sharing the risk and rewards for such an undertaking. In Islamic banking and finance,  
247 the financial intermediation is merely a passing-through arrangements similar to the concept of fund management (Iqbal,  
248 2011). This type of financial intermediation is in total contrast with the conventional banking where funds are regarded as  
249 direct liabilities and entails cost to the bank.

250 Islamic banking and finance like any other conventional institution is a business organisation where profit  
251 maximisation is its main objective. Conventional banking regards profit as a factor of production, capital and labour. They  
252 are not concerned with individual welfare because the pursuit of self-interest automatically promotes the collective goal.  
253 Islam on the other hand recognizes profit as signifying the firm's endeavour to create, enlarge and maintain the balance  
254 between revenue and cost. Islam also regards business as a social obligation of the individuals and it places business as  
255 among the most beneficial and noblest of vocation (Hassan, 1998). However, Islam recognizes profit as being created out  
256 of real economic activities. It can be achieved not just through imposition of interest but via trade transactions by owning  
257 assets and trading these assets for profits. Being trader, Islamic banking is assured of profit. The *Mudharabah* and  
258 *Musharakah* financing contracts are designed to ensure that Islamic banking and finance is able to generate profits. For  
259 some sectors where financing on the basis of *Mudharabah* and *Musharakah* is not feasible, the contemporary scholars  
260 have suggested other instruments which can be used for purpose of financing like *Murabahah*, *Ijarah* and *Istisna'* (Taqi  
261 'Usmāni, 1998). After all Islam does not recognize money as subject-matter of trade, it has no intrinsic utility and is only a  
262 medium of exchange. Islam believes that profit is generated when something having intrinsic utility is sold for money.  
263 Therefore, Islamic financing is always based on illiquid asset which can create real activities and inventories.

264 The bottom line is that Islamic banking must not rely solely on being pure financial intermediaries but opted to non-  
265 pure financial intermediaries through transactions like *Murabahah*, *Bai' Bithaman Ajil*, *Ijarah*, *Salam* and *Istisna'* (Siddiqi,  
266 2006). In other words, Islamic banking and finance must always undertake trading of real assets in order to generate  
267 profits. This is in contrast to the conventional banking which relies on financial assets to realise profit through imposition  
268 of interest. In essence, Islamic banking should reflect real assets in its balance sheet and not financial assets as in the  
269 conventional banking.

270 From the preceding paragraphs, it seems that there are two operational approaches which characterize Islamic  
271 banking since its inception some forty years ago. According to Kahf (2000) the two approaches are;

- 272 1. Islamic banking as mere financial intermediaries

273 Under this approach, the bank does not take any business activities in buying and selling goods directly with the  
274 customers or in providing venture capital only at the request of its clients. According to this approach, financing activities  
275 must always begin from the user of funds. Banks are mere intermediaries channelling funds to and from each sector of  
276 the economy.

277 This approach is desired and promoted by the central banks because they would want to see Islamic banking  
278 equal to its conventional counterpart. They argue that this approach ensure specialization, efficiency and justice to all  
279 concerned.

280 Non-pure financial intermediaries or Business approach.

281 This approach was pioneered by the Kuwait Finance House. In addition to financial intermediation, Islamic banks  
282 also owns showrooms, maintain warehouses and buys goods to be offered to customers on *Murabahah* basis. Faisal  
283 Islamic bank of Egypt even own and manage housing estates for sales to its customers under *Murabahah* financing. This  
284 approach receives strong support from Islamic scholars because it demonstrates the fundamental role of Islamic banking  
285 and finance as trader and financial intermediaries. Such approach is however, met with strong resistance from the law  
286 makers especially the central bank (Abdul-Rahman, 2009).

287 Pursuing the role as trader, Islamic banking and finance need not have to emulate what the Kuwait Finance House  
288 or Faisal Islamic bank has undertaken. The Islamic banking and finance particularly in Malaysia may form strategic alliance  
289 with various housing developers to ensure special allocation of housing units to the banks which upon completion of  
290 construction can be traded with the interested clients. By having this kind of arrangement the bank is able to fulfil its role  
291 as financial intermediaries providing finance to house buyers under deferred payment contract and significantly establish  
292 it as trader of residential and commercial real estates without having to become real estate developer.

293 To become an active trader, Islamic bank requires contacts with suppliers of commodities other than houses so as  
294 to enable it to dispose merchandise produced in the name of the bank under *Murabahah* or *Salam* contracts. Standing  
295 arrangement with suppliers and marketing agencies can considerably reduce transaction cost and financial risk for the  
296 Islamic bank. This arrangement eliminates the need of the Islamic bank to have its own warehouse or inventories.

## 298 5. Realising the Maqasid Al-Shari'ah

300 The main purpose of setting Islamic bank and finance is to realise the *Maqasid al-Shai'ah* in banking and finance, to fulfil  
301 social welfare responsibilities and religious commitment, promoting the Islamic value as well as protecting the need of the  
302 Islamic society without undermining its commercial viability (Dusuki and Abozaid, 2007, Dusuki and ISRA, 2008). In order  
303 to realise this objective, Islamic banking and finance must be able to demonstrate its readiness to embrace the real role  
304 as financial intermediation offering facilities that differs from the normal conventional banks. Islamic banks is therefore,  
305 not mere financial intermediaries but also an active participant in trade transactions.

306 In doing its business, Islamic banking and finance is expected to display the highest regards to the fundamental  
307 principle of *Shari'ah* in business. Since the early establishment of Islamic banking, it is recognized that equity-based  
308 financing of *Musharakah* and *Mudharabah* has always been promoted as financing method that involve real economic  
309 activities and thus is closer to the achievement of *Maqasid al-Shari'ah*. Debt financing on the other hand though it is  
310 *Shari'ah* compliance is not in line with *Maqasid al-Shari'ah* and therefore, should not be pursuit seriously to avoid criticism  
311 of Islamic banking as mere replication of conventional system. Ensuring social welfare is another objective Islamic  
312 banking and finance has to observe while conducting business. Abuse of sale contract like in the case of *Bai' al-Inah*  
313 where *Shari'ah* requires a selling party to hold all liabilities arising from defective goods sold base on *Khiar al-aib* rules  
314 but in reality bank hold no such liability is to avoided because it will victimize the customers (Dusuki and ISRA, 2008).  
315 Thus while Islamic banking seem to be doing trade transactions it must give due consideration to the equitable demand  
316 for fairness to its clients by not overcharging the price or using *hilah* to legitimise transactions.

## 318 6. Policy Recommendation

320 Islamic banking and finance has a unique role in the development of the Islamic *muamalat* system. It is a financial  
321 intermediary that functions as fund mobiliser and provider of finance but its role is not confined to pure financial  
322 intermediation but also display as an active role of trader. The prohibition of *riba* made it impossible for Islamic banking  
323 and finance to give monetary loan and charge interest in order to make profits. Under the circumstance therefore, Islamic  
324 bank has to play the role of not mere financial intermediation but also trader of goods for sale to the customers. In order  
325 to achieve these objectives Islamic banking and finance must first demonstrate that they are capable of instituting  
326 changes in the manner of doing its business;

327 1. Islamic banking and finance must display its courage to discard the conventional banking mentality by  
328 assuming the role of traders and focusing on trading of goods rather than mere providing financing like the  
329 conventional banking.

330 It must return to its root and avoid imitating the practices of conventional banking focusing on Profit and loss  
331 sharing activities and reducing its dependency to the debt-based transactions of *al-murabahah*, *al-Bai' Bithaman*  
332 *Ajil, Ijarah* and *Inah*.

333 Islamic banking and finance must strengthen its business procedures by standardizing its legal documents,  
334 accounting procedures and terminology of transactions. This is to avoid ambiguity and achieve harmony among the  
335 Islamic banking and finance all over the world.

336 It must promote greater cooperation amongst the Islamic banking and finance to meet the challenge as trading  
337 partners in the economy.

338 Product reengineering is another area of concern in the development of Islamic banking and finance which  
339 requires a closer look by the institutions. Successful innovation of a flagship product that can distinctively be associated  
340 with Islamic Banking and finance serve to as the benchmark of Islamic finance which will silence critics of Islamic banking  
341 and finance as mere replication of conventional banking. Success of such an endeavour will also boast Islamic banking  
342 as a vibrant and independent financial system unique on its own and moving away from its over dependence to its  
343 conventional counterpart.

## 345 7. Conclusion

347 In conclusion therefore, Islamic banking and finance is a unique institution playing the role of not only an intermediary of  
348 finance but also an active trader seeking to achieve profit from its effort and also ensuring equitable benefit to the society  
349 it serves as embodied in the *Maqasid al-Shari'ah* in banking and finance.

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# Industry of the Region in 1941- 1945: Problems of the Reorientation to “A War Footing”

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## Abstract

Investigation of the problems connected with functioning of the regional systems and development of their operating overhead are becoming of current importance. This is due to the crisis processes that occur in the country and the world in recent decades. The used methods of meeting them are not effective. It is necessary to create new ways of maintaining high economic growth and this explains an increasing interest on issues related to the searching for "growth points" of the modern economy. And the key aspect that determines the gradual process of development of any country, from our point of view, is realization of organizational changes. References to such kinds of issues made by historians are not accidental. The problems connected with the origin and evolution of the economic authorities (public institutions) in a particular historical situation, their organizational structure and activities are under study. In general, the historical experience of the previous reforms nowadays should be an effective basis for the following organizational changes. In this respect, the problems of the development of the industrial management system in the individual regions of the USSR during the Second World War (for Russia - the Great Patriotic War), as the experience of successful reform of the economy during the system crises tend to be interesting for investigation. In a short period of time an agrarian republic transformed into a predominantly industrial region contributing to its further powerful rise.

**Keywords:** World War II, Russia, the Republic of Tatarstan, region, industry

## 1. Introduction

The modern model of the Russian economy can no longer be a guarantee of stability and progressive development in future. In recent years economic growth rates are inclined to shift into low gear and sluggish development is observed. Besides western sanction actions only add negative notes. The above-listed causes searching for the mechanisms of impact on the existing system, which will give her a dispersing effect.

In this regard it is necessary to analyze the impact of government reforms on the structural elements of the system which at certain stages of development of Russia gave a positive effect and contributed to the accelerated growth of the domestic economy.

The relevance of this work is determined by the fact that the questions of regional economy and the ensuing problems of management of its branches, the development of management personnel are hardly reflected in the theoretical studies. That is why in this article the features of the industrial development in the Republic of Tatarstan (Tatar ASSR) during the Great Patriotic War are observed in the historical sequence.

The objective of the paper is the analysis of organizational adjustments in industrial management of the Republic of Tatarstan (the region of Russia) in the period of the Great Patriotic War (1941-1945ss) and their influence in the economic growth.

## 2. Research Methodology

The methodology of the paper is based on the approaches, concepts and methods of scientific knowledge. The author relies on the idea of dialectical development which is the foundation for such kind of approaches like historical method, objectivity and systemacity. When defining a method and process under consideration the certain order has been kept for its consistent study taking into account the characteristics of its development under the influence of different external and internal factors.

The methodological foundation of this paper is an approach based on the use of the principle of historicism. The phenomena and processes in the context of their spatial-temporal dependence in close relationship with other socio-economic, political phenomena and processes and with the certain historic circumstances are reviewed on its basis. Guided by this principle the author tries to examine the evolution of administration agencies of Tatar ASSR industry (the

58 Republic of Tatarstan) in the dynamics of management system development of the industry in the USSR during the war.

59 The principle of scientific objectivity involves an impartial consideration of the research subject and also suggests  
60 the analysis of the set of historical facts in their contradictory relationship and interaction which is the important factor for  
61 the subsequent formulation of judgments about the challenges under the investigation and the formation of views on  
62 historical events and phenomena.

63 The principle of objectiveness in the study of the activity of Central and local bodies of state power and  
64 administration for the implementation of economic policies helps to avoid some categorical judgments and conclusions, to  
65 consider the positive and negative trends in the development of the region in 1941 – 1945ss. In particular, when  
66 analyzing historiography and source material, the author avoids competitive assessments in the matter of organizational  
67 activities of the Soviet authorities in the field of restructuring of the management industry apparatus of the Republic during  
68 the war. These principles have been used in conjunction with the methodological approaches of scientific knowledge,  
69 especially with problem-chronological approach.

70

### 71 3. Results

72

73 We propose the main thesis that World War II despite serious difficulties, destruction, loss of life, etc., at the same time,  
74 produced a progressive effect on the development of individual regions. In particular, the Republic of Tatarstan (the  
75 modern republic of the Russian Federation, in the period in question – Tatar Autonomous Soviet Socialist Republic) was  
76 able to grow from an agrarian to a predominantly industrial region of the Soviet Union.

77 Considering the conditions for the development of the Soviet economy at the beginning of the war it should be  
78 mentioned that at this period a model of industrial management of the country was built, one of the main advantages of  
79 which was strict discipline and responsibility of all control system objects. At the end of June 1941 the Council of People's  
80 Commissars of the USSR adopted the first plan of the wartime – "mobilization plan of national economy" for the III quarter  
81 of 1941. The plan was one of the most important measures for the restructuring of the Soviet economy and putting it on a  
82 war footing and especially the concentration of capital works and material resources for the construction of defense  
83 enterprises in the Volga region, the Urals and Western Siberia. August 16, 1941 the Council of People's Commissars of  
84 the USSR and the CPSU (b) submitted by the State Planning Committee passed the military-economic plan for the IV  
85 quarter of 1941 and 1942 for such regions as the Volga, the Urals, Western Siberia, Kazakhstan, Central Asia. (Gilmanov  
86 1977, p. 65; The Directives of the CPSU 1957, p. 707-712) The adoption of these plans meant that the brunt of the  
87 economic support of the war in these conditions laid down in the east of the country, including the Volga region. The  
88 restructuring of the industry in these areas on a war footing had to create conditions of getting more productive effect of  
89 smaller industrial potential.

90 Thereupon the Tatar ASSR became one of the most important arsenals of the country to repulse enemy's attacks.  
91 The newspaper "Red Tatarstan" wrote that "it is impossible to find a plant, a factory or a workshop in the country that  
92 doesn't execute the front-line orders in a varying degree". (The Red Tatarstan 1942 January)

93 The resolution of the joint plenum of the Tatar Regional Committee and the Kazan city committee of the CPSU (b)  
94 on November 13, 1941 makes clear the problems facing the republic's industry at the initial stage of the war – "to ensure  
95 the unconditional implementation of plans of IV quarter 1941 achieving strict adherence to the daily schedules and rhythm  
96 of each company, workshop and plot; to organize the work of enterprises in such a way to maximize the use of existing  
97 equipment, to organize the production process properly; to improve strongly the management of the Stakhanovite  
98 movement in the factories; to render assistance with redundant equipment, materials in order to perform the military  
99 tasks; to accommodate all workers, engineers and technical workers coming from the evacuated plant at the expense of  
100 compacting the population of Kazan as soon as possible...". (Tatarstan during 1963, p. 69-70)

101 The reorientation prepossess of the industry to military production began in Kazan and its regional centers, new  
102 branches of industry (instrument, rubber, chemical-pharmaceutical and etc.) (Tatarstan during 1963, p. 91-92) appeared  
103 and were rapidly developing, new enterprise come into service.

104 At the same time the government began to close economically inefficient enterprises. It was decided to eliminate  
105 the Kazan state sago plant "Komsomolets" (the journals of the Council of National Commissioners of Tatarstan on  
106 October 7, 1941 number 49), mineral water plant "Izhevsk Source" (the resolution of the Council of National  
107 Commissioners TASSR on November 20, 1941 number 570). As for the latter enterprise the decision was reconsidered  
108 and it was transferred from the federal to the local submission. (NA TR. Collection. P-6292. Inventory 1. File 286. Leaf  
109 187, 195, 212)

110 A rigid daily schedule was put into operation in all the enterprises of the republic that, in turn, improved intrafactory  
111 planning, forced to mobilize domestic resources with greater persistence and to use all production facilities. (The Red

112 Tatarstan 1942 July)

113 At the time of the reorientation of the local industry to the military regime, the country began the reception, location  
114 and launching processes of the evacuated enterprises. Over 70 companies were located in the territory of the republic  
115 during the war. Large engineering, instrument-making enterprises, Gorbunov aircraft factory were evacuated to Kazan in  
116 the summer and autumn of 1941. Moscow confectionery factory "Bolshevik" was evacuated to the village Morkvashi of  
117 Verkhneuslonsky district; tobacco factory "Ducat" – to Kazan, cotton factories and many others to Yelabuga, Mamadysh  
118 and Naberezhnye Chelny. Only in Stalin (now the Volga) district of Kazan were located five major industries, five central  
119 committees, the People's Commissariat of Food Industry, three procurement agencies, one agricultural industry artel. For  
120 their location the Executive Committee of the District Council allocated 15 thousand square meters of the production  
121 space, 6 thousand square meters of storage facilities, three car garage, two rooms for workshops plants. (Gilmanov  
122 1977, p. 70-71) The list of companies that were evacuated to the Tatar ASSR only in 1941 are enumerated in the table  
123 №1.

124

125 **Table №1.** The list of companies that were evacuated to the Tatar ASSR. in 1941. (NA TR. Col. P-7233. Inv. 1. F. 4666.  
126 L. 115; NA TR. Col. P-4580. Inv. 1. F. 4966. L. 1, 2, 4)

People's commissariats	Enterprises
<b>Enterprises of the Union submission</b>	
People's Commissariat of Food Industry of the USSR	- Confectionery Factory "Bolshevik" - Tobacco Factory "Ducat" - Tobacco Factory of Vyborg
People's Commissariat of Public Health of the USSR	- Plant dental burs
People's Commissariat of Agriculture of the USSR	- Biofactory № 2 - Engine service plant
People's Commissariat of Industrial Materials of the USSR	- Sleeper impregnation plant
People's Commissariat of General Engineering of the USSR	- 2 <sup>nd</sup> watch factory
People's Commissariat of Textile Industry of the USSR	- Krenholm Manufacturing Company - «Proletarian vanguard» factory
Foreign departmental	- Machine accounting factory - Photographic paper factory № 7 - Copying factory
People's Commissariat of River Craft of the USSR	- Repair yard of Voznesensky - «Communist International» repair yard
People's Commissariat of Rubber Industry of the USSR	- Pilot-production plant - «Red rubberer» factory
People's Commissariat of Wood Industry of the USSR	- Parfinsk plywood plant
<b>Enterprises of federative submission</b>	
People's Commissariat of Motor Transport of the RSFSR	- Bemesk autogarage equipment factory
People's Commissariat of Light Industry of the RSFSR	- Ribbon-loom and dress factory № 3
People's Commissariat of Local Industry of the RSFSR	- Bakovsky rubber plant
People's Commissariat of Agriculture of the RSFSR	- Gomel wax foundation plant
People's Commissariat of Industrial Building Materials of the RSFSR	- Glasswork «Friendly climb» - Ivotsk glasswork
<b>Enterprises of local submission</b>	
People's Commissariat of Light Industry of the TASSR	- Shoe factory «Labour» - Spinning and knitting factory - Technical felt factory - Leather factory «Red giant» - Bitsevskiy valeno-felt shoe factory - Klintsovskiy shoe factory
People's Commissariat of Food Industry of the TASSR	- Chocolate factory shop "Red October" - Confectionery plant «Spartak» - Fruitwinery plant - Vyborg confectionery factory
People's Commissariat of Wood Industry of the TASSR	- Vitebsk instrumental furniture factory
People's Commissariat of Local Industry of the TASSR	- Font foundry factory - Vitebsk brickyard
People's Commissariat of Dairy and Meat Industry of the TASSR	- Bryansk municipal dairy plant

Some of the evacuated to the republic enterprises merged with the same type of local enterprises strengthening their production capacity and some were transferred to the other departments. Due to the transfer of haberdashery and harmonica factories to the People's Commissariat of Light Industry of the RSFSR, Tatpolygraph – to the printing industry management of the Council of National Commissioners of the TASSR and the writing machine plant to the People's Commissariat of Ammunition of the USSR, 2 enterprises were directly subordinate to the People's Commissariat of Local Industry of the TASSR: Tatmetroves and the peat factory of Kazan.

The number of enterprises of the TASSR People's Commissariat of Local Industry being in local submission greatly increased. (table №2)

**Table № 2.** The structure of the district industry of the TASSR People's Commissariat to January 1, 1941 and the conditional changes to September 1, 1941. (NA TR. Col. P-3049. Inv. 6 add. F. 12. L. 1)

	On January 1, 1941	On September 1, 1941	Growth (in %)
Districts included in the local industry	29	52	79
The number of district industrial plants and independent production units	34	54	58,8
The number of productive industries	17	19	11,7
The number of productions	84	167	98,8

The party bodies paid much attention to the problems of the reception, accommodation and employment of the evacuated people. The department of evacuation of the Council of National Commissioners of the TASSR prosecuted this subject. Only in August 1941 about 57 thousand evacuated people arrived in the republic and at the beginning of September more than 175 thousand people were accommodated (in the spring of 1942 - about 266 thousand people). (Gilmanov 1977, p. 70, 77-78) In the ensuing years the stream of evacuated people reduced.

The structural change at the level of ministries and departments began; it was connected with the necessity to fill need in products for the front and the population of the republic in a full measure. However it must be noted that during the 1941-1945 the fundamental changes in the system of control were not made, the reforms had mainly selective character. We believe that there were several reasons for that and the most important were the following:

Firstly, the model of management, formed in the 1930s, and based on the branch principle, centralized management that fitted the conditions of wartime when the orders of higher authorities had to be fulfilled exactly.

Secondly, an insufficient number of managers and specialists connected to the fact that the number of employees in many departments and commissariats was reduced by more than by half (workers were mobilized to the front).

Thirdly, there was the lack of funding of ministries and departments. Allocated funds were not always enough even for the maintenance of workers to say nothing of the labour power industrial intake.

At the initial period of war the republic was represented by the following organizational units: the People's Commissariat of Local Industry of the TASSR, the People's Commissariat of Food Industry of the TASSR, the People's Commissariat of Light Industry of the TASSR, People's Commissariat of Wood Industry of the TASSR, People's Commissariat of Dairy and Meat Industry of the TASSR, the Administration of the local fuel industry of Council of National Commissioners of the TASSR, the Administration of the industry of building materials of the Council of National Commissioners of the TASSR, industrial cooperation and enterprises of the Union and the federal subordination, evacuated to the republic in 1941-1942.

There were clearly differentiated duties of the leaders at all levels in the control system of the republic industry and any deviation from these rules could lead to serious consequences. For example, at the level of the Council of People's Commissars (CPC) of Light Industry of the TASSR, the Administration of the local fuel industry of the CPC of the TASSR, the Administration of the building materials industry of the CPC of the TASSR, enterprises being in federative and union subordination F.M.Kowalsky was in charge; S.M. Sharafeev was the head of the activities of the People's Commissariat of Local Industry the TASSR, the People's Commissariat of Food Industry the TASSR, fish trust and industrial cooperations. (NA TR. Col. P-6292. Inv. 1. F. 421. L. 95-96) Similar orders were established in the other People's Commissariat, administrations and factories. At the same time throughout the course of the war the degree of responsibility of managers, duties, etc. had a variable character. Thus, in accordance with the order of the People's Commissariat of Local Industry of the TASSR number 185 of 22 November 1941 (NA TR. Col. P-3049. Inv. 5. F. 334. L. 52,53) within the people's commissar's competence were such activities as guidance of the economic planning department, of the financial, staff and wage sectors, the special sector, the central accounting, the building materials enterprises of regional subordination and the deputy people's commissar was in charge of the production and technical



175 department, the maintenance department, the local industry of supply and sale, all regional enterprises, except for the  
176 enterprises of building materials, enterprises of the district industry. By the middle of the war on the basis of the order  
177 number 1 on January 4, 1943 (NA TR. Col. P-3049. Inv. 5. F. 401. L. 1) a new division of responsibilities between the  
178 people's commissar and his deputy was put into operation: the first was responsible for the enterprises of regional  
179 subordination, the economic planning department, the central accounting, the financial sector, the mobilization  
180 department and the local industry of supply and sale, and his deputy - for the enterprises of district (city) subordination,  
181 the production and technical department, the staff and wage sector, the maintenance department.

182 Considerable attention was paid to the optimization of the existing departments, agencies, trusts and companies  
183 from the side of the operating overhead. Thus due to the resolution of the CPC of the TASSR number 377 of 18 August  
184 1941 "About the staff reduction of people's commissariat, administrations and economic authorities of the TASSR, as well  
185 as the elimination of unnecessary administrative units and economic instrument" from September 1, 1941 the staff of all  
186 the commissariats, administrations and economic organizations of the TASSR of 689 units was reduced. At the same  
187 time the Union of Metal Industry and The Union of Different Industry of the Tatar Industrial Council were combined into a  
188 single trade union The Union of Different Industry. (NA TR. Col. P-128. Inv. 1. F. 3476. L. 86)

189 At the early period of the war in order to bring the industrial leadership to the sources of raw materials some control  
190 trustified industries began to transfer from Kazan to some articulate areas. However the result of management activities  
191 in the distant areas of Kazan was ineffective. A great amount of problems, mainly organizational, put the brakes to the  
192 work of the trustified industry enterprises. For instance, the management of the trust Oil Industry that in July 1941 in  
193 accordance with the decision of the CPC of the TASSR was transferred from Kazan to Chistopol. After several weeks of  
194 work it became clear that this step had had an extremely negative impact on its activity – the trust turned out to be  
195 essentially cut off from the leadership of their organizations and enterprises, located in 47 districts of the Tatar  
196 Autonomous Soviet Socialist Republic (only a small part of them had a telephone communication with Chistopol). (NA  
197 TR. Col. P-128. Inv. 1. F. 3504. L. 81) A similar situation was observed in the management system of the Tatar Alcohol  
198 trust. Having been transferred to Mamadysh, alcohol industry was in a breaking point because the trust could not fix the  
199 telephone communication with the subordinate enterprises; the telegraph and post passed through Kazan, as a result the  
200 mail reached the enterprises during 3 weeks. As a consequence of the above said the trust's instructions were constantly  
201 late. (NA TR. Col. P-128. Inv. 1. F. 3504. L. 91) The executive committee of the Fishtrust were replaced from Kazan to  
202 Pestrechinsky District (fish farm "Ushnya"). Here, as in the previous cases, a lot of organizational problems appeared: the  
203 trust received the postal bulletins after 8-10 days of waiting, the administrative board renewed by 90% because of the  
204 conscription. Only 8 administrative units existed instead of 18 fixed ones. (NA TR. Col. P-128. Inv. 1. F. 3502. L. 550)

205 All these resulted in the fact that by the end of the first year of the war a number of administrations was either  
206 eliminated or transferred back to the capital of the republic, some of the trusts were reorganized. Thus, in accordance  
207 with the resolution of the CPC of the RSFSR № 270/76 from September 19, 1941 the Meat trust was eliminated and its  
208 functions were transferred to the People's Commissariat of Meat and Dairy Industry of the TASSR. (NA TR. Col. P-128.  
209 Inv. 1. F. 3501. L. 553, 554, 556) As for the Tatar fish it was agreed to transfer it back to Kazan, and since November  
210 1941 in accordance with resolution CPC of the TASSR, in order to reduce administrative expenses it was decided to  
211 liquidate it and form the Department of the fishing industry of People's Commissariat of Food Industry of the TASSR. (NA  
212 TR. Col. P-128. Inv. 1. F. 3502. L. 549) However, in practice this solution was not carried out.

213 An important step in reforming the management of industry of the republic in the first year of the war, aimed at  
214 creating an effective system of control over the building materials industry, as well as saving funds for the maintenance of  
215 excess staff, was done. It was the elimination of the Administration of the building materials industry of the CPC of the  
216 TASSR (the order for the CPC of the RSFSR 1445 / 233rs of August 31, 1941 and the Resolution of the CPC of the  
217 TASSR number 450 of September 19, 1941 (NA TR. Col. P-128. Inv. 2. F. 3476. L. 242)). Its functions were transferred  
218 to the People's Commissariat of Local Industry of the TASSR. However, the errors made in the reorganization of the  
219 Commissariat, and, to a greater extent as the loss of control over the activities of the industry led to the fact that during  
220 the first half of 1942, the management of construction materials industry of the CPC of the TASSR was reconstructed on  
221 the basis of the subdivision of the People's Commissariat of Local Industry of the TASSR.

222 In the following 1942 the Resolution of the CPC of the RSFSR of October 31, 1942 number 777 and the Resolution  
223 of the CPC of the TASSR from November 19, 1942 number 568, of December 1, 1942 the Local Fuel Industry of the CPC  
224 of the TASSR was organized on the basis of the District Forestry, Kazan City Fuel Committee) and the Peat regional  
225 subordination (Kizichesky and Borisoglebsky).

226 In accordance with the Resolution of the CPC of the TASSR number 38 of January 29, 1943 "About the  
227 organization of peat enterprises in the management of local fuel industry of the CPC of the TASSR " The Resolution of  
228 the CPC of the TASSR number 434 of September 29, 1943 as well as the Order of the People's Commissariat of Local

229 Industry of the TASSR and management of local fuel industry of the CPC of the TASSR number 20 of February 12, 1943  
230 (NA TR. Col. P-3049. Inv. 5. F. 400. L. 1) 8 peat enterprises were organized – (Aktanysh, Buinsk, Drozhzhanovsk,  
231 Zelenodolsk, Naberezhnye Chelny, Savinovo, Chistopol, Yutazy), 6 city fuel factories (Bugulma, Elabuga, Zelenodolsk,  
232 Mamadysh , Chistopol, Yutazy). In addition, in January 1944, the regional peat enterprises were organized (Elabuga,  
233 Kukmor, Tsiypa) and regional fuel factories of district subordination.

234 Further, based on the Resolution of the CPC of the TASSR number 815 November 10, 1944 and the Order of the  
235 People's Commissariat of Local Industry of the RSFSR number 301 in early 1945 the Kizichesky peat enterprise and the  
236 Kazan city peat factories were given under the authority of the executive committee of the Kazan City Council. On the  
237 basis of government directives and the Orders the People's Commissariat of the RSFSR on fuel № 01-13-26 dated  
238 March 3, 1945 and the Order of Head of the local fuel industry of the CPC of the TASSR the number 22 from March 31,  
239 1945 instead of existing in the Management local fuel industry 22 district forest harvesting, 13 peat enterprises, 6 city fuel  
240 enterprises were formed 16 wood industrial sectors of district subordination in charge of the Tatar peat trust, 3 city fuel  
241 enterprises and 13 district fuel enterprises of district subordination. It should be mentioned that at the postwar period, on  
242 the basis of the Resolution of the CPC of the TASSR number 820 of November 17, 1945, from February 7, 1946  
243 Biklyansky, Sheremetyevo wood industry sectors, the Otar peat enterprises were reorganized under the Administration of  
244 the local fuel industry with the direct subordination to the Tatar fuel trust.  
245

#### 246 4. Conclusion

247

248 Upon the whole, the system of industrial management of the TASSR turned out to be prepared for unexpected enemy  
249 aggression; there was not chaos or panic. During the 1941-1945 the series of the operational decisions aimed at the  
250 optimization of individual sectors were undertaken through the reorganization of the management personnel. The  
251 investigation proved the fact that during the war the restructuring processes touched upon only some operating  
252 overheads, the reorganization had a predominantly cosmetic character, which indicated the effectiveness of the sectoral  
253 management of the economy of the region that had been created in the prewar period. At the same time these  
254 transformation processes had a great effect. In that way the gross industrial output of the Volga republics exceed twice  
255 the level of the first half of 1941, and the enterprises of Commissariats military industry increased by 5.6 times (Dyakov  
256 U.L. 1988, p. 207). The growth of the gross output during the 1940 - 1945 years reached 181%. Just in 1942, the unit  
257 weight of the Volga region, the Urals and Siberia in the industrial output increased by 3.3 times in comparison with the  
258 pre-war period. The growth rate of the gross output produced by the TASSR industry within 5 years of the war (1941-  
259 1945) achieved 16.95% (Tatarstan for 50 years 1967, p. 15).  
260

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262

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265

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267

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# Relationship among Influential Factors of Entrepreneurial Intention in Terms of Gender: Case of Postgraduate Students in Malaysia

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## Abstract

In the last two decades, entrepreneurship has become an important concept, not only in economy, but also in politics, education and research. Studies have shown that entrepreneurship is a promoter for economic development so that entrepreneurial intention is gaining more importance in developing countries like Malaysia. This study aims to find out the relationship among influential factors of entrepreneurial intention (previous experience, education, attitude, subjective norms, and behavioral control) in terms of gender. Data collection was conducted in Universiti Teknologi Malaysia (UTM) in June 2014. A total of 380 questionnaires were distributed among 187 male and 193 female postgraduate students. The results showed that there was no significant difference between females and males in previous experience, education, attitude, subjective norms, behavioral control and entrepreneurial intention. Therefore, there was no significant difference in entrepreneurial intention between males and females.

**Keywords:** Gender, Entrepreneurship, Entrepreneurial Intention, Previous Experience, Education, Attitude, Subjective Norms, Behavioral Control.

## 1. Introduction

Entrepreneurship has been recognized as a promoter for economic development (Baughn, Cao, Le, Lim, & Neupert, 2006). Therefore, in the past few years, the number of universities offering entrepreneurship courses has increased dramatically which indicates the increasing importance of entrepreneurship in social, economic and political dimensions.

Entrepreneurship is gaining more importance in Malaysia. Studies show that entrepreneurial activities support the economy of Malaysia; therefore, Malaysian governors have allocated special funding facilities for interested people. The focus of Malaysia on entrepreneurship moved to a higher level when the Ministry of Entrepreneur Development was established in 1995. Malaysian government has put entrepreneurship as a key factor in economic growth and a mean to create new jobs and reduce the rate of unemployment.

In the past few years, more graduate students have shown interest in the outcomes of entrepreneurship such as independence and satisfaction. In a study conducted in Ireland, almost half of the participated students mentioned their goal to become self-employed and open their own business (Hart & Harrison, 1992). In another study in the U.K., again almost half of the students expressed their intention to become self-employed (Ismail, et al., 2009). These findings show significant increase in the students' intention to run their own business, compared to the previous decade. For example, in a study conducted by Brenner, Pringle and Greenhaus (1991), it was found that only 5% of the participants were willing to start their own business.

In the global dimension, entrepreneurship is a rather new concept. Therefore, the number of empirical studies in this field is limited in certain areas (Lorz, Müller & Volery, 2011). Despite the numerous numbers of studies on entrepreneurial intention, there is a questionable issue in determining the differences in entrepreneurial intention between males and females. This study aims to investigate whether there is a significant difference in entrepreneurial intention of postgraduate students in Malaysia in terms of gender or not.

## 2. Literature Review

According to the theory of social learning, different socialization experiences and social expectations of women and men result in diverse work preferences or motivations. Based on the arguments of Bandura (1986), gender development is affected by various factors such as occupational systems, educational practices, media, and peers. Bandura (1986) explained the difference between the socialization of men and women. Women might score lower self-efficacy, be less confident in their abilities, lack powerful personal efficacy expectations regarding various careers which are related to behaviors, and thus might not achieve their complete career potential due to their different socialization experiences (Chen, et al., 1998). Moreover, sex-role socialization experiences instruct and inform young girls about the gender roles that are suitable for them and those that are not. Studies on gender stereotyping indicate the typical association of masculine characteristics with entrepreneurship. These stereotypical views have adverse impacts on the development and entry of women in entrepreneurship; whereas, a higher entrepreneurship performance is demonstrated by men (Gupta et al., 2009).

The impacts of gender on entrepreneurial intentions are expected to be more strongly reflected in some contexts such as Saudi Arabia. The socialization experiences of young women are formed by strict expectations imposed by gender roles within the Muslim societies of the Middle East. The first and foremost roles expected of women are to be homemakers, mothers, and wives, whereas men are expected to protect their families. The power of men does not only rise from economic justifications like their 'bread winner' identity; it is rather embedded in their politics, society, religion, and culture. The gender ideology that has been promoted in the political culture of Saudi elevates sex segregation and idealizes the domesticity of women (Bandura, 1986). Strict segregation between the socializing places and workplaces of men and women has been instituted since 1960's with particular laws. Although women of Saudi have increasing access to the right to work and study, there are serious restrictions in their becoming involved with political life. They also lack an opportunity of properly entering and participating in the economic life. Moreover, enough role models of prosperous and successful female entrepreneurs have not been provided by the new phenomenon of the entrepreneurship of women in order for the pursuit of entrepreneurial initiatives as desirable and legitimate career path to be reinforced. One of the members of Saudi Management Association, from the Women's branch revealed in an interview in 2006 that "this issue does not concern a great number of women; some even believe the recent changes to be wrong while others merely do not wish for women to be visible or to change"(Chen, et al., 1998). Subsequently, entrepreneurship might be considered by the female Saudi youths to be an improper gender role; therefore, they are less motivated to engage in entrepreneurial careers. Moreover, women might not be certain about possessing the skills and qualifications necessary in a successful pursue of entrepreneurial initiatives. Even in cases where they are greatly confident about their entrepreneurial abilities, they might be uncertain about whether their business receives social recognition and support or not (Gupta, et al., 2009).

## 3. Methodology

### 3.1 Participants

The participants were chosen from postgraduate students in UTM, Malaysia during 2014. The sample for the study (n=380) consisted of 187 males and 193 females who were in their final year of study and were considered appropriate for a decision in entrepreneurship. The participants were asked to provide the researcher with their demographic information including gender, age, faculty as well as major. Table 1 shows the respondents' demographic backgrounds.

**Table 1:** Summary of Participants' Socio-demographic Characteristics

	Frequency	Percent
<b>Gender</b>		
Male	187	49.2
Female	193	50.8
<b>Age</b>		
22-27 years old	80	21.1
27-32 years old	184	48.4
32-37 years old	41	10.8
More than 37 years old	75	19.7

<b>Faculty</b>		
IBS	250	67.9
MJIIT	14	3.8
Engineering	58	15.8
Psychology	32	8.7
Economy	14	3.8
<b>Major</b>	16	7.8
IT	10	2.6
MBA	265	69.7
Engineering	59	15.5
Psychology	40	10.5
Economics	6	1.6

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### 3.2 Procedure

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A total of 380 questionnaires were distributed among the UTM postgraduate students. This was normally scheduled after classes to avoid interruption of the participating students' learning program. Before completion of the questionnaires, the researcher explained the purpose of the study for the participants. The researcher also indicated that there were no preferred responses. The respondents then signed the consent forms. Key concepts including entrepreneurship and small business enterprises were explained to ensure a common understanding of the terms by the researcher and the respondents. Entrepreneurship was explained as creation of a business based on Gartner (1985), but also ownership of small enterprises not necessarily created by the respondent. Small businesses were described to include micro, and informal enterprises including kiosks, and hawking. This definition was used, as the purpose of the study was not to capture innovation, but intention towards entrepreneurship.

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The respondents answered categorical and multiple choice questions on the background and demographic variables, and gave responses to Likert-scale questions on a scale of 1 to 5, 'strongly agree' to 'strongly disagree,' covering perceptions of personal and social desirability, and feasibility of entrepreneurship. The exercise took between 20-30 minutes. To safeguard anonymity and confidentiality of the responses, the researcher collected the questionnaires and the signed consent forms separately. The respondents retained copies of the signed consent forms for their records. The completed questionnaires were well secured against possible interference, damage, or deterioration.

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The completed questionnaires were all given unique identifiers ranging from 1-380, for ease of reference, and to safeguard data integrity. The different responses were then coded. The nominal gender variable, male, was coded (1) and female (2). Inapplicable questions, such as whether the experience was positive/negative where the respondent had indicated that he/she had never started business, were coded (9) and missing responses (99). The responses to the Likert-scale questions were coded from 1 to 5 for 'strongly disagree' to 'strongly agree'. A database was then created for all the variables, in SPSS, showing what kind of variable the response was: numerical or nominal, the size of the variable, and what the codes meant. The data were then keyed into the database. Thereafter, an exploratory data analysis was run to check for the obvious errors. Necessary corrections were made.

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### 3.3 Data Analysis Method

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The data analysis included simple descriptive statistics, correlation and t-test. The t-test was used to compare means, whether the scores for males and females are different (Kothari, 2004). Simple descriptive statistics including frequencies and percentages were used to analyze the respondents' background and demographic data. Mean scores and standard deviation were calculated for the Likert-scale questions to develop a participant profile.

## 4. Results

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To construct the independent and dependent variables, the means of items related to each variable in the questionnaire have been calculated. Table 2 presents some descriptive statistics of the variables. As can be seen, Skewness and Kurtosis values for all research variables are less than 1. We can therefore accept that the distribution of variables does not differ much from normal distribution and being normal theory about those variables is true.

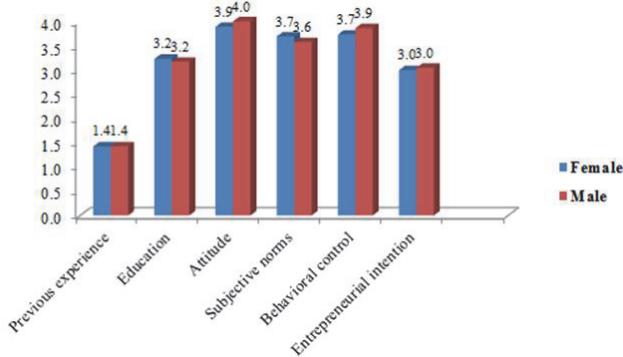
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**Table 2:** Descriptive Statistics of Research Variables

	N	Min	Max	Mean	SD	Skewness		Kurtosis	
						Statistic	Std. Error	Statistic	Std. Error
<b>Previous Experience</b>	380	0.0	2.7	1.4	0.6	-0.2	0.1	-0.6	0.2
<b>Education</b>	150	1.4	4.5	3.2	0.6	-0.7	0.2	0.3	0.4
<b>Attitude</b>	200	1.2	5.0	3.9	0.8	-0.9	0.2	0.8	0.3
<b>Subjective Norms</b>	378	1.0	5.0	3.6	0.9	-0.9	0.1	0.6	0.3
<b>Behavioral Control</b>	376	1.3	5.0	3.8	0.7	-0.7	0.1	0.7	0.3
<b>Entrepreneurial Intention</b>	295	0.9	4.4	3.0	0.7	-0.5	0.1	0.0	0.3

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A suitable statistical method as independent sample t-test was also performed to consider the existence of any statistical difference between research variables in terms of gender. As Figure 1 shows, there is an apparent difference between men and women in mean scores. Hence, we applied independent sample t-test to examine whether these differences are statistically significant or not. As can be seen from Table 3, there is no significant difference between males and females in previous experience, education, attitude, subjective norms, behavioral control and entrepreneurial intention ( $p > 0.05$ ).



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**Figure 1:** Comparison of Means of Research Variables by Gender

**Table 3:** Summary of t-test Result for Level of Research Variables by Gender

		Levene's Test for Equality of Variances		t-test for Equality of Means						
		F	Sig.	t	Df	Sig. (2-tailed)	Mean Difference	Std. Error Difference	95% Confidence Interval of the Difference	
									Lower	Upper
<b>Previous Experience</b>	Equal variances assumed	.05	.823	-.01	378	.992	.00	.06	-.13	.13
	Equal variances not assumed			-.01	377.34	.992	.00	.06	-.13	.13
<b>Education</b>	Equal variances assumed	3.11	.080	.61	148	.545	.06	.10	-.13	.25
	Equal variances not assumed			.60	139.22	.549	.06	.10	-.13	.25
<b>Attitude</b>	Equal variances assumed	1.52	.219	-.99	198	.324	-.11	.11	-.33	.11
	Equal variances not assumed			-.99	193.45	.325	-.11	.11	-.33	.11
<b>Subjective norms</b>	Equal variances assumed	.28	.598	1.25	376	.212	.12	.09	-.07	.30
	Equal variances not assumed			1.25	375.95	.212	.12	.09	-.07	.30
<b>Behavioral control</b>	Equal variances assumed	.52	.471	-1.85	374	.064	-.13	.07	-.27	.01
	Equal variances not assumed			-1.85	369.76	.065	-.13	.07	-.27	.01
<b>Entrepreneurial intention</b>	Equal variances assumed	.04	.839	-.58	293	.565	-.05	.08	-.22	.12
	Equal variances not assumed			-.58	291.72	.565	-.05	.08	-.22	.12

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## 5. Conclusion

This study aimed to find out the relationship among influential factors of entrepreneurial intention (previous experience, education, attitude, subjective norms, and behavioral control) in terms of gender. The respondents were chosen from postgraduate students in UTM in Malaysia during 2014. In total, the sample (n=380) consisted of 187 males and 193 females who were in their final year of study and were considered appropriate for a decision in entrepreneurship. According to the obtained results, there was no significant difference in entrepreneurial intention between females and males. This finding was not in line with the findings of other studies because gender influences intention for entrepreneurship in some countries like Saudi Arabia (Bandura, 1986).

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# The Legal Status and Responsibility of the State Corporations in the Russian Federation

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## Abstract

An important feature of the activities of corporations with government participation is a unique legal status that provides breaks and allows to pursue the dominant policy in a number of industries of strategic importance and of innovative nature for the country. The priority was the concept of special and not contractual nature of corporate relations. The result of decided difference was large-scale changes in the legislation of the Russian Federation on legal entities. The changes affected not only the Civil Code of the Russian Federation but also the Federal law of 08.02.1998 No. 14-FL "On limited liability companies" (The Federal law from 08.02.1998 No. 14-FL (edit. on 05.05.2014) "About societies with limited liability", 2014), the Federal law dated 26.12.1995 No. 208-FL "On joint stock companies" (Federal law dated 26.12.1995 No. 208-FL (edit. on 22.12.2014) "On joint stock companies", 2014). The article discusses some of the characteristic features of the organizational-legal form, powers and functions of the state Corporation, legal differences corporations and business entities. In addition, the form of ownership, as well as the issues of exclusion of civil liability of the state Corporation are considered.

**Keywords:** state corporation, joint stock company, a business entity.

## 1. Introduction

State Corporation as a special legal form has all the necessary characteristics of a legal entity under Russian law, both legal - acts independently in the civil turnover; is responsible for its obligations belonging to it by right of ownership of property, and so on, and the material - has internal organizational unity and external autonomy inherent property separateness.

At the same time for public corporations are characterized by several features, contributing to the specificity of the legal form of the legal entity:

- 1) non-commercial character of Corporation, which means the absence as a main purpose of activity for profit, the use of secured profit only in the performance of statutory functions and, as a consequence, there is no obligation to transfer profit to founder (p. 1 Art. 50 of the CC of the Russian Federation (Civil code of the Russian Federation (part one) from 30.11.1994 # 51-FL (publ. on 22.10.2014), 2014), p. 3 Art. 26 of the Federal law of January 12, 1996, № 7-FL "On non-profit organizations» (Federal law dated 12.01.1996 No. 7-FL (edit. on 31.12.2014) "On noncommercial organizations", 2014));
- 2) the founder of the state Corporation is Russian Federation, which means that no one, except the Russian Federation, has no authority to manage the Corporation and to oversee its activities. In its turn, the state may not terminate its Foundation, without eliminating the;
- 3) the public nature of the activity, because the Corporation carries out it in the interests of the whole society and



- 57 to solve socially significant problems;  
58 4) strictly special-purpose character of the activity and use of property;  
59 5) the formation, operation and termination of the existence on the basis of special laws;  
60 6) the absence of necessity to have incorporation documents; the regulation by law of the procedure for the  
61 formation of management bodies and the appointment and dismissal of officers of the Corporation; a special  
62 form of reporting the results of operations;  
63 7) after making the property contribution of the state Corporation Russian Federation loses freehold interest in  
64 this property which is transferred to the Corporation.  
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## 66 2. Materials and Methods

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68 Today, neither in science nor in practice there is no consensus regarding the content of the concept of "Corporation".  
69 Usually it refers to: Association of persons on the basis of membership, as an Association of persons and capital;  
70 association of only capitals (business entities). It must be considered that the division of legal entities under the criteria of  
71 the membership corporations, and institutions still has not received legislative recognition in Russian law. It is an element  
72 of the doctrine of the remaining disputed on the merits.

73 First, if we talk about institutions, they are traditionally recognized as independent legal form, and not as legal  
74 persons. The same can be said about corporations

75 Secondly, for example, the business entities, established by one founder, cannot be regarded as associations.

76 Thirdly, the concept of "membership" in the Russian legislation is used mainly in relation to non-profit  
77 organizations, and commercial organizations only in relation to production cooperatives (art. 107 of the CC of RF).

78 In addition, membership exists in the peasant (farmer) farms that are not recognized as legal entities (p. 3 art. 1,  
79 art 14 of the Federal law of June 11, 2003, № 74-FL "On peasant (farmer) economy") (Federal law dated 11.06.2003 No.  
80 74-FL (edit. on 23.06.2014) "On peasant (farmer) economy", 2014).

81 From this follows that, for example, the business entities, which are the pooling of capitals, can't be classified as  
82 corporations.

83 Taken into account the above-stated, it can be concluded that the determining factor in this case is not the  
84 terminology, but the powers of state corporations and the functions that they perform. Here, the legislator used the term  
85 "Corporation" not in the traditional sense, but as a synonym for the term "organization". Using by the legislator for  
86 denotation of considered legal form of the legal entity of the term "state" is, in fact, reflects the fact that the property of the  
87 state corporations initially formed at the expense of the state, which they controlled, and used for the purposes  
88 established by law. And the activities of public corporations aimed at implementing the objectives of the state in the  
89 relevant legislative acts (OECD Guidelines on Corporate Governance of State-owned Enterprises, 2005).

90 Also in favor of the use of the term "state" speaks socio-public orientation of functions of corporations, the order of  
91 formation of their Supreme bodies of management and control over the activities of these organizations.

92 In the Russian Federation are set up and are functioning legal entities, legal form of organization of which does not  
93 fit into any of the existing forms of commercial or non-commercial organizations of civil legislation. This, in particular, is  
94 the Bank of Russia, the Pension Fund of the Russian Federation, social insurance Fund, compulsory health insurance  
95 Fund. A distinctive feature of such legal entities is mainly public nature of their functions and their tasks, the successful  
96 implementation of which form the substantive basis for the effective functioning of the society and the state.

97 This allows you to recognize as quite reasonable and realizable offers for the introduction in the Russian legislation  
98 the known legal systems of several countries the category of legal entity of public law with the possibility of their existence  
99 in various forms, relevant socio-economic characteristics of the tasks for which they are intended.

100 The analysis allows to identify the following main features of the legal entity of public law:

- 101 - it is created by the state without the participation of individuals;  
102 - the legal basis of its formation and functioning is a public legal act;  
103 - it is the carrier of the public will, public rights and duties, for what it is vested with authority. Such authority may  
104 be of operative, administrative or other character, but in the broadest sense it is the management authority.  
105 They are discretionary, i.e. decision of the legal entity of the public law, accept at their discretion, but within the  
106 law, apply to third parties;  
107 - the capacity of such person is special, target and suggests the focus on the implementation of the public policy  
108 interests.

109 However, the issues relating to civil-legal status of legal entities of public law of their creation, registration,  
110 management, grounds and procedure for prosecution, the legal status of their property and other should be in more

111 details and legislatively regulated.

112 One of the most important considerations when discussing the legal status of public corporations, is the question of  
113 the legal nature of the transferred property.

114 Federal law "On nonprofit organizations" and Federal laws regarding the establishment of public corporations  
115 establish that the state transfers to the corporations the ownership of property in the amount necessary for the successful  
116 implementation of the assigned to the appropriate Corporation social, managerial, or other socially useful functions.

117 In Art. 209 of the CC of RF the right of property is revealed through traditional civil rights triad of powers:  
118 possession, use and disposal. Accordingly, a public Corporation, like any other owner, shall be entitled to make in respect  
119 of its property any action, not inconsistent with law and other legal acts, and not violate the rights and legitimate interest  
120 of others.

121 Opponents of the Institute of public corporations unreasonably appreciate the act of transfer of state property into  
122 the ownership of these entities as an example of illegal "privatization" of this property.

123 However, at privatization happens the alienation of state property into private property. This circumstance plays a  
124 crucial role in determining the actual content of the right of ownership of public corporations on passed to them property.

125 Unlike a private Corporation owners can exercise their right to own not at their own discretion, but only for the  
126 purposes, which is set before them by the legislator, i.e. ultimately by society and the state. At the same time happens the  
127 exclusion of the turning of results of the possession, use and disposition of this property in their favor in the sense that the  
128 inherent understanding of the benefits in the format of entrepreneurial activity: all profits derived by the Corporation from  
129 the investment of surplus funds, securities, etc., can be directed only to the solution of problems for which it was created.

130 Strictly speaking, as the government Corporations are created by the state and there is no other founders, it cannot  
131 be said that the donation of corporations property forever go out of state ownership. As a matter of fact, this refers to the  
132 transfer of state to legal person of authority for state property management. This, in particular, shows a certain ambiguity  
133 in the legal regime of property of public corporations. On the one hand, this property is embodied in law as property of  
134 legal entities, and on the other, the real powers of the owner are in the hands of governments, consisting of civil servants.

135 In this respect it is significant that the state reserves to himself the decision on the fate of the property of the state  
136 Corporation, including its liquidation.

137 For example, part 2 Art. 18 of the Federal law "On the state Corporation "Russian technologies" provides that the  
138 property of this organization after its liquidation proceeds in Federal ownership. This suggests that the status of public  
139 corporations in this respect similar to the status of fiduciary owner of the property allocated to such owner by a third party  
140 (in this case the state).

141 Essentially, all this means that form of ownership of public corporations does not apply to classic forms, enshrined  
142 in p. 2 art. 8 of the Constitution of the RF (The Constitution of the Russian Federation (adopted by popular vote  
143 12.12.1993), 1993) and p. 1 art. 212 of CC of the RF (public, private, municipal), but can be qualified as provided by the  
144 specified standards of different ownership or as another kind of public property along with the state and public.

145 This issue needs further comprehensive study, and the status of assets of public corporations should be clarified  
146 legislatively.

147 The analysis of the peculiarities of the legal status of public corporations suggests the need to consider their socio-  
148 economic entity, due to the content of the tasks for which they are created. This raises the question if could the functions  
149 assigned by law to the Corporation be independently implemented, on the one hand by government agencies, and on the  
150 other business entities, in particular the joint.

151 In principle, all without exception these functions to some extent are already implementing and the tasks ultimately  
152 will be decided only by the state. However, the Soviet experience convincingly demonstrated organizational inefficiency,  
153 economic overinvestment and strategic futility of this approach, not mentioning its complete incompatibility with current  
154 market realities.

155 However, the market, as demonstrated by the Russian practice of recent years, is not able to solve the system of  
156 strategic socio-economic problems, which have national, public value. Business in the face of equity and other  
157 commercial business companies finds the main purpose in making a profit. But the process of solving these problems, as  
158 a rule, has long-term character, involves huge investments, exceptional organizational efforts, is impossible without the  
159 availability of administrative powers, and even if they have a commercial perspective, do not guarantee a quick return on  
160 capital. Thus, the business, even under condition that such tasks on its financial, organizational, moral potential are within  
161 its power (in Russian business is not obvious), objectively not interested to take care of all the fullness of the social and,  
162 not least, political responsibility, and economic risks associated with their decision.

163 Mainly the comprehension of the state of the fact that the solution of some vitally important for Russia's socio-  
164 economic objectives is not achieved and cannot be achieved without adequate material and other costs in the traditional

forms of legal entities, led to the establishment of public corporations as a natural process, driven by the needs of socio-economic development of modern Russia. As legal entities of public law, they are instruments of indirect regulatory impact of the state on public relations. Of course, their creation is directly linked with increased role of the state in their regulation. Being legal entities of public law, they are instruments of indirect regulatory impact of the state on public relations. Of course, their creation is directly linked with increased state role in their regulation. But at the same time in the laws for the creation of corporations is consistently secured market component of this regulation: state Corporation within its competence are involved in the solution of the above-mentioned problems of the Russian business in the appropriate market conditions.

The expediency of establishing of public corporations was analyzed on the example of activity of the state Corporation "Agency for deposits insurance" on the implementation of its functions - the insurance of the deposits of citizens, rehabilitation and liquidation of banks. Also the business is poorly managed with a function for the implementation of competitive management (liquidation) banks, meaning not the satisfaction of self-interests, but the problem essentially solving.

In the end, based on the foregoing, it can be concluded that in the modern social, economic, political conditions, the most appropriate way of ensuring the implementation of a separate state government objective is the establishment for these purposes, public corporations as legal persons with special competence. The latter means that they have a unique combination of strictly target standing with the public nature of the task and the vesting in a particular amount of power.

Ongoing around the state corporations theoretical disputes can have serious practical social, economic and even political consequences. The proposed changes will require significant resources to implement and will result in a corresponding loss of time, which the state cannot afford in the fast (and sometimes unpredictable) changing situation in the global and Russian economy.

The state Corporation is liable for its obligations with all its property, which according to the legislation of the Russian Federation may be levied, that is to have solely independent property liability, the limits of which are determined by the value of the property owned government Corporation of the right of ownership. Therefore, a state Corporation is not liable for the obligations of its founder - the Russian Federation - as well as the founder of the state Corporation is not liable for the obligations of the latter (p. 2 art. 25 of the Federal law "On noncommercial organizations"). This rule is enshrined in the Federal laws that created state Corporations.

In some cases, failure of the property of the state Corporation are entitled to rely on additional funding for activities related to the main activity. For example, the performance of the obligations under the compulsory insurance of deposits may be carried out on the offer of the Board of Directors of the Agency at the expense of the reserve Fund of the Government of the Russian Federation (article 40 of the Law). In case of confirmation by the Board of Directors of the Agency decision of the management Board of the Agency of the impossibility of compensation on deposits on time without replenishment of the Fund of obligatory insurance of deposits due to additional funds (excluding insurance premiums and other scheduled receipts) the Board of Directors of the Agency, within a period not exceeding seven calendar days after the insurance event, takes one of the following decisions:

- 1) to apply to the Government of the RF with a request for allocation to the appropriate Agency funds as fiscal loans. The government of the Russian Federation shall take an appropriate decision;
- 2) to apply to the Government of the RF with a request for allocation to the Agency with additional funds from the Federal budget. At impossibility to allocate these funds to the Government of the Russian Federation in the framework of its powers contributes to the State Duma of the Federal Assembly of the Russian Federation the draft Federal law on introducing relevant amendments to the Federal law on the Federal budget for the respective year (art. of Law 41).

Similar legislative language may indicate the presence of joint responsibility of the founder-state debts of the Corporation.

In the Civil code of the Russian Federation, the legislator representing the formula of joint responsibility, establishes that before a claim against the person who, in accordance with the law, other legal acts, or the terms of the obligation shall bear liability in addition to another person, which is the principal debtor, the creditor must present a claim to the primary debtor. But only if the principal debtor has refused to satisfy the creditor or the creditor has not received from him within a reasonable time response required, this requirement can be presented to the person bearing subsidiary liability (p. 2 art. 399 of the CC of the RF).

Joint responsibility may be established by law, other legal acts (decrees of the President of the Russian Federation, decrees of the Government of the Russian Federation) or the terms of the obligation, the latter should be understood as the terms of the contract. Depending on the reason of attracting additional debtor to subsidizing,

responsibility can be divided into statutory, contractual and tort. Statutory joint responsibility - responsibility of founders (participants), the owner of the property of a legal person or other persons who have the right to give mandatory for the entity specified or have the opportunity otherwise to determine its validity. The cases of statutory joint responsibility are:

- 1) subsidiary responsibility of founders (participants), owners of the legal person or other persons who have the right to give mandatory for the entity specifying or otherwise have the ability to determine its validity, the obligations of a legal entity upon its insolvency (bankruptcy) in the case of an insufficiency of assets (p. 3 art. 56 CC of the RF);
- 2) subsidiary responsibility of the General partner, who became a participant (shareholder) of the company or a member of a production cooperative in the conversion of the partnership, respectively, in the company or a production cooperative, the responsibilities transferred to the company or a production cooperative from the partnership. The ability to attract vicarious liability is valid for two years (p. 2 art. 68 CC of the RF);
- 3) subsidiary responsibility of participants in a full partnership and of the General partners in the limited partnership for obligations of the partnership, including; occurred prior to their entry into the partnership. Participant, retired from the partnership, is responsible for the obligations of the partnership incurred before the date of his retirement, along with the remaining participants within two years from the date of approval of the report on the activities of the partnership for the year in which he retired from the partnership (p.1,2 art.75, p. 2 art. 82 CC of the RF);
- 4) subsidiary responsibility of participants in the company with additional liability for its obligations in the same for all fold to the value of their contributions, determined by the constituent documents of the company (p. 1 art. 95 CC of the RF)
- 5) subsidiary responsibility of the parent company (partnership) for the debts of the subsidiary in the event of insolvency (bankruptcy) of latest fault of the principal (p.2 art.105 CC of the RF);
- 6) subsidiary responsibility of the members of the production cooperative in the amount and in the manner stipulated by the law on production cooperatives and the charter of the cooperative, for the obligations of the cooperative (p. 2 art. 107 CC of the RF);
- 7) subsidiary responsibility of the property owner, state-owned enterprises (i.e. founder) for the obligations of the latter with the lack of his property (p. 5 art. 115 CC of the RF);
- 8) subsidiary responsibility of the members of the consumer cooperative for its obligations within the deposited part of the additional contribution of each member of the cooperative, which they are required to pay within three months after approval of the annual balance in order to cover the resulting losses (p. 4 art. 116 CC of the RF);
- 9) subsidiary responsibility of the owner of the private property or public institutions (i.e. founder) for the obligations of such institutions with a lack of funds at the disposal of the institution (p. 2 art. 120 CC of the RF);
- 10) subsidiary responsibility of the members of the Association (Union) for the obligations of the Association (Union) in the amount and in the manner stipulated by the constituent documents of the Association (Union) (p. 4 art. 121 CC of the RF). In the case of withdrawal from the Association (Union) at the end of the financial year former member of the Association (Union) shall bear subsidiary responsibility for obligations of the Association (Union) proportional to its contribution in the two years since the release (p. 2 art. 123 CC of the RF);

However, in our case, the state as the founder are not liable, but only in virtue of the law should make additional funding

The Federal law vested power of bankruptcy trustee on the State Corporation "Agency for deposits insurance". The changes that have occurred in the control system of bankruptcy, are of fundamental importance, since the need for public participation in the management of the bankruptcy of credit institutions is recognized and a special corporate body (Agency) is created through which is provided such public participation. As it is known, the special basis of liquidation of a legal entity is recognized insolvent (bankrupt). However, in the case of public corporations the law establishes that on the data is non-profit organization provisions of the Federal law of October 26, 2002 № 127-FL "On insolvency (bankruptcy)" do not extend (Federal law dated 26.10.2002 No. 127-FL (as amended it ed on 29.12.2014) "On insolvency (bankruptcy)", 2014).

Some scholars such an approach of the legislator consider to be incorrect, because the Corporation is a huge, powerful structure that uses huge amounts of money from the Federal budget, which, in fact, monopolized the private sector. (Roi, O.M. and Dening E.N., 2009) It is obvious that the state, by setting such an exception to the General rule, gave the Corporation a special "privileged" position in relation to other entities. Such an exception can be justified by those special "good" purposes for which a public Corporation is created, however, the boundaries of such "promotion"

273 must not be contrary to the legal order and all existing legal doctrine. Thus, on the one hand, independent nature of  
274 responsibility of the Russian Federation on its obligations and the inability to attract property public corporations for the  
275 debts of the state should be welcomed. On the other hand, aims and objectives, which in some cases puts the state  
276 before created state corporations, requires more financial costs than the economic contribution of the state when they are  
277 created.

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### 279 3. Conclusion

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281 Also should be noted the unacceptable in the conditions of market economy the establishment of exceptions of the  
282 Institute of civil liability for public corporations, for example in relation of the state Corporation "Olympstroy", which have  
283 the right of refusal unilaterally from the agreement concluded with the performers of works (services) and providing  
284 funding for the construction of Olympic facilities and implementation of other related activities for its own account. In our  
285 opinion, it violates the fundamental principles and the early civil rights such as freedom of contract, the equality of the  
286 parties, judicial protection of violated rights and others, and is subject to cancellation in the prescribed manner.

287 Thus it can be stated that the choice of the state Corporation as a legal form was largely determined by the  
288 possibilities of:

- 289 a) simplification of the process of restructuring and consolidation of state ownership in certain sectors;
- 290 b) fundamental flexibility in use of funds, identifying areas for possible investment, financing, implementing long-  
291 term programs;
- 292 c) realization of selective "trimming" of the administrative system

293 Also very important was the factor of limited time and the desire to overcome the inhibition to address a number of  
294 key tasks. In this regard, the establishment of public corporations has become a proactive tool (framework) "institutional  
295 fixing" of individual priorities for public policy, the personification of responsibility for the solution of priority tasks.

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# The Relationship between Audit and Risk Management Committees on Financial Performance of Non-financial Companies in Nigeria: A Conceptual Review

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## Abstract

In recent years, cases of dissatisfaction from shareholders in reflection and recording of corporate financial activities, this has given rise to establishments of Audit and risk management committee and inclusion in the governance code as one of the governance mechanism for companies. It has become very serious issues of fraudulent practices by management, hence the need for audit system to signal any form of information asymmetries. This paper is purely conceptual review of past articles on corporate governance mechanism, board committees and Corporate Governance Code in Nigeria. The code defines what is needed for establishment of audit Committee by Corporations. The conceptual framework on audit and risk management committee is proposed for further study looking at Tobin q and ROA as measure of accounting and market performance respectively.

**Keywords:** Audit Committee, Corporate Governance, Risk Management Committee, Nigeria, Financial performance.

## 1. Introduction

The Board of Directors (BOD) of organization has generated focus of stakeholders in business in the past few decades (Daily & Dalton, 1994; Ellstrand, Tihanyi, & Johnson, 2002; Finegold, Benson, & Hecht, 2007). There have been disagreements in regards to director's role in business management as stipulated by agency theory (Jesen & Meckling, 1976). The duties and functions of directors are classified into three ; Shaker,( 1989) namely; Appointment and removal of Chief Executive Officers (CEOs) and top management of the company; Executive pay determination; and Managerial and executive issues by the top management. Other functions of the board committees are the formulation and establishments of board committees such as independent audit committees and risk management committee. Other role of company's directors were identified by Lorch and MacIver (1989) in Brickley et al., (1997) are resources independent labeled control and services. The control role is that managers are monitored by directors as fiduciaries of stockholders, the services includes the advice by BOD to CEOs and to top management on their activities. The recourse independence role entails BOD critically facilitating the acquisitions of resources needed by the firm to perform. The objective of this paper is to critically examine the relationship or association between various dimensions of audit committee characteristics and financial performance and to access the relationship between risk management committee and financial performance. These objectives mentioned above motivated this research article.

### 1.1 Importance of Board Committees

1. To receive and deliberate reports and recommendations from management of the firm and to make necessary recommendations to the board of directors in respect of the financial reporting, accounting policies, internal control system, internal and external audit processes.
2. To assist the board of directors in fulfilling its oversight duties and responsibilities on risk management policies as approved by the board in respect of the risks inherent in the businesses of the firm and the control processes with respect to such risks; the risk profile of the firm and the risk management, compliance and control activities of the companies.

- 57 3. To monitor the compliance systems in place by which management renders and discharges its regulatory and  
58 legal obligations in respect of the firms business and to review compliance systems and procedures within the  
59 bank to monitor that there is appropriate disclosure to the board of areas of operating and non-financial risk.

60 The need for detailed review of day to day economic activities, and ensuring accountability and transparency in the  
61 management of company funds led to the start of the legitimacy of the audit (Guxholli, Karapici, & Dafa, 2013). According  
62 to many researchers of audit origin, the first traces and testimony about the audit area were found in the form of  
63 commercial laws and accounting reports so many centuries back. With the increasing number and size of companies and  
64 growth, Auditing has become very important (Guxholli et al., 2013)

65 It is adequate to bring attention to some of the numerous examples of insolvency and bankruptcy of large  
66 companies such as "Enron" (2001), World-Com's". "Parmalat" Scandal, Collapse of some notable banks in Nigeria in  
67 2008 and so many other examples are reason for audit committee (Guxholli et al., 2013; Lin & Hwang, 2010; Stewart &  
68 Munro, 2007).

## 70 2. Literature Review and Development of Hypotheses

71  
72 The study will review literature in the area of corporate governance structure in Nigeria and relevant areas of board  
73 committees

### 75 2.1 Corporate Governance Code in Nigeria

76  
77 It is generally agreed that corporate failures in Nigeria is as a result of weak corporate governance mechanism. In order  
78 to increase the corporate governance systems, the SEC in Nigeria issues a corporate governance code to regulate the  
79 activities of board of directors. The board of SEC reveals the 2003 and 2008 corporate governance code weaknesses  
80 and came up with the 2011 codes which is believed will ensure highest standards of transparency accountability and  
81 good governance mechanism. The code is only applicable to the public companies but the board of SEC implores other  
82 companies like the private and small and medium scale entities to adopt the set code or principles. The board committees  
83 should determine the extent to which its duties and responsibilities should be undertaken as stipulated by SEC code  
84 through her committees. The board may in addition to audit committee as required by CAMA 1990 may also establish  
85 governance/remuneration committee and risk management committee and all other committees as deemed by the board  
86 depending on the size of such organization.

87 Corporate governance deal with the manner the custodian of finance of corporation guarantees themselves of  
88 getting returns on their investments (Morck, Shleifer, & Vishny, 2001; Voeller, Bremert, & Nicole, 2013) corporate  
89 governance has been designed to explain the mechanism that ensures management performance in an efficient and  
90 effective manner. This governance mechanism are designed to reduce agency problem between actors in business  
91 (Kamardin & Haron, 2011; Latif, Kamardin, Nisham, Mohd, & Adam, 2013). Corporate governance may also be defined  
92 as a system consisting of all the persons steps and activities to ensure stewardship over an entity's assets (Lin & Hwang,  
93 2010). Absentee's owners' interests are protected normally with the presence of good strong and good corporate  
94 governance as a result; resources available will be utilized to the best knowledge of the top management and board of  
95 directors. Therefore, the role of corporate governance is to comply with the relevant code in financial reporting process  
96 and compliance with the Generally Accepted Accounting principles (GAAP), International Financial reporting Standards  
97 (IFRS) and maintain the credibility of corporate financial statement (Lin & Hwang, 2010). However, governance  
98 mechanisms are supposed to increase financial performance because they provide good quality in ensuring financial  
99 reporting process.

### 101 2.2 Audit Committee

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103 Auditing is very important in any business line-up. Apart from compulsory or regulatory requirements, it could be  
104 considered a way to mediate and moderate agency conflicts and information asymmetries (Cohen, Holder-Webb, Nath, &  
105 Wood, 2011; Voeller et al., 2013; Watts & Zimmerman, 2014). Internal audit function is one of the pillars of corporate  
106 governance (Abiola, 2012), he found out that is significant relationship between audit committee and performance. In a  
107 similar research conducted in Malaysia by (Ismail, Iskandar, & Rahmat, (2008) on corporate reporting, audit committees  
108 and its quality stipulates a positive relationship and financial performance. This result is also in line with the result of Song  
109 & Windram, (2004) who states that the existence of audit committee will reduce and solve agency problem. However, the  
110 role of corporate governance in a developing economy is to ensure that board committees such as audit committees are

established to ensure the quality of corporate financial reporting (Rehman, 2012; Xiaoyan, 2013). They found out there is positive relationship between audit committee and financial performance. Other studies that found significant positive relationship are follows (Ismail et al., 2008)(Ismail et al., 2008). However, there are also contrary views about audit committees (Leng, (2004) states that is negative significant relationship between the variables in the research "the impact of corporate governance practices on performance" He further states that the role of the audit committee has nothing to do with the financial performance of any enterprise. Similar to the study above, a study on the relationship between audit committee independence and earnings management shows negative result (Saibaba & Ansari, 2013) and this finding is consistent with the idea that a lack of independence impairs the ability of boards and audit committees to monitor management. Absence of corporate law in any nation and different accounting regime can also deteriorate the performance of the auditors and create financial instability in developing market (Xu & Wang, 1999). Menon & Williams, (2001) also states that the existence of the audit committee is for cosmetic reason as it has no significant association with performance. The agency theory is good in explaining the relationship because the existence and presence of audit committee is a good way of reducing information asymmetry and agency problem (Jesen & Meckling, 1976). The corporate governance code of Audit committee is also to ensure that the new IFRS is complied with (Edogbanya & Kamardin, 2014). The Audit committee meeting is another corporate governance code of importance to firm in Nigeria. There are no principles concerning the Frequency meeting of audit committee meetings, with corporate governance code acknowledging that the meetings should be as frequent as possible to effectively carry out the committee's duties, functions and responsibilities(SEC, 2011). Researches that shows positive relationship between audit committee are as follows (Aldamen, Duncan, & Kelly, 2012). On the contrary, other results shows negative relationship as (Sharma, Naiker, & Lee, 2009). The frequencies of the audit committee indicate seriousness and effectiveness of the audit committee. Based on the above explanation, theoretical and empirical justification, the below hypotheses is developed.

- H1. *There is a positive Relationship between Audit size and financial performance of non- Firm Company in Nigeria*
- H2. *There is a positive Relationship between Audit independence and financial performance of non- Firm Company in Nigeria*
- H3. *There is a positive Relationship between Audit committee meeting and financial performance of non- Firm Company in Nigeria*

### 2.3 Risk Management Committee

According to the Nigerian Code Corporate Governance NCCG (2011) The Board of any organization may form a Risk Management Committee to assist it in its oversight of the risk function or profile, risk management framework and the risk-reward system to be determined by the Board of Directors (BOD). This is one the BOD committee as required by the Corporate Governance code. It is important but not mandatory for firm to have one. Risk is a day to day activity of any business entity. Scholars postulate that organizational performance could be enhanced if there is good management committee in place. Performance of company largely depend on the risk management mechanism (Akindele, 2012). Business failures is also as a result of risk management mechanism (Davies, 2013; McShane, Nair, & Rustambekov, 2011). The following studies also shows positive relationship between RMC and firm performance (Gordon, Loeb, & Tseng, 2009; Graham & Rogers, 2002; Hoyt & Liebenberg, 2011).on the contrary, the following studies states that risk management committee have a negative relationship with performance (Bartram, S. M., Brown, G. W., & Conrad, 2009; Beasley, Clune, & Hermanson, 2005; Hoyt & Liebenberg, 2011). Because of the above inconclusive results, there may be need for re-investigation of risk management committee and performance. The signaling role of Chief Executive Officer (CEO) characteristics is important in reporting information asymmetry (Daily & Dalton, 1994). Based on the above explanation, theoretical and empirical justification, the below is hypothesized

- H3. *There is a positive Relationship between the presence of risk management committee and firm performance of non- Financial Company in Nigeria*

### 2.4 Theory

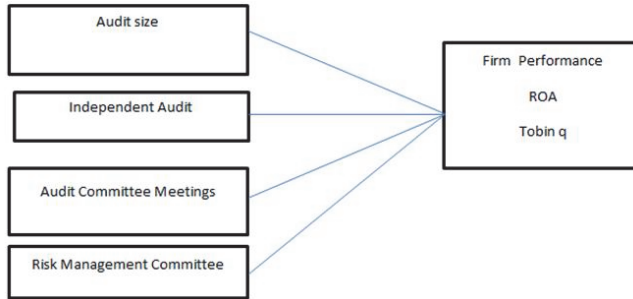
Signaling theory is appropriate to explain the variables. The theory states the important of behavior when two parties are involved. This theory is crucial in raising alarm when there is information asymmetry (Connelly, Certo, Ireland, & Reutzel, 2010; Spence, 1973). Signaling is always important as a method of diversifying investments of the owners are usually communicated to the capital market (Brandes, Hadani, & Goranova, 2006). Another theory which can explain the below framework is the agency theory Jesen and Meckling (1976)and Watts and Zimmerman (2014).



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### 3. Conceptual Framework and Methodology

This paper adopts signaling theory to explain the model. The Relationship between Audit and Risk Management Committees on Financial Performance of non-financial Institution in Nigeria. This Theory is good in explaining two behaviors in an Organization in order to explain how firm uses Board of directors to Communicate to the Shareholders on the financial activities of the company (Spence, 1973). In practical terms, companies with excellent operating performance usually disclose information to the public to promote public image of the business firm (Bhattacharya, 2007; Chiang, 2005). The Corporate governance variables include in the proposed framework is as follows; Audit Committee characteristics and risk management committee. The study will also look at Return on Accounting and Tobin q as proxy for performance measurement (Brickley et al., 1997; Haniffa & Hudaib, 2006).



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Fig 1.1. Proposed Conceptual framework, 2014.

Table 3.1 Proposed Measurement for the sampled variables

Variable	Proposed measurement	Author
Return on Accounting (ROA)	Earning before tax divided by the total assets of the firm	Haniffa and Hudaib (2006) Kamardin and Haron (2011)
Tobin Q	common shares plus the total debt divided by the book value of asset	Haniffa and Hudaib (2006) Kamardin and Haron (2011)
Independent Audit Committee	the percentage of Non-executive committee on the Audit Committee	Karamanou and Vafeas (2005)
Audit size	the total numbers of audit members serving in the Audit committee.	Karamanou and Vafeas (2005)
Audit meeting	the number of meeting held by the members of Audit committee	Sharma, Naiker and Lee (2009)
Risk Management committee	proxy as 1 for presence and 0 otherwise for risk management committee	Hoyt and Liebenberg (2011)

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### 4. Methodology

To address the issue of board committees, in the context of the transformation of financial reporting and corporate governance, the paper adopts review approach. The research presented here holds on an analysis of discourses within the range of documentary evidence and is based upon an examination of some publications and materials emanating from academic research carried out in the past. This study proposes multiple linear regressions using STATA statistical tool for the sampled variables. The proposed sample represents 100 non- financial companies listed on Nigeria Stock exchange out of the population of 136. This sampling frame is according to Krejcie and Morgan (1970). This method is adopted because it will take care of the following test; homoscedasticity, linearity, multi-colinearity and normality assumption (Haniffa & Hudaib, 2006). This paper is purely a conceptual review.

### 5. Conclusion

The paper examines the conceptual review of relevance of the audit committee and risk management committee.

197 Signaling theory is in support of the establishment of audit committee and all other committee as prescribed by the  
198 corporate governance code. The important of board committee cannot be over emphasized. That is why the corporate  
199 governance code of Nigeria made it mandatory as one of the committee to be established by the Board of Directors. The  
200 function of this committee is to oversee the financial reporting process and ensure that the all relevant and material  
201 information are disclosed.

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# Modeling and Development of a Methodology for Assessing the Socio-Economic Processes in the Management of Business Incubators

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## Abstract

The aim of our studies was to develop recommendations to management representatives of business incubators concerning its management structures, as well as to the public authorities in charge of regulation of this sphere. In this article a methodology for assessing the socio-economic processes of business incubation was developed ;it differs from the previously proposed by foreign and Russian scientists systematic approach to the consideration of the management of the business incubator and the ability to quantify the level of development of management processes, which allows to identify and calculate the available socio-economic resources in their development. This article includes first proposed models describing the effect of management processes of business incubators on their effectiveness (a model showing the influence of the process of establishing criteria for selecting businesses on the number of jobs created in the business incubator; a model illustrating the effect of the process of formation and use of sources on financing on the financial profitability of the business incubator, and so on). The use of these models in the practice of management of business incubators might give the opportunity to consider the influence of qualitative factors (the goal of business incubation, the quality of services provided; qualification of personnel, etc.) in the assessment of business incubators as a socio-economic systems. Results of the study are universal and can be used as a methodological tool for improving the management of any business incubators.

**Keywords:** business incubator; business incubation; socio-economic processes; modeling; management business incubator.

## 1. Introduction

Intellectual capital is becoming one of the key resources, the use of which is a source of innovation. L.A. Anosova, giving the definition of the term "innovation" writes the following: "it means materialized latest scientific and technical ideas. When they receive recognition in the market of consumers, they, along with the science are considered in the context of globalization as the foundation, and in addition to this as a tool to improve competitiveness and security, as well as a basic element of a new type of society, the development of which is based on knowledge (Anosova, 2010).

As it was noted in the annual message to the Federal Assembly of the Russian President, in recent years, Russia has achieved much, but in the coming years we have to be able to solve a whole range of complex urgent national problems, among which were mentioned modernization of the economy and its transfer to an innovative way of development, improving governance, and others. The political orientation of these areas has been identified and proposed in the "Strategy of socio-economic development of Russia until 2020" (2).

A necessary condition for the implementation of the given objectives is to intensify the processes of scientific and technological renovation of the economy, the introduction of adequate, relevant production technologies which meet modern times requirements in all sectors and industries.

It is well known that Russia's economy is dominated by mostly morally and physically obsolete fixed foundations, which consequently hinder the development and introduction of new production technologies. This contrariety leads to technical and technological gap between foreign manufacturers of high technology products.

According to international ratings of innovative activity and the competitiveness - their level in the Russian Federation is extremely low (Table. 1).

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**Table 1** - International ratings of innovative activity and competitiveness of some countries by the method of INSEAD, BCG and GCI WEF \*

	Global Innovation Index INSEAD, 2013		Global Innovation Index BCG, 2012		The Global Competitiveness Index WEF 2013-2014	
	The total score	Rating	The total score	Rating	The total score	Rating
Switzerland	66,6	1	2,23	3	5,67	1
Sweden	61,4	2	1,64	10	5,48	6
UK	61,2	3	1,42	15	5,37	10
Netherlands	61,1	4	1,55	12	5,42	8
USA	60,3	5	1,80	8	5,48	5
Finland	59,5	6	1,87	7	5,54	3
Hong Kong	59,4	7	1,88	6	5,47	7
Singapore	59,4	8	2,45	1	5,61	2
Russia	37,2	62	-0,09	49	4,25	64

\* Compiled by the authors using sources (3;4;5).

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This can be explained by the fact that many business organizations, which form the basis of economic system in every developed country in the world, over a long period do not have the necessary investment and suitable innovation providing.

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International and domestic experience prove that without the existence and activity of many small businesses market cannot be developed. Small businesses are created and liquidated. Their emergence and development create a kind of "movement" being is a necessary link, without which no energy of interaction of various components of the market is transferred.

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Small businesses are a stimulant to create a high level of competition in the market for goods and services, resulting in improved product quality and higher standards of living. Eventually, they form the middle class, which is considered to be the basis for the stability of any society (Gamidullaeva, 2013).

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Effective means of reducing failures in business, increasing the share of surviving businesses are business incubators - a type of specialized infrastructure facilities to support small business, along with foundations, business centers, educational, informational and other service structures (Shamray, 2005).

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The term of "business-incubator" means the socio-economic system, the functioning of which is aimed at supporting small businesses by providing a comprehensive set of services (accounting, legal, consulting, information, etc.), as well as the promotion of their business (Gamidullaeva, 2009).

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Overseas experience shows that for the successful development of business incubation, a significant attention of state and local authorities is vitally important. Business incubator is not an organization that brings immediate returns (except for social). The return on investment comes from firms, grown in a business incubator, and the period of formation of firms is typically 3-4 years. Without significant financial investments and other financial assistance to implement it is quite difficult the technology of business incubation.

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It is not surprising that the development of business incubators is the focus of the governments' attention in different countries

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Support for small businesses based on business incubation is considered a strategic perspective as the most important factor of social and economic development of the Russian Federation. Regarding this the problem of increasing the efficiency of business incubators deserves special attention.

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Questions to the management of business incubators as socio-economic systems are insufficiently studied and highlighted in scientific papers (Aaboen, 2009; Bergek and Norrman, 2008; Chen, 2009; Kemp, 2011; Lilai, 2010; etc.). The topic of the systematic approach to the management of social and economic processes of business incubation is not covered, as well as methods of evaluating the management processes and results of operation of business incubators.

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## 2. Methods

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Business incubation in Russia has passed a certain path of development, but has not yet become effective functioning sector of the economy.

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The main problems faced by the business incubator in the Russian economy has been attributed as follows (MGIMO, 2012): low entrepreneurial activity (32%), difficulty in finding partners and sponsors (30%), lack of experience in the business incubation and poor infrastructure in business incubation (17%), poor infrastructure in the region (20%), lack

100 of support from authorities (15%).

101 In the study of the problem of improving the efficiency of business incubators authors have developed a method of  
102 estimating the management data of socio-economic systems.

103 All quantitative calculations in this article are based on data obtained from the study of 12 business incubators from  
104 different regions of the Russian Federation: Krasnoyarsk region, Moscow Region, Republic of Mordovia, Penza region,  
105 Nizhny Novgorod region, Omsk, Vologda, Kurgan Oblast, Saratov Oblast, the Republic of Tatarstan, Rostov and  
106 Novosibirsk regions.

107 The key task of effective management shall consist in the formation, implementation and use of a comprehensive  
108 performance management system based on the projected and current changes in the internal environment, as well as the  
109 impacts of external changes (Vasin, 2012).

110 System for managing business incubators can be characterized by a set of quantitative and qualitative indicators,  
111 though their degree of influence on the results of business incubators is often underestimated.

112 The evaluation of these parameters is of great significance, since it is possible to determine the basis of the  
113 reserves in the management and improve the management of business incubators.

114 Formation of indicators` aggregate for assessing management business incubators has been performed according  
115 to the following principles:

- 116 1. Each of the subsystems of the system of business incubators should be fully covered by indicators.
- 117 2. Within each subsystem indicators that reflect the sequence of management actions shall be designed.
- 118 3. When calculating the indicators it is necessary to combine (if possible) several analytical techniques that help  
119 to reflect the actual and the desired state of a management event.
- 120 4. Efficiency indicators should be calculated with the greatest possible accuracy.

121 In this study, the following indicators to measure a variety of activities in the management of business incubators  
122 were developed: the planning of activities in the process of incubating firms as well.

123 Approaches to the calculation of indicators that reflect the level of any management activities are slightly different  
124 depending on the research methods used in the analysis of specific activities.

125 Calculation of the first group of indicators is the result of a combination of several methods, which includes the  
126 method of questioning and the expert-analytical one. The scale of assessment of an indicator in this case is formulated to  
127 carry out a comparison of estimates of actual use criteria, directions and other methodological components of the system  
128 of business incubators and their expected effectiveness, the importance from the viewpoint of business executives and  
129 government agencies (as determined by the results of the expert survey ). Criterion or method was evaluated in fractions  
130 of a unit in the range from 0 to 1, with a gradation into six main states: a complete lack or insignificance of a certain  
131 criterion (0), a very small degree of use or efficiency (0 - 0.2), rather insignificant level (0, 21 - 0.4), the average level  
132 (0.41 - 0.6), greater level(0.61 - 0.8), a very high level (0.81 - 1.0) of the actual application and effectiveness.

133 To calculate the value of expert indicators we used the method of the expert survey. The qualitative composition of  
134 experts formed the executives of large, medium and small businesses, as well as government representatives.

135 The number of experts corresponds to a small sample of experts Students. The average coefficient of awareness  
136 experts is 0.72. The average coefficient of reasoning for all experts is 0.85, which indicates a high degree of reasoning.  
137 Level of competence of the expert group was 0.785, which corresponds to an above - average level.

138 The second group of indicators is calculated on the basis of evidence obtained as a result of a questionnaire  
139 addressed to managers and internal clients business incubators. Indicators in this group are totals that characterize  
140 performance of business incubators: the number of jobs created per tenant (MRC); the survival rate of businesses after  
141 leaving the business incubator (CB); financial profitability of the business incubator (RF).

142 Thus, the indicator of the effectiveness of using a set of services is calculated as follows:

$$143 \Pi_{\text{yca}} = \sum U_s * I_{\text{ass}} \quad (1),$$

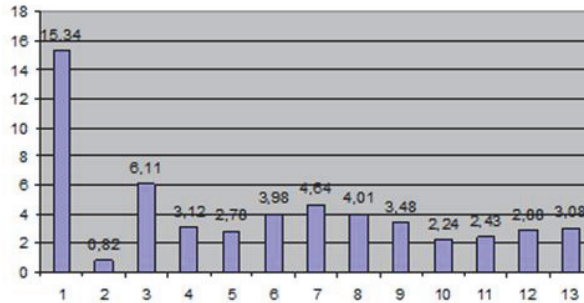
144 where  $U_s$  – the actual use of each service (on the scale);

145  $I_{\text{ass}}$  – expert assessment of the importance (on the scale).

146 Similarly, we calculated performance indicators of the use of information dissemination channels about business  
147 incubators, service quality, relationship with the staff of tenants of the business incubator, working conditions, the use of  
148 sources of funding business incubators and others.

149 Comparing the maximum level of a particular indicator to its actual value, calculated on the basis of information on  
150 certain activities of the business incubator, we can draw conclusions about the level of control of various processes of  
151 business incubation.

152 An example of such comparison is presented in the following comparison chart illustrating the performance of  
153 using a set of services among the business incubators and the maximum possible value (see Fig. 1).  
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155 1 - maximum  
156 2-13 - business incubators of the aggregate sample.

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159 **Figure 1.** Levels of performance indicator using a set of services  
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161 Due to the fact that the calculated figures reflect the quantitative evaluation of the management value processes of  
162 business incubators, it is possible to determine the most significant management measures to improve the system of  
163 business incubation.

164 In fact, almost every indicator can calculate some limiting value, which theoretically can be achieved with constant  
165 use of the criteria areas, sources that are used in the calculation of each indicator.

166 This work includes the analysis of the influence of individual indicators concerning management business  
167 incubators at some of the results of business incubators using correlation and regression analysis method.

168 Models of discovered dependencies are linear and represent equations of the line:

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$$Y = A_0 + A_1 X \quad (2),$$

170 where Y – a resultative indication or a dependent variable;

171 X – a factorial indication or an independent variable;

172  $A_0$  – a conditional value of resultant variable at the zero value factor variable;

173  $A_1$  – a parameter of the equation (point approximation, i.e. the approximation function).

174 To quantify the closeness of the connection between the indicators, the correlation coefficient r is used. It is  
175 defined by the formula:

176 
$$r = \frac{\sum XY - (\sum X \sum Y / n)}{\sqrt{(\sum X^2 - X^2/n)(\sum Y^2 - Y^2/n)}} \quad (3),$$

177 where n - the number of objects of the study.

178 Qualitative assessment of closeness of the connection by using the scale of Čedok (Table 2).  
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180 **Table 2 -** The scale of Čedok  
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Indicator of the closeness of the connection	0,1-0,3	0,3-0,5	0,5-0,7	0,7-0,8	0,9-0,99	1
The characteristic of connection	weak	moderate	noticeable	tight	Very tight	functional

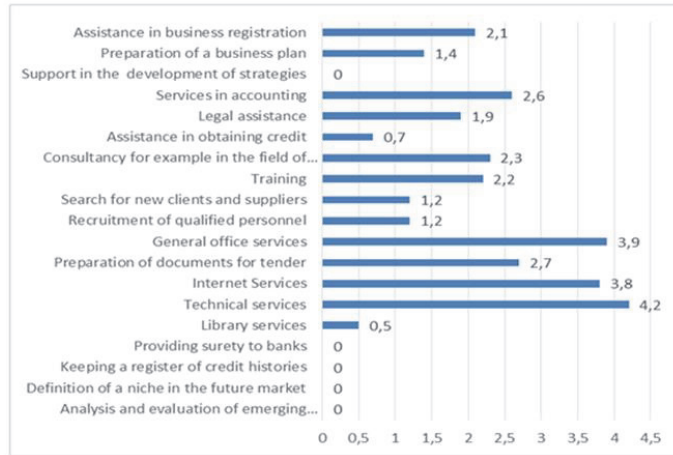
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183 The significance of the coefficient which was found can be checked by the criterion for significance using Student's  
184 criterion, the estimated value of which is determined by the formula:

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$$S_p = R \sqrt{\frac{n-2}{1+r^2}} \quad (4).$$

186 The resulting value is compared with the tabulated value at P = 0.95. The excess of the estimated value of the  
187 table shows the significance of the coefficient found.

188 The algorithm of the application of this technique can be seen in the example of calculation of performance  
189 indicators using a set of services.

190 The study found that incubators have a very small range of services, apart from providing space for rent. Last  
 191 service is provided by all incubators. The most frequently provided services consist of helping in the registration process,  
 192 technical services, Internet services, less likely - accounting services and assistance in the preparation of the business  
 193 plan (see Fig.1)  
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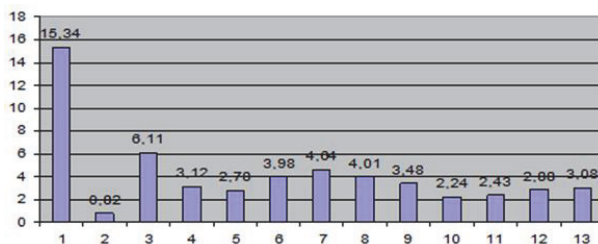


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**Figure 2:** Average estimates of the frequency of services business incubators

However, experts have identified some very important services, which are generally absent in business incubators. Experts have mentioned as important ( in the range from 0.8 to 1) services such as the provision of a guarantee to the banks, keeping a register of the credit history, the definition of a niche market in the future, analysis and evaluation of emerging companies, business plan preparation, support the development of strategies and assistance in obtaining credit, legal assistance and general office services.

Calculating the efficiency indicator obtained from the set of services, we have the opportunity to compare them with each other and with the greatest possible value. The maximum value in this case, is the sum of importance identified by experts for all kinds of services, and it is equal 15.34. (Fig. 3).



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1 - maximum  
 2-13 - business incubators of the total sample

**Figure 3:** Levels of performance indicator obtained from the set of services.

Thus, clearly shows that the indicators of incubators lag behind the maximum possible value of this indicator, provided the provision of all kinds of services to the maximum extent.

We carried out a correlation analysis which showed an association between the ratio of the effective use of services and the number of created jobs in the incubator. The correlation coefficient was 0.8196, therefore, the association is considered as strong. Student criterion at the confidence level P = 0.95 exceeded the table value and was equal to 4.5, indicating the significance of the coefficient.



220 Regression model under these conditions is as follows:

221  $y = 2,732x - 1,016,$

222 where  $x$  – indicator of the effectiveness of using a set of services;  $y$  – number of jobs created per tenant.

223 Correlation analysis revealed an association of this indicator with the value of the exponent of the survival of  
224 enterprises. The correlation coefficient was 0.6675, indicating no significant associations. Student criterion which was  
225 2.84 exceeded the table value, thus it confirms the significance of the coefficient found.

226 Descriptive model that reflects the relationship between performance, takes the form:

227  $y = 0,08x + 0,339,$

228 where  $x$  – indicator of the effectiveness of using a set of services by business incubators;  $y$  – the survival rate of  
229 businesses.

230 The analysis revealed the dependence of this parameter on the value of financial profitability of incubators. The  
231 correlation coefficient was 0.8309, therefore, it is considered as strong. Student criterion 4.73 confirmed the importance of  
232 this factor.

233 Regression model thus is as follows:

234  $y = 0,146x + 0,3,$

235 where  $x$  – indicator of the effectiveness of using a set of services;  $y$  – financial profitability of business incubators.

236 In this study, were also drawn up a model reflecting the relationship between other indicators of assess of the  
237 socio-economic processes management business incubators and their outcome indicators.

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239 **3. Results**

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241 Detailed results of the analysis are presented in Table 3. The proposed method has been tested in a business incubator  
242 "Penza regional center to promote innovation" (Penza). Its implementation contributed to the growth of effective indicators  
243 of the business incubator.

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245 **Table 3 -** The tightness of correlation between the original and the total activity of the business incubator

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Input indicators	The correlation coefficients ( $r_{yx}$ ), determination ( $r^2_{yx}$ ), significance for Student t-test of the correlation coefficient ( $\xi$ )														
	Quantity of jobs per 1 tenant				The survival rate of enterprises after leaving the incubator				Financial profitability incubator						
	$r_{yx}$	measures of association	$r^2_{yx}$	$\xi$	significance $r_y$	$r_{yx}$	Measures of association	$r^2_{yx}$	$\xi$	significance $r_y$	$r_{yx}$	measures of association	$r^2_{yx}$	$\xi$	significance $r_y$
The effectiveness of the use of distribution channels for business incubator	0,8456	Strong	0,72	5,01	signif.	0,3851	Modest	0,15	1,32	Insignif.	0,5205	Modest	0,27	1,93	Insignif.
The effectiveness of the use of measures to raise public awareness about the business incubation	0,7611	Strong	0,58	3,71	signif.	0,5500	Modest	0,30	2,08	Insignif.	0,6911	Modest	0,48	3,02	Signif.
The significance of the objectives of business incubation	0,7597	Strong	0,58	3,69	signif.	0,7169	Strong	0,51	3,25	signif.	0,7133	Strong	0,51	3,22	Signif.
The effectiveness of using a set of services	0,8196	Strong	0,67	4,52	signif.	0,6675	Modest	0,45	2,84	signif.	0,8309	Strong	0,69	4,73	Signif.
The significance of the criteria for selection of companies to the incubator	0,7784	Strong	0,61	3,92	signif.	0,5467	Modest	0,30	2,06	Insignif.	0,8859	Strong	0,78	5,97	Signif.
Quality of services	0,7184	Strong	0,52	3,26	signif.	0,784	Strong	0,61	4,00	signif.	0,366	Weak	0,13	1,20	Insignif.
Customer relationship with the staff of the business incubator	0,7551	Strong	0,57	3,65	signif.	0,6433	Strong	0,41	2,7	signif.	0,7516	Strong	0,56	3,60	Signif.
equipment status	0,3826	Moderate	0,15	1,33	Insignif.	0,4034	Moderate	0,16	1,40	Insignif.	0,5963	Modest	0,36	2,30	Signif.
Conditions of work in the business incubator	0,7930	Strong	0,63	4,1	signif.	0,6524	3amer.	0,43	2,7	Signif.	0,5282	Modest	0,28	1,97	Insignif
Qualification of the incubator's staff	0,6027	Modest	0,36	2,38	signif.	0,7081	Strong	0,87	3,17	signif.	0,4492	Moderate	0,20	1,59	Insignif
The effectiveness of the use of sources of financing of the business incubator	0,9086	Very strong	0,83	6,90	signif.	0,238	Weak	0,06	0,78	Insignif.	0,8893	Strong	0,79	6,15	Signif.

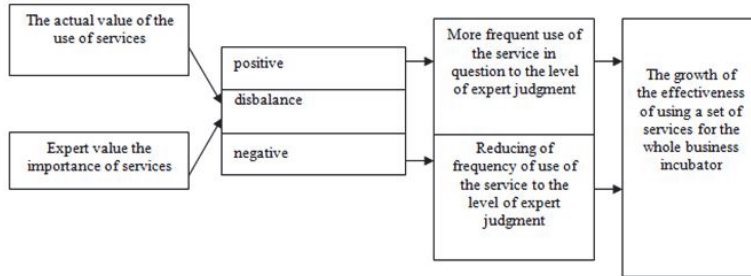
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248 The obtained results allow us to optimize and improve the activities of business incubators. As an example, we consider  
249 the general scheme which offers advice to management of business incubators basing on such a socio-economic  
250 process of business incubation, as the provision of an optimal set of high-quality services. This element needs to be  
251 considered in two aspects:

- 252 1. optimal range of services offered;
- 253 2. quality of service.

254 Indicator of the effectiveness of using a set of services serves to evaluate if the set of services is well-formed and  
255 to identify the scope for optimizing the management in this regard.

256 This is the process of improving the use of a set of services represented in general form (see Fig. 4).  
257



258  
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260 **Figure 4:** Diagram of improving the use of a set of services  
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262 Another aspect in this element is the quality of delivery service. Rationalization of management in this case is associated  
263 with bringing the actual level of the index to the level recommended by experts.

264 Analysis of the elements of the functional components of the system of business incubators suggests the  
265 divergence of the actual situation with its desired level.

266 Effective management of such entities as business incubators allows to realize the significant opportunities  
267 available to them. We conducted a study of the functional components or subsystems in the overall system for managing  
268 business incubators, such as, firstly, the planning of a business incubator, and secondly, the process of business  
269 incubation itself and, thirdly, the quality control. Each of these components includes elements which can improve  
270 performance of all of the incubator if effectively controlled.

271 We have derived indicators to measure the main components of the subsystem. Conditions of the most of the  
272 proposed indicators have a significant impact on the effectiveness of the business incubator. Thus, managers of business  
273 incubators can affect them intentionally to improve the efficiency of the organization. As for the other indicators, we  
274 suggest managers to use expert opinion to justify management decision-making. This will, in our view, optimize the  
275 management of business incubators.  
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#### 277 4. Discussion

278 Having determined the key factors which have the greatest impact on the effectiveness of a business incubator as a  
279 socio-economic system, we obtained a possibility of rational distribution of resources for its operation and development.

280 Identified dependence needs to be periodically corrected, that is not particularly difficult.

281 Proposed by some authors methods (Dibraeva, 2011; Lalkaka, 2003; Monastirskiy, 2009; Tormysheva, 2012;  
282 Shestov, 2013; Dee et al, 2012; etc.), do not have differences in a systematic approach to the consideration of the  
283 management of a business incubator. Our proposed technique provides the ability to quantify the level of development of  
284 management processes, which allows to identify and calculate the available socio-economic resources in their  
285 development.  
286

287 This study presents a model describing the effect of management process of business incubators on their  
288 effectiveness (model influence the process of establishing criteria for selecting businesses to the number of jobs created  
289 in the business incubator model of the effect of the process of formation and use of sources of financing on the financial  
290 profitability of the business incubator etc.). The use of models in the practice of management of business incubators gives  
291 the opportunity to consider the influence of qualitative factors (the goal of business incubation, the quality of services

provided; qualification of personnel, etc.) in the assessment of business incubators as a socio-economic system. The proposed dependences are universal and can be used in the practice of management in any business incubator.

Promoted by a number of researchers to evaluate the effectiveness of business incubator system KPI, in our opinion, does not allow to take into account the current socio-economic processes of business incubation in the dynamics, as well as to identify existing reserves of development.

Thus, the use of our proposed methodology for assessing the effectiveness of business incubators in Russia is essential in contemporary conditions, as it will allow a comprehensive approach to the evaluation of the data structures and taking management decisions, and as a consequence, increase the effectiveness of their work in the form of higher socio-economic performance evaluation of their activities.

## 5. Conclusions

This research has allowed to disclose reserves in the management of business incubators and improve management activities in order to improve the impact of their activities as socio-economic systems.

The conclusion that follows from the results of the study allows management authorities to focus on the specific socio-economic processes of management of business incubators, but it doesn't mean ignoring the other indicators because only integrated management will ensure the maximum efficiency.

The study developed a method that has the following characteristics:

First, it provides an opportunity to review the business incubator as a socio-economic system and the usage of the many factors that can later be supplemented;

Secondly, the technique allows not only to determine the level of particular indicators characterizing the efficiency of socio-economic processes of business incubation, but also to identify existing reserves of development to define key factors that have the greatest impact on the effectiveness of business incubators, and compare objects of research between themselves.

However, the presented method is limited by a number of conditions of its application in practice.

1. Set of factors such as input and output, and moreover their importance will vary depending on the territorial entity where the analysis is carried out. Each region has its own core competencies, reflecting the potential of its territory (Vasin, 2009).
2. Set the original data should be sufficient for finding the significant coefficients and identifying patterns.
3. Found patterns should be stable enough for a certain period of time.

As promising directions for further research we suggest to develop forecasts of the development of business incubators based on the proposed mathematical models that reflect the influence of factors on productive performance of the business incubators, but only in the medium term. In this case, it should be noted that the transfer of patterns of correlation, measured and varying aggregate, from static to dynamics is not, frankly speaking, correct, and requires checking conditions for the admissibility of such a transfer (extrapolation) that goes beyond the statistics (Eliseeva and Yuzbashev, 1995).

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## Development of Investment Attractiveness of Oil and Gas Region in Terms of Economical Instability

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### Abstract

At the present moment the assessment of investment attractiveness of oil and gas regions is a crucial scientific and practical task. The paper analyzes development issues of investment attractiveness of oil and gas regions under sanctions and discovers main development trends, current state and prospects of investment attractiveness of Khanty-Mansi Autonomous Okrug – Yugra. A risk assessment is performed and an authors' model of classification of regions by their investment attractiveness is elaborated in the research. An assessment of investment activity is made and mid-term strategic development trends of investment attractiveness are set. Research objective: to make an assessment of investment attractiveness development of a sector-specific region and to substantiate mid-term strategic development priorities of Khanty-Mansi Autonomous Okrug – Yugra. The authors developed a group of activities, aimed at innovative development and hi-tech support has been developed.

**Keywords:** investment attractiveness, investment climate, investment risk, investment potential, development, regional economics, forecast, priorities, strategy, oil and gas regions.

### 1. Introduction

Present-day economic realities which reflect intense political nature of modern economic affairs in the world force regions' and countries' leaders to search for more effective ways to attract investors to their governorships by means of promotion and development of the investment attractiveness of the region.

In terms of economical instability and sanctions applied a special importance is given to regions that are able to promptly reorganize their economies to develop resource potential which is capable of providing population with own-produced goods and services. Due to recent geopolitical developments Khanty-Mansi Autonomous Okrug – Yugra has faced new tasks and objectives which are meant to maintain high standard of human well-being based on balanced sustainable economic development, import substitution of goods, labour and services.

The investment attractiveness is susceptible the most to innovation development, introduction of new goods, their manufacturing technology and consumer promotion technology. An increase in volume of innovative product considerably ensures the stabilization of the economic growth of the region. An improvement of the quality of life of Yugra population depends directly on the investment attractiveness of the region and both internal and external investments. With all that in terms of sector-specific economic development the increase of investment attractiveness of the region will promote an economic diversity, and the government support for the development of the investment attractiveness will play a key role in this case.

### 2. Research Methodology and Methods

Goal of this research work reviews different approaches to the assessment of regions basing on their investment attractiveness, determines methods associated with the issue under inquiry, determines theories that can be taken as a basis for the forming category "investment attractiveness". Basing on the analysis of the investment attractiveness of the

57 particular oil and gas region a choice of assessment criteria has been proved and the classification of regions by their  
58 investment attractiveness has been suggested. The following methods were employed in the research: logical: a  
59 morphological analysis and a Delphi method, a method of situational analysis and forecast; formal: classical methods of  
60 economic analysis and statistics, e.g. traditional methods of economic statistics, methods of decision theory.

61 Khanty-Mansi Autonomous Okrug – Yugra is the main oil and gas region of Russia and one of the major oil and  
62 gas regions in the world. It is the donor region and takes a lead in several basic economic performances which are oil  
63 production, electric power production, industrial production output, natural gas production. Organizations of the  
64 autonomous okrug form a substantial part of the Russian economy, this is about 7,5% of industrial production and 15,1%  
65 of government budget revenue. The share of Khanty-Mansi Autonomous Okrug – Yugra in all-Russian oil production  
66 volume in 2013 was 48%.

67 104 oil and gas companies, 6 oil refineries, 8 gas refineries and 1 condensate stabilization plant operate within the  
68 territory of the okrug. The region's share in total output of gas production in Russia is 5%. In 2013 255,1 million tons of oil  
69 and 33,0 billion m<sup>3</sup> of associated petroleum gas were produced.

70 Khanty-Mansi Autonomous Okrug – Yugra is an export-oriented region and its export accounts for 95,6% of the  
71 overall volume of foreign trade turnover when import accounts for 4,4%. Crude oil is 99,4% of the overall export volume.  
72 Import of goods and services into the region increased by 8,4 % within the last year (21). Khanty-Mansi Autonomous  
73 Okrug – Yugra is the sector-specific oil and gas region with a limited number of basic industries in the structure of the  
74 regional economy and well developed additional and auxiliary industries.

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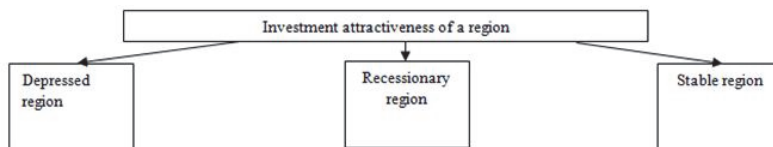
### 3. The Main Part of Research

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78 The investment attractiveness of Khanty-Mansi Autonomous Okrug – Yugra has typical regional features because it  
79 depends on the local market structure and the demand existing within the region's territory. In this connection the  
80 necessity to improve a mechanism of governmental support for the investment attractiveness becomes top-priority. This  
81 mechanism combines elements of federal, regional and municipal levels in strategic chain of command for each industry  
82 which ensures the development of a favourable investment climate within every territory and the adaptation of its facilities  
83 to the terms of separate industries. Thus, northern regions have their own specific peculiarities associated with an  
84 extensive use of hydrocarbon resources, severe climate, personnel shortage in socially important industries and absence  
85 of optimal logistics of goods and resources, all of this increases investment risks and serve as a deterrent for the  
86 development of the investment attractiveness of the region in general.

87 The investment attractiveness as a set of criteria that induce investors to invest the capital in this industry with  
88 favour (Kuzbozhev E.N. Koziyeva I.A., 2003). is supposed to classify regions by certain characteristics into one or another  
89 type of state of regional economic development. The classification of regions developed by the European Economic  
90 Community (EEC) (fig. 1) (Shchiborshch K.B., 2003) strictly divides all the regions into 3 types: a region with stable  
91 economy, an economically stagnant region and a region with an average economic development. This division is a main  
92 decision-making reason for investors to invest.

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96 **Figure 1.** The EEC classification of regions by investment attractiveness.

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98 According to the EEC classification depressed regions are the ones with uncertain prospects and negative development  
99 trends, they are at a standstill and growth rate tends toward a zero point. An income from investments in these regions is  
100 well below the average level in the country.

101 Recessionary regions are the territories which experience the decline of industrial production and social-economic  
102 development. The capital investment rate of return is difficult to assess.

103 Stable regions are economically sustainable regions. There are positive forecasts for changes in industrial  
104 production. The investment income may be above the average within the country (Shchiborshch K.B., 2003). When  
105 making a decision to invest, such a strict division provides only 33% selection of a region with a stable economy and that

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as experience shows is not quite fair to recessionary regions which have reserves for stabilization.

The authors of this paper suggest more detailed region assessment model according by the investment attractiveness level, (Bogvolova L.L., Buzmakov A.V., 2014).

**Table 1.** Region classification by the investment attractiveness level

Classifier	Attribute
1. New region	A region where all types of manufacturing are underdeveloped, home-made products and technologies are either at the design or laboratory testing stages at best. Financial investment in this region is of a high risk but these risks may be covered by excess return on investments and opportunity to capture local market. From the ordinary investor's point of view this region is not preferable for investment.
2. Advancing region	Together with types of manufacturing which are currently at the design stage there is a number of types of manufacturing which are already at the industrial production stage. The region's risk and revenue are more balanced due to current developments occurring in operating enterprises.
3. Region with stable growth	This type of region is characterized by a large quantity of enterprises having set up industrial production and successful work both on regional and federal markets. A series of products (including technologies) goes for export. Both revenue and risk levels are average within the country.
4. Stagnation region	Regions where a number of enterprises which introduce new technologies is decreasing. A connection between research centers and manufacturing is weakening. Outdated and obsolete products are produced. Current demand for products is maintained basically by domestic consumption, the export volume is decreasing. An investment inflow is provided mainly by already existing enterprises. The production and revenue levels are still high enough but investment in these territories is not recommended since there are obvious trends for recession and increase of risk for capital investments in the long-term.
5. Region with stable recession	Regions that do not produce new types of products and do not introduce new technologies and facilities. Some manufactures are either closed or transferred to other regions. A number of enterprises introducing new technologies and facilities is approaching a zero point. The product export is practically not performed. The investment inflow volume in the region is declining. The revenue and risk levels are in inverse proportion to the constant growth of the latter.
6. Depressed region	Regions with recession trends in industrial production. There is a weak or missing connection between research centers and manufacturing. The investment level is the lowest amongst all types of regions and is of a random character. The infrastructure for attracting new investors is poor. The risk level is high which does not guarantee possible high revenue level.

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A region-specific economic stability of Khanty-Mansi Autonomous Okrug – Yugra is substantially affected by market conditions on the international fuel and energy market, this has a negative impact on the overall investment attractiveness of the region and plays an important role for prospective investors who invest not in oil or gas producing industry (Deryabina Y., 2003).

In 2013 over 69 projects with a total amount of 580,7 billion roubles were implemented in Khanty-Mansi Autonomous Okrug – Yugra.

**Table 2.** Investment activity of Khanty-Mansi Autonomous Okrug – Yugra.

Industries	Number of projects	Investment capacity of projects, mln. rub.	Includes implemented, mln. rub.	Share of total investment volume, %
Petrochemical cluster	35	133 467,5	110 663,625	22,98
Electric power	4	321 404,00	103 585,00	55,34
Timber cluster	9	10 232,464	4 721,96	1,76
Construction	11	21 343,55	21343,55	3,67
Ore mining cluster	1	5 270,00	5 270,00	0,90
Public Private Partnership (PPP) development	4	86 767,12	42 216,00	14,94
Solid household waste (SHW) recycling	1	493,00	493,00	0,08
Agriculture	3	1 679,18	1 679,18	0,29
Food processing industry	1	50,00	50,00	0,04
Total:	69	580 706,814	290 022,31	100

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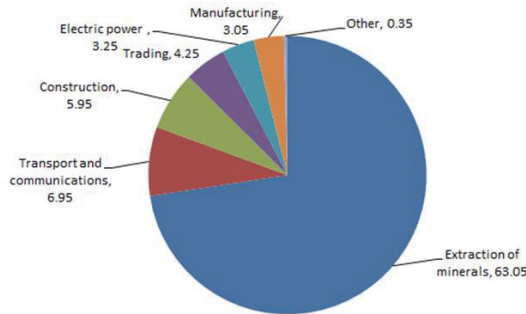
Khanty-Mansi Autonomous Okrug – Yugra belongs to the group of regions with sustainable growth: the investment volume is increasing, new technologies are being introduced, flagship products are going for export. The peculiarity is

125 that the high investment attractiveness is ensured by its abundant natural reserves and as the result by its economic  
126 activity namely in the sector of natural resources management.

127 It is also important to take into account that Khanty-Mansi Autonomous Okrug – Yugra is one of the drivers of the  
128 Russian economy being a main supplier of the high value resource – hydrocarbons. According to the statistics of 2013  
129 Khanty-Mansi Autonomous Okrug – Yugra ranks first in oil production including gas condensate with 51,1% of the total  
130 volume, first in electric power generation with 7,9% of the total volume, second in natural gas production 4,7% of the total  
131 volume and second in industrial production with 7,6% of the total volume (The report on social and economic  
132 development of KMAO-Yugra in 2013).

133 General profile of companies operating within the okrug territory considerably affects the industrial trend of the  
134 regional economy. The structure of the gross regional product (GRP) clearly represents present-day economy of Khanty-  
135 Mansi Autonomous Okrug – Yugra as the sector-specified (Bogomolova L.L., Buzmakov A.V., 2013).

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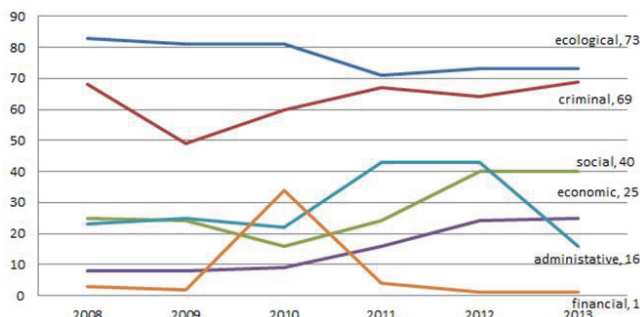
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139 **Figure 2.** The GRP structure of KhMAO-Yugra in 2012

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141 The natural resources industry i.e. the extraction of minerals accounts for 63,05% which is the largest share in the Gross  
142 Regional Product of the region. The second and third places are taken by “Transport and communications” and  
143 “Construction” with 6,95% and 5,95% respectively. Low shares of these industries in the GRP structure does not mean  
144 low mobility of population, slow pace of housing development or low development level of transportation. These are  
145 highly developed industries. They are attendant and serve to maintain the basic regional industry i.e. the hydrocarbon  
146 production as well as to bring additional income for the region. “Trading” and “Electric power” with 4,25% and 3,25%  
147 respectively are on the fourth place. Extensive expenditures for transport services, underdeveloped infrastructure and  
148 scarce logistics opportunities for entrepreneurs in this industry retard trading development. As for the electric power  
149 industry, individual persons and several oil-and-gas companies are among the end consumers of this developed industry.  
150 Quite a few major electricity consumers namely oil and gas companies produce it themselves. Based on such a severe  
151 imbalance in the economy structure of Khanty-Mansi Autonomous Okrug – Yugra the investment risk detection and  
152 analysis are extremely significant question for investors.

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156 **Figure 3.** Components of the investment risk in Khanty-Mansi Autonomous Okrug – Yugra in 2008-2013

(Rating agency “Expert RA”)



157 The ecological risk in Khanty-Mansi Autonomous Okrug – Yugra has been the most acute issue in the region within the  
158 last 6 years. First of all it is associated with a specific nature of the industrial production which in its turn is connected with  
159 a high risk of environmental disasters. Among economic activities the major contribution to pollutant emissions is made  
160 by the “extraction of minerals” section which accounts for 70-82% in 2008-2012 and the “transport and communications”  
161 section with 10-24%. With all that there is an increase of pollutant emissions made by transport and communications  
162 which occurs against the background of decreasing tendency for the extractive industry (The official web-site of public  
163 authorities of Khanty-Mansi Autonomous Okrug – Yugra).

164 Oil and petroleum derivatives are the main environmental pollutants when extracting and transporting  
165 hydrocarbons. There has been a considerable growth of average annual hydrocarbon concentrations (petroleum  
166 derivatives) within recent years, moreover the number of measurements taken which exceed the background values is up  
167 to 20% of the sampling, but soils within license blocks can be regarded as non-polluted, that is to say that hydrocarbon  
168 concentrations are less than 500 mg/kg (The decree of the Government of Khanty-Mansi Autonomous Okrug – Yugra №  
169 410).

170 Criminal risk comes the second among the investment risks in Khanty-Mansi Autonomous Okrug – Yugra. The  
171 migrant stream is likely to become a real menace to the social stability. A substantial growth of migration activity is typical  
172 for the region. In 2013 61722 foreign residents arrived in the autonomous okrug which is 16,2% more in comparison with  
173 51718 residents in 2012. With all that 53494 foreign residents departed in a given period of time, it is 18,8% more in  
174 comparison with 43437 residents in 2012 (The report on social and economic development of KMAO-Yugra in 2013).  
175 Along with aliens having arrived the number of crimes committed by them increased by 11%. Moreover downward  
176 dynamics of crimes is also maintained by indigenous peoples of the North, the rise in crime was 15% in 2013 (Analytical  
177 memorandum, 2013).

178 Social risk in Khanty-Mansi Autonomous Okrug – Yugra is significantly lower than ecological and criminal ones and  
179 takes the 3<sup>rd</sup> place among all investment risks. However the social risk has grown almost 2 times within the past 2 years.  
180 Due to the negative geopolitical situation and the oil price downturn a lot of programs are being cancelled. The region  
181 budget for 2015 has been enacted provided that all social obligations to the society will be fulfilled.

182 A situation on the region's labor market caused by the extensive employment of the expat workforce remains quite  
183 acute. An employers' pent-up demand on the labor market, an inability to use Russian workforce due to a disparity of  
184 supply and demand for the workforce, i.e. a discord between the occupational structure of unemployed citizens and open  
185 positions available stimulate employers to employ foreign residents.

186 In 2013 a quota for issuing alien work permits in Khanty-Mansi Autonomous Okrug – Yugra included 50786 permits  
187 which is 16,0% less in comparison with 60545 permits in 2012 (The report on basic performance results, 2013).

188 Economic risk is also rather high and has got a growth trend over the past years. The regional economy is  
189 resource-based, it means its development fully depends on mineral resources produced and world market prices. Every  
190 year the situation becomes more tense due to a natural depletion of the regional resource base. In every oil and gas  
191 region the largest deposits are discovered and developed above all others but in course of time the scale of discoveries  
192 declines (The decree of the Government of Khanty-Mansi Autonomous Okrug – Yugra № 512).

193 Despite the systematic decrease of the well flow rate and the depletion of producing fields local authorities  
194 constantly try and involve additional resources to diversify the economy (The list of valid subsoil licenses, 2014).

195 The geopolitical situation has significantly affected the results of the 2014 fiscal year but the region has enough  
196 reserves to stabilize the economy and in the mid-term prevent the reduction of the economic development indicators.

197 Administrative risk has reduced considerably within the past 5 years. This is associated with development and  
198 initial application of numerous programs like “New school of Yugra”, “Employment promotion in Khanty-Mansi  
199 Autonomous Okrug – Yugra in 2012-2014”, “Efficiency improvement of budgetary expenditures in Khanty-Mansi  
200 Autonomous Okrug – Yugra over a period till 2014”, “Small and medium enterprise development in Khanty-Mansi  
201 Autonomous Okrug – Yugra in 2011-2013 and till 2015”, “Social and economic development, investment and innovations  
202 in Khanty-Mansi Autonomous Okrug – Yugra over a period of 2014-2020” and many others which will be successfully  
203 completed despite the negative economic trends.

204 The regional budget management has come up to the brand new level of performance: the budget of the  
205 autonomous okrug for 2014-2016 has been formed in the structure of state-run programs, this will allow to increase  
206 responsibility and interest in executives of state-run programs to achieve results under limited financial resources. 25  
207 state-run programs arranged into 3 business areas are supposed to be completed in 2014-2016. The programs'  
208 expenses are more than 96% of total budget expenditures (Methodological instructions (recommendations) of the  
209 Department of Finance).

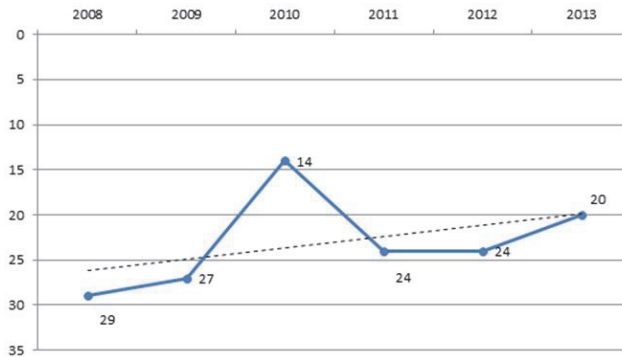
210 Financial risk is the lowest one of all risks reviewed. This is explained by fiscal capacity of all programs being

211 implemented in the region and by well balanced budget itself as well.

212 In 2013 the budget revenue of the autonomous okrug was 136 684,5 million roubles which is 100,1 % in the  
213 amended annual plan. The amended annual plan for tax revenue was not implemented by 340,6 million roubles or 0,3%,  
214 it is for corporate tax mainly. With all that several tax revenues were ahead of the target figures: an individual income tax  
215 was over by 267,1 million roubles, a corporate property tax was over by 6,6 million roubles (The report on performance  
216 results, 2013).

217 Analyzing the structure of the economic activity of the region it becomes obvious that for decades of the regional  
218 economy development the top-priority goal has been to maintain the oil and gas sector of the regional economy being an  
219 intense source of both regional and federal budget replenishment. Conditions for other industries and investment projects  
220 were being created after all the others. The situation has changed over the last years when special programs concerning  
221 agricultural development, tourism, construction and other fields of investment activity for economic diversity purposes  
222 were launched and realized.

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**Figure 4.** Investment risk rating in Khanty-Mansi Autonomous Okrug – Yugra in 2008-2013.

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The investment risk rating in Khanty-Mansi Autonomous Okrug – Yugra displays the aggregate level of risks that prospective investors might come across within this territory. From 2008 till 2010 the rating remained on a comparatively low level for the region. In 2010 the rating grew substantially owing to adopting essential target programs aimed to improve the investment climate in the region. These programs are “Agroindustrial complex development of Yugra in 2011-2013 and for the period till 2015”, “Development of the forest industry complex of Yugra in 2011-2013”, “Development of the investment attractiveness of Yugra in 2011-2013” and others. But the developments happened within the following years showed that the effectiveness of a program-target method for the regional economy development did not prove itself properly in the first year when the programs were launched. The year of 2013 was marked with establishing an investment fund in Khanty-Mansi Autonomous Okrug – Yugra. Its purpose is to finance infrastructure facilities so crucial for investors to implement investment projects; and projects stipulated by concessionary agreements. The establishment of the investment fund has a positive effect on the investment risk level of the region having raised it by 4 points and ranked 20 (The investment rating of Russian regions).

The investment risks analysis revealed that in the long-term the risks would decline due to effective measures to create favourable environment for investment projects of different scale and to achieve positive results from already adopted programs and measures designed to develop the investment attractiveness of the region.

The investment dynamics will be characterized by the outstripping growth of private investments in comparison with the government ones. In general the investment growth of the natural resources sector will not exceed the growth of other private investments over the period. However the mid-term investment growth path will be defined largely by the investment dynamics of the fuel and energy complex.

In the basic variant the investment increase is estimated as 1,3 % in 2012, 1,0 % in 2013, 3,1% in 2014 and 1,8% in 2015.

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**Table 3.** Growth rate of fixed investment

Parameter type	2011	2012	2013	2014	Forecast 2015
Fixed investment - total	119,3	101,3	101,0	103,1	101,8
Oil and gas complex	111,1	100,7	100,5	100,7	101,0
Manufactures	70,4	100,3	101,0	101,0	101,2
Power industry	130,2	103,0	102,0	104,0	104,0
Transport and communications	78,6	100,0	100,5	101,5	101,0
Education	85,0	100,0	100,5	101,0	100,5
Health care	68,0	101,0	101,0	101,0	101,0
Construction complex	99,5	100,0	102,0	101,5	100,7

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Within the forecast period the construction of new low-power plants will start in the region. The mid-term investment policy priorities are projects involving associated petroleum gas processing.

Fixed investments in education and healthcare will increase moderately both in budget (more than by 10% annually in nominal terms) and private expenditures. Education and healthcare shares in the total volume of investments will have increased from 1,1% in 2011 to 1,3% by 2015.

In general, the share of budgetary investment in the investment structure will decrease (from 4,5 % in 2011 to 3,4 % in 2015). Budgetary funds will be allocated to community facilities and housing programs of the region.

In the mid-term the investment share of companies' own expenses will increase in the investment structure because of stimulation of enterprises to contribute their income to the production modernization (investments due to profit will increase by 8,0-10,0% annually in nominal terms) and improvement of proper use of amortization deductions.

During the forecast period of 2015 investments from bank loans and other sources will make a remarkable contribution to the total amount of raised funds; funds obtained from participation interest in housing construction (organizations and population) (The decree of the Government of Khanty-Mansi Autonomous Okrug – Yugra, 2012).

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#### 4. Discussion

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The Government of Khanty-Mansi Autonomous Okrug – Yugra pays great attention to upgrading the investment attractiveness of the region having undertaken various events and measures to stabilize the regional economy. The target-program method serving to improve the investment climate and to reduce investment risks is supposed to elaborate different programs and legal acts.

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Thus, to create a favourable investment climate of the Performance standard for executive authorities of Khanty-Mansi Autonomous Okrug – Yugra in order to provide a favourable investment climate in the autonomous okrug was elaborated and implemented. The standard serves to improve the investment climate in Khanty-Mansi Autonomous Okrug – Yugra and taking into account the best regional practices to provide necessary conditions for enhancing the investment inflow into the region, business and authority interaction, improving transparency of entrepreneurship support system.

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It should be noted that a series of events within the framework of the Standard have already completed. Particular measures have been taken to enhance regulatory legal acts on elimination of ungrounded administrative barriers which obstruct to perform investment activity and to establish transparency of government support for the investment activity. As the result the Law of the autonomous okrug of March, 31, 2012 № 33-oz "On government support for investment activity in Khanty-Mansi Autonomous Okrug – Yugra" has been passed, the Council of the Government of Khanty-Mansi Autonomous Okrug – Yugra on issues of the investment activity development in Yugra has been established, a special bilingual web portal about the investment activity in Yugra is being created. To support the investment attractiveness of the region mechanisms of financial support in the form of government guarantees have been formed; subsidies for partial expenditure compensation of construction of utility networks and engineering infrastructure; subsidies for partial expenditure compensation of interest payment for attracted loans; favourable stimulating tax climate is ensured.

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A group of actions aimed at innovative development and hi-tech support has been designed. It suggests the investment attractiveness development of the region for the next year of 2015 and includes maintenance and implementation of the technical platform and innovative organizations, development of the infrastructure which actuates "an innovative elevator", stimulation of innovation activity in companies, support for innovation activity in organizations, implementation of the Concept of the innovation activity in Khanty-Mansi Autonomous Okrug – Yugra until 2020 (The report on results, 2013).

## 5. Results

Summarizing the results of the research conducted we can notice that classification criteria for regions by their investment attractiveness suggested in this paper will offer a proper orientation for investors to invest successfully and be of a practical use i.e. it will find practical application. Parameters for region classification by the investment attractiveness may be regarded as investment development criteria for territories with different resource potential but approaches to the assessment of investment risks reviewed in this research will encourage investors to invest into the regional economy. The results of the scientific research are among the following:

- The economic assessment of the resource potential of Khanty-Mansi Autonomous Okrug – Yugra has been performed;
- The economic assessment of the investment attractiveness of the oil and gas region has been performed;
- The investment risks have been economically feasible;
- Strategic priorities of the investment activity development in Khanty-Mansi Autonomous Okrug – Yugra have been set;
- Activities of the government support for the investment attractiveness development of the region and favourable investment climate creation have been reviewed.

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## The Futility of Nigeria's Flirtation with American Politico-Systemic Model: The Imperative of Political Culture

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### Abstract

This paper focuses on the politico-cultural explanation for the failure of Nigeria to replicate and sustain the American political type democratic system. It looked as such variables as their history, culture, religion, and political culture itself as its units of analysis. Our aim and objective, is to demonstrate that, like revolution, political systems are outgrowths of political and socio-cultural experiences of peoples, and thus may not be sustainably imported or transferred from one country to another. The work is purely comparative, and descriptively analytical. Data for its development were generated from secondary qualitative sources. It concludes that there are multi-pronged factorial disparities in Nigeria's political evolution vis-à-vis the America's, most of which have both historic and politico-cultural nexus. It therefore suggests that Nigeria should look inwards to appreciate its unique history and culture for enduring political model than flirting unsustainably with the American political systemic model which, itself, provides an explanation for its sustenance and relative stability.

**Keywords:** Political Culture, American and Nigeria Democracy, Comparative Politics, ethno-Religious Identities and Politico-Systemic Model.

### 1. Introduction

It was Sekou Toure who in France in 1959 warned that "to take part in the African revolution, it is not enough to write a revolutionary song; you must fashion the revolution with the people. And if you fashion it with the people, the songs will come by themselves, and of themselves." This paper is about African reality, and the need to adopt African formula in the process of unraveling African contemporary problems. This writer argues that to the extent that African nations are different from the Western European and other developed market economies in terms of their history, culture and political evolution, application of the latter's solutions to the former's predicaments tend to compound and obscure, rather than clarify, and make more manageable the African problems. Thus, application of alien formulas only exaggerate the relative role most people (including Africans) assign to governments and politics in the total setting of their lives. Nigeria as a political entity is used in this study as a case of specific reference.

Since independence, Nigerian policy makers have had this great appetite for the American type political model and have often flirted with it. Some of the variables necessary for understanding Nigeria political system are inherently unique to Nigeria by virtue of its own history. However, others are "imported", presumably as solutions to Nigeria's national predicament of nation-building. And our position is that they have not worked given Nigeria's peculiar realities.

When "political culture" is used as our unit of analysis, the whole essence of the "useful model" assumes more significance. As political scientists, however, we cannot unequivocally argue that any political culture is "superior" than the other rather, each culture has its peculiarity, drawn from its unique historical evolution. Therefore, the question left unanswered is: what have the two political entities in common? Or what makes the American model so attractive to Nigerian policy makers to presuppose the solutions to Nigerian political problems? Clearly, there are some variables shared in common by Nigeria and the United States, viz: English colonialism, heterogeneity of race, multiple of religious faith, party system, and presidential system of government.

To better capture the direction of this paper, few pertinent questions are in order, viz:

- a. What are American political culture and its origin?
- b. What is the origin of American political culture?
- c. What is the history and role of religion and race American and Nigerian political evolution?
- d. What are the major consequences of British colonialism in formation of both the American and Nigerian

57 political systems?

58 e. What the history, nature, and role of political parties in the lives of both political systems?

59 These questions are not totally exhaustive. The choice of variables above is a function of shared traits by the two  
60 systems under study. How these questions are answered would certainly throw some light in the discourse and equally  
61 serve as a guide for policy makers in Nigeria as they strive to fashion out strategies needed for stabilizing the polity as  
62 well as the way the country is organized politically in the future.

63

## 64 2. Theoretical Framework

65

66 In their *Comparative Politics*, Almond and Powell, Jr. (1978:25) state that:

67

68 *political culture is the set of attitude, and feelings about political current in a nation at a given time; that it has been*  
69 *shaped by the nation's history and by the ongoing process of social, economic, and political activity; that attitude*  
70 *patterns that have been shaped in past experience have important constraining effects on future political behavior. The*  
71 *political culture affects the conduct of individuals in their political roles, the content of their political demands and their*  
72 *response to laws.*

73

74 When Nigeria is placed within the context of the reasoning above, we can argue that as a product of amalgamation  
75 and as a "nation" "constructed" from a number of ethnic, cultural, political, and geographical sub-nationalities who had no  
76 common bonds, national building would be problematic. Nigeria is a country whose population by and large had little or  
77 no loyalties towards another grouping, except for their local and immediate cultural units. Thus, it may become difficult if  
78 not impossible to build a stable nation in the strict sense of that word, and to such extent, realize the benefits derivable  
79 from sustained national unity. Because of these varying history, belief system, attitude towards a given legal system (as  
80 the introduction of the controversial Sharia legal system in Nigeria suggests), often there manifests a seemingly  
81 centrifugal force within the polity whose pull tends to disrupt any genuine attempts to forge a stable political system. In  
82 fact, while the "melting pot" theory can explain the nature of American system, the "tossed salad" theory will better  
83 conceptualize its Nigerian coloration.

84 Political culture or its absence can therefore provide a *modus vivendi* for the manifest political instability in Nigeria.  
85 Today, new agitations are rife for self-determination for various sub-regional and ethnic groupings like the Movement for  
86 the Emancipation of the Niger Delta, MEND, Movement for the Actualization of Sovereign State of Biafra, MASSOB, the  
87 Oodua Peoples Congress of the Yoruba ethnic group, and the AREWA, representing the Hausa/Fulani nationalistic  
88 interest, respectively.

89 In addition, the Systems Theory can offer a useful explanation for the inability of the Nigerian state to fashion out a  
90 stable political system. Easton (1953), is credited with pioneering the application of this framework to the analysis of  
91 political process. Easton "considers the political system as existing with the environment of other systems ... which  
92 affects it and are in turn affected by it through continuous transactions and exchanges" (Anifowose and Enemu, 2008:21). The system, he argues, has interdependent parts of which none can function independent of the rest.

93 We would rather add that the nature of the demand made of a system has a direct effect on the type and the  
94 nature of output to be realized. Now in the Nigeria's scenario, the demand often made of the system tend to be *dis-*  
95 *articulated* having been influenced by divergent cultural and sometimes, clashing religious values, as the introduction of  
96 the Sharia legal system into Nigeria's secular constitution has demonstrated. To this end, a non-Moslem Nigerian residing  
97 in the Muslim parts can be a victim of Sharia jurisprudence in total violation of his/her rights as protected by the secular  
98 order in the non-Moslem legal jurisdictions of the same "nation".

99

## 100 3. The Origin of American Democracy

101

102 In an elaborate study of democratic politics that distinguishes its fundamental belief from other form of governments,  
103 Prothro (1965:52), holds that:

104 The democratic view of the nature of man is based on the principles of equality and humanism, and progress; the  
105 democratic view of the nature of politics is based on the principles of majority rule and minority rights. Democratic theory  
106 leans on these beliefs – equality, humanitarianism, individualism, majority rule, minority rights, - and from them gains its  
107 enduring appeal.

108 When the three principal, however general, ideals expressed above namely, equality, political participation, and  
109 inalienable rights are extrapolated and subsumed into our analysis, one can deduce the philosophical origin of the

110

111 American democratic system.

112 One of the impulses that gave rise to the colonists' voyage to the Americas was their dissatisfaction with the  
113 absolute monarchy in England. They sought the need for expression and participation in the political decisions that  
114 affected their lives. This need was uniformly sought and embraced by all the protesters of monarchic rule who left  
115 England for the new world. Granted that Nigeria's founding fathers had sought for independence from England, one can  
116 hardly say they equally motivated in that endeavor. Besides, they did so for their individual interests. That means,  
117 individuals who had the privilege to succeed the colonial apparatus had self-interest motivations. These were the  
118 elements the 'dependistas' referred to as "*comprador bourgeoisie*". For example, the economic and political order they  
119 inherited and maintained found itself invariably at odds with the urgent needs and aspiration of the Nigerian people as  
120 was represented by the quest for independence. To what extent can we make the same argument about America's  
121 founding fathers? Granted that some of them were the "owning class", and slavery itself for example (which was of  
122 course much later) represented equation at odds with the principles of equality, we can nevertheless argue that slaves  
123 were not considered humans but "property". Hence slaves, understandably, could not have shared the benefits of equality  
124 with their owners.

125 While there was no unanimity of opinion regarding the need for independence in the Nigerian scene, in the United  
126 States, several revolutions commonly referred to as the Glorious Revolution, (Silverman, 1989:61), continuously  
127 questioned the authority of the British Crown and its colonial governors, except in England by merchants who benefited  
128 from the status quo. In Nigeria on the other hand, certain individuals representing a different cultural religious and political  
129 loyalties were opposed to independence. Alhaji Abubaka Tafawa Balewa was opposed to independence until it became  
130 evident that Britain would relinquish power anyhow. Balewa was quoted as expressing belief that "independence would  
131 not be a feasible object for Nigeria ..." (Richard Sklar, 1963:87,98). His reluctance to accept power was demonstrated by  
132 the length of time the Europeans stayed in the northern civil service ever after independence".

133

#### 134 4. The Role of Political Culture

135

136 American political culture traces from the writings of European philosophers as Thomas Paine's "Common Sense" and  
137 John Locke's "Social Contract". Basically, American political culture elevated individual rights over property rights. It also  
138 espoused the right of consent of the people - popular sovereignty - and held that the governed and the governors have, in  
139 forming the society, reached a social contract in which 'each' gave up some of its rights for the common good; that when  
140 it becomes evident that the government does not represent or reflect the popular opinion or consent, the people have the  
141 right, under that contract, to withdraw their allegiance or overthrow such government and institute another in its stead. To  
142 this end, they consciously rejected monarchical and overbearing system of governance, and embraced popular  
143 sovereignty with its attendant recognition of popular consent.

144 In light of the foregoing, we may now ask: What is Nigerian political culture? From what philosophical doctrines or  
145 ideals does it emanate? Who were or are the heroes of the Nigeria's founding philosophy, if any? Answers to these ailing  
146 questions are not easily handy except reduced to ethnic, religious, and regional levels of analysis. That is, one may find  
147 answers if one were to ask: What is the Ibo, Yoruba, or Hausa/Fulani political cultures, respectively?

148 Therefore, while it may be right to argue that there exists no political culture unique to the Nigerian entity  
149 historically, it will nonetheless be wrong to argue that it does not exist within her ethnic, religious, cultural, and nationality  
150 boundaries - Nigeria being a "nation" of nations. Furthermore, to the extent they exist only within the identified levels  
151 above, how does one reconcile this phenomenon with any notion of over 250 distinct languages which, we might add,  
152 represents a commensurate distinct political cultures within this artificial national boundaries.

153 A school of thought may argue that Nigerian political culture exists within its colonial heritage - reflecting its past  
154 colonial relationship. But we hold a contrary view simply because it has not been adequately validated or demonstrated in  
155 contemporary scholarship, especially given the obvious overt sub-nationalistic consciousness, courtships, and loyalties in  
156 Nigeria. For example, a typical Nigerian is first either "Hausa/Fulani", "Ibo", or "Yoruba" before he/she is a "Nigerian". In  
157 contrast, Americans, including those obtaining citizenship through naturalization see themselves first as "Americans"  
158 before they are North Carolinians, Texans, Floridians, New Yorkers, or Californians, etc.. He would identify his Spangle  
159 Banner flag before he recognizes his neighboring state on the map of the United States or his Confederate Flag. Here,  
160 sense of patriotism gravitates around the American flag and Lady Liberty - a symbol of nationhood and freedom.

161 In his narration of the "Crisis of the Union" Professor Morgan of Yale University alluded to how in an attempt to  
162 save the Union a concerned northerner in the U.S. Senate in 1861 beckoned on his countrymen in the name of 'America';  
163 reminded them in a form of battle cry, "Remember the Alamo", of how the sovereignty of the United States, and what  
164 history would hand over to their future generations if in the cause of dissent, (brought about by the divisive issue of

165 slavery), they were to "lose this great Union",

166 What may have resembled Dr. Morgan's narration was the "patriotic" cry of Dr. Nnamdi Azikiwe in his "One  
167 Nigeria" movement. However, it was later to be argued that Zik's One Nigerianism was basically a flirtation with a unitary  
168 system of government as opposed to Awolowo's federalist model - each with its inherent ethnic consciousness.

169 Political and cultural beliefs, we must note, are all but powerful forces necessary for shaping the agenda and goals  
170 of a nation. They affect what people will regard as reasonable and desirable. The stability of the American political system  
171 stems historically to many compromises - *Connecticut or Great Compromise, Missouri Compromise, the Compromise of*  
172 *1850; 1877 Wilmot Proviso, Crittenden Compromise of 1860*, just to name a few. These compromises were all the more  
173 significant as embodiment of the founding fathers' intent on forming an enduring Union. In Nigeria, on the contrary, history  
174 has shown that "*though tribe and tongue may differ in brotherhood we stand*" was an utopian slogan as well as a utopian  
175 ideal.

176 The founding as an amalgamation of the Northern and Southern Protectorates was forced on its people for British  
177 administrative convenience. There were no known inputs or compromises between the north and the south over any  
178 conditions imposed on them by the British. Hence, since the British handed a fragile "national entity" in October of 1960,  
179 he North has been opposed to the East as the East, the West (see John Gamble 1987:338). These oppositions are real  
180 as no section is willing to make concessions or give up, as is the case with the north, what it considers a "divine right" or  
181 manifest destiny of perpetually occupying the seat of government - all based on cultural idiosyncrasies and sectional  
182 value system that are often based on abstract principles that mean nothing to other groups. In other words, how does a  
183 society or polity evolve a common political culture that would reflect the sensitivities and common value of the generality  
184 of its people if their political history and value systems are divergent? It may be germane to argue that while American  
185 politico-cultural ideals may not have resulted in a "perfect Union", they have nevertheless, served a useful source of many  
186 solutions to their problems of nation-building.

187

## 188 5. History and Role of Religion

189

190 The "Americans" were torn by religious differences in Europe before their embarkment on the great "discovery" of the  
191 "new world". Common heritage however allowed different religious groups to thrive relatively side-by-side alongside their  
192 need to form a perfect union (once they got to the other side of the shore). This was exemplified during the Great  
193 Awakening by the multiplicity of different sects, and before that period, in the settlement of the Penn's Colony of  
194 Pennsylvania and Lord Baltimore's Colony of Maryland, (Devine, et al, 1987; Boyer, et al, 1990 ).

195 But besides religious accommodation, we can also state that historically, American religious beliefs are based on  
196 the Greco-Roman and Judeo-Christian tradition. In fact one can argue that Americans shared a common religious beliefs,  
197 their different denominations notwithstanding. Nigerians hardly speak of religion in the same sense. Perhaps, Professor  
198 Ali Mazrui's (1986) concept of "triple heritage" - traditional, Islamic, and Christianity religions - captures the Nigerian  
199 experience. Even in that context, they are just as different faiths and belief systems as one could ever try to understand.

200 Perhaps, Americans may have envisaged the problems associated with legislating morality, hence providing in  
201 their constitution that "*government shall make no laws respecting an establishment of religion nor prohibiting the free*  
202 *exercise thereof*" – something that has been generally acknowledged as the doctrine of "*separation of church and state*".  
203 In Nigeria's case on the contrary, *Sharia law*,( an Islamic law), was halfway shoved down the throat of the rest of  
204 Nigerians whose Christianity-based laws did not find expression in the secular constitution Nigeria operated at  
205 independence. It was the same forces behind the Islamization of the Nigerian constitution that registered Nigeria into the  
206 controversial membership of the Organization of Islamic Countries, OIC, during the regime of General Ibrahim Badamosi  
207 Babangida.

208 Because of what it claimed was a "moral" or christening political responsibility, Americans sought to "expand the  
209 area of freedom". This was the major underlying principles of its proclamation of "manifest destiny" - to expand "from sea  
210 to shining sea". Hence, Indians were by that effort either to be "civilized" christened, assimilated, or uprooted from their  
211 lands. The Americans succeeded in that crusade because they carried with them a common political, cultural, and  
212 religious ideologies or themes embraced by all. But similar stimuli in Nigeria which came in the form of the Islamic Jihad  
213 did not succeed because it did not penetrate into the southern heartlands. Hence its influence was limited predominantly  
214 to the northern parts of the country and to some degree in some parts of Yorubaland, especially since the pilgrimage to  
215 the Hajj (Mecca) became a status symbol.

216 How does one, reconcile these factors in order to encourage ones optimism that subscribing to "alien models"  
217 would provide solutions to Nigerian problems of nation building? British colonialism is another factor Nigeria shares in  
218 common by the two entities under study. This factor might as well have made adoption of American model all the more



relevant. For example, while the United States fought to get Britain off her back and subsequently stripped herself of all paraphernalia of British social status symbols as *Lord, Sir, Dame*, or other titles of nobility etc., they continue to be admired and used by some class of Nigerians after fifty years of independence. This class subscribe to the "world view" which holds that Anglo-Saxon nations and peoples represent the apex of civilization and development; that the perceived gap between Anglo-Saxon peoples and Africans in terms of growth and development is a function of certain political arrangements unique to Anglo-Saxon peoples; Hence, those political arrangements, it would seem, irrespective of their irrelevance to the African reality, is, to them, the most appropriate and the only solution to Nigeria's problems of nation building.

## 6. History, Nature, and Role of Political Parties

General Ibrahim Babangida in 1989 announced that in order to defuse sectionalism in partisan politics, his regime would recognize only two political parties, namely, National Republican Congress, NRC, (after the American Republican party) and the Social Democratic party, SDP, (after the American Democratic party). These names are no coincidences in our view. Although analysts are of the view that Babangida had in mind to create ideologically based parties – conservative and liberal, respectively. The question however is: must they be identical to the America's in nomenclature? Some follow-up questions would be in order here: Does name make political party? Or, does "conservative" make conservatives?

Could there have been any better explanation for the choice of names except perhaps the assumption that they are the major parties of the American democracy; they have been "working" in the United States since 1860, therefore, they ought to work in Nigeria simply by virtue of those assumptions. It sounds syllogistic. One possible, yet ridiculous reason for the choice may well be that every possible name has been used to mobilize popular support in Nigerian politics in the past; that nothing else will be less identical to names which had already been used in the past. Thus, "imported" names from a "working" democracy will do the magic.

The history of American political parties is a history of Thomas Jefferson's "States' rights" advocacy versus a "strong central government" advocacy Alexander Hamilton. The basic disagreement between these two individuals representing the Federalist, and Anti-Federalists, respectively, did not revolve around personality nor was it ethnic-based like Nigeria's. Rather, it was a conflict of ideas on how each thought the government ought to be organized. By today's standard, it was neither "left" nor "right".

Alexander Hamilton pushed for a strong central government because it was his opinion that since the states were quasi- autonomous, or so, some felt, it would be to the advantage of the Union if the center was stronger than (periphery). Considerations were in terms of security since historical experience showed that colonies could not defend themselves from the English, Spanish, and French military in those formative years. In fact this consideration led the United States to assume an isolationist foreign policy posture in those early days of its independence. Historians and political scientists alike have come to the consensus that even the Monroe's Doctrine was nothing more or less than a self-defense doctrine. It used to be believed that the doctrine's primary consideration was the need to protect Latin America from the imperialistic tendencies of France and Great Britain.

Hamilton also advocated for the loose construction of the constitution in his crusade to strengthen the central government. In that effort he was able to influence the Supreme Court decision when the latter used the "implied powers" doctrine and the "necessary and proper" clause to uphold the establishment of the Bank of the United States against the strict constructionists like Jefferson. Jefferson felt that the Constitution did not expressly authorize the Federal government to establish banks. If the states were supreme vis-à-vis the central government, Hamilton argued, people's allegiance would shift toward the states and in that way incapacitate the central government. Is there any wonder then, that even after the American Civil War, Americans considered themselves as, first, American, before identification with their states of origin?

As a result of these contending ideological views, two political parties emerged. The first election to the presidency of George Washington was only by electoral votes. In fact it was certain that "George" would be elected president even before the end of the Revolutionary War. A footnote is in order here: several political parties have emerged and evaporated during the course of American history depending on their strength and popular appeal. However, they have not taken any deep sectional, religious, or ethnic coloration.

In Nigeria, on the other hand, except for the defunct Peoples' Union of 1908, formed in the wake of protest against British water scheme tax in Lagos, modern political parties emerged out of ethnic youth movements (Sklar, 1963). Even before this period were multiples of partisan groups whose interests and objectives were not well articulated, nor were they sympathetic to any known national agenda. It is beyond the scope of this essay to detail the activities of these splinter groups. However, youth movements in Nigeria were voluntary associations based on kinship or regional affinity,

e.g., village group, district, or tribe. ( Sklar, 1963: 65-67). The Ibo Union of Lagos was the back-bone of the National Council of Nigeria and Cameroon, with an Ibo native son, Dr. Nnamdi Azikiwe as its leader. The Pan-Yoruba movement or "Ogbe Omo Oduduwa" gave life to the Action Group which was led by a Yoruba native son, Chief Obafemi Awolowo as a parallel partisan group. Only Hausa/Fulani did not as a rule form a tribal union, which may reflect the primacy of Islam as an integrative factor in their society during this period. However, Northern People's Congress, NPC, was later formed with wide Hausa/Fulani following under the leadership of Moslem, Alhaji Aminu Kano and Alhaji Ahmadu Bello, The Saduana of Sokoto who, speaking to a British journalist in the early days of independence stated that he doesn't believe in "one Nigeria" on question of employment of non-Hausa/Fulanis ([www.m.youtube.com/watch/v=\\_WSosECbcmM](http://www.m.youtube.com/watch/v=_WSosECbcmM)) (video retrieved June, 24, 2014; Tordoff, William, 1984:113-115).

One interesting and perhaps contrasting element of the de- development of the Nigerian political parties as opposed to America's is that Awolowo, according to Sklar (1963: 67) advocated among other things:

*... the principle of ethnic affinity ... he argued that pan-tribal unity was a necessary condition for political advance ... The educated minority in each ethnic group are the people who are qualified by natural rights to lead their fellow nationals into higher political development. See also (Awolowo, 1947: 64)*

Does that sound "elitist"? Awolowo may not be blamed given the level of literacy in Nigeria during this period. However, his fervent belief in tribal loyalty was not conducive for the kind of national question facing the country during those formative years. Similarly, in reference to Dr. Azikiwe, noted that:

*notwithstanding his constant affirmation of non-tribal African values, could not be less mindful of the fact that he was identified by his people (the Ibo) with their own national pride. His career typified their growing assertiveness in Nigerian affairs, his clash with the elite leadership of the Youth Movement was both a sign of latent Ibo-Yoruba tension and a major contributing factor to the ethnic hostility that erupted later ... " (Sklar, 1963:55).*

The British have often been blamed for utilizing the "divide and rule" tactics in their colonial administration of Nigeria. However, to what extent did African political "leaders" contribute to the success of that tactics? In-as-much-as Jefferson advocated for states' right, can we apply the same parallel to understanding the early Nigerian political parties' dichotomy without exaggeration? Nigeria's political parties have continued to take ethnic coloration and flavor. The Action Group and the United Party of Nigeria (UPN) represented the Yoruba (Western) lineage in the First and the Second republics" respectively. The National Council of Nigeria and Cameroon (NCNC) and the Nigerian Peoples' Party (NPP) represented the Ibo (Eastern) lineage in the First and Second "republics", respectively, while the Northern Peoples' Congress (NPC) and the National Party of Nigeria (NPN) represented the Hausa (Northern) political allegiance during the same periods.

Today, APGA is known for its overwhelming Ibo followership, as is AD-turned CAN of the Yorubas before the merger of convenience of few political parties recently in the name of opposition, APC, to the streak of PDP successions at the federal level since 2007. To say the least, these parties have been antagonistic of one another along ethnic lines. While it is common in the United States to come by such questions as "Jimmy who?" (for Jimmy Carter) or "Dan who?" (for Dan Quayle), in Nigeria on the contrary, one can with a high degree of certainty predict who would run for which office from which ethnic group without a prior scientific study. In other words, old faces have continued to reappear in the Nigerian political scene under different colors or party names representing, for sure, ethnic loyalties.

While it was possible for Ronald Reagan, after having defeated George Bush in the "primaries", to turn around and appoint him to his vice presidency, or George Bush to have appointed Mrs. Elizabeth Dole whose husband, Robert Dole, was his opponent as his labor chief, in Nigeria, on the contrary, such practice would be an aberration.

## 7. Conclusion

From the fore-going essay and emergent variables of our analysis, this paper concludes that with the benefit of the dissimilar peculiarities, Nigeria's politico-cultural socialization differs from the America's. Similarly, it is easy to conclude that major efforts to form a stable political entity in Nigeria has not realized the major objectives of such efforts, hence demanding a paradigm shift that would respond to the peculiar politico-historic, social, and cultural realities of Nigerians.

As Nigerians and scholars alike begin to address these issues, we may even raise more questions, and hopefully arousing more curiosity for further investigations. Also by looking inwards for a home-grown solutions, we might find useful answers to problems and questions of nation-building. History has shown that as we continue to look outward for ready-made solutions for Africa's problems the origins of which we have not consciously tried to understand, we would

328 continue to compound and exacerbate the problems associated with nation-building.

329 It is, therefore, the responsibility of Africanists, to put on their intellectual amour in search for solutions to the  
330 problems of Africa. If we appreciate that these problems are real, then we must equally agree that their solutions are  
331 inevitable. It is in keeping with that effort that further research on this phenomenon is not only recommended but  
332 inevitable.

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## Chinese Conception of International Law as the Response to the Challenges of Today

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### Abstract

The article analyses different interpretations of the norms and principles of international law by subjects of international law, which represent different cultures, makes it impossible to effectively solve the problems, confronting the world community. The clash of civilizations, which the United Nations is trying to solve through the dialogue of the last decade speaks about different for many cultures perception of human values, which is reflected in approaches to the interpretation of the principles of international law. The authors raise the question about the possibility of perception as ideas of problem solution of other, non-Western, i.e., non-Christian cultures, represented by subjects of international law, occupying more and more leading positions in selected regions. The article analyzes the Chinese concept of international law, the basic principles which are used in other Asian countries (India, Thailand, Myanmar, Nepal, Pakistan, Afghanistan, Mongolia, Indonesia) to regulate international relations among themselves and even with the European states and North America. The authors argue the appropriateness and adequacy of this concept to resolve territorial disputes, the establishment of a sustainable trade and economic relations, the formation of effective legal models of minimization of ethno-cultural conflicts, achievements of civilization harmonization in international legal cooperation.

**Keywords:** fragmentation of international law, the concept of international law, the conflict of civilizations.

### 1. Introduction

Globalization is an objective process. It can't be stopped or avoided. Globalization makes the world joint, what has the pluses and minuses. It destroys lasting relationships, creates new conditions for development. Many people consider it as one of the sources of global conflict and international terrorism (V.F. Antipenko and A.V. Antipenko, 2014). The events of the last decades prove the inefficiency of the modern system of international law and the impossibility of using the existing universal mechanisms to ensure peace, security and prosperity of mankind. "Westernization" of many states, accompanied by the idea of the rule of law in the Western sense, leads to the hidden and even open (Islamic State in Iraq and Syria - ISIS) rejection with subsequent confrontation. The efforts of states to solve problems with the use of regional international legal mechanisms can be called successful.

International lawyers, theorists, and practitioners, give different explanations to the imperfection of the modern international legal system and the ineffectiveness of international mechanisms in the regulation of these relations. So, the scholars point to such phenomenon as "fragmentation" of international law" among the reasons that threaten the world order (I. Brownlie 1988). The problem of fragmentation of international law is the subject of great attention of international lawyers: Koskenniemi M., Hafner G., Dupuy P. M., Simma B., Martineau A.-Ch., Jouannet E., Abi-Saab G., Rao P. S., Fischer-Lescano A., R.A. Kolodkin R., Poiedynok O. etc., it is included in the agenda of the international law Commission of the UN, it is discussed in the Sixth Committee of the UN General Assembly (O.R. Poiedynok, 2013).

Fragmentation (at least its threat) is seen in the proliferation (growth, increase, expansion) of international legal norms and institutions, in the autonomy or self-sufficiency of some international legal regimes, in the dissemination of international law in those spheres of relations that were not previously considered suitable for international legal regulation. Also it is indicated on regionalization and specialization of international law, in particular in areas such as human rights and international trade, the creation of international courts and other bodies, applying, interpreting the international law and having competence, which coincides completely or partially. This leads to conflicts between legal norms and regimes, interpretation and application of the same norms in various situations, to the collapse of the integral and homogeneous international legal system (R.A. Kolodkin, 2005).

The perception of fragmentation of international law depends on the nature of the understanding by the specific

57 researcher of international law in general. So, established in the Russian legal science and approved by the Commission  
58 under international law of the UN, the perception of international law as a unified and holistic law (universalist or  
59 constitutional approach) is still not shared by those scholars who see it as just a collection of loosely interconnected  
60 subsystems (particular or pluralistic approach). Thus, the universalist choose as a starting point, the general international  
61 law and, as a rule, deny the existence of self-contained regimes, highlighting the danger that bears fragmentation.  
62 Particularists incline to apply the methods of sociological analysis of certain characteristics of the individual regimes. In  
63 their opinion, special regimes are self-sufficient, and fragmentation is a natural phenomenon and even useful (O.R.  
64 Poiedynok, 2013).

65 On the other hand, the scientists talk about such a result of globalization, as the formation as opposed to the  
66 Westphalian system of international relations a kind of "Eastphalian" system, highlighting as an indicator of a different  
67 understanding of the content of state sovereignty, which is a key element of the Westphalian system. The term  
68 "Eastphalian" sovereignty has been used by scholars (Kim Sung Won, David Fidler, Sumit Ganguly, Tom Ginsburg, Lo  
69 Chang Fa) to describe China's view as a political authority, in the same manner as "Westphalian" has been used to  
70 describe Western Europe's sovereignty.

71 In our opinion, these concerns arise from researchers because of fear to perceive international law differently as a  
72 legal system that can develop only in the mainstream of Western Christian civilization. Historically, the science of  
73 international law accrued and developed in the bosom of the Catholic Church and its theological thought (Bartolome de  
74 Las Casas, Francisco de Vitoria, Francisco Suarez, and others), due to which the international law (law of Nations) was  
75 called the right of "Christian Nations". Later Protestant theologian Hugo Grotius was the first scientist who, in fact,  
76 separated by international law from Christian theology and created a rational conception of international law based on  
77 natural law of the mind. However, this did not prevent later Woolsey from defining international law as a set of "rules that  
78 Christian states shall recognize mandatory in relations with each other and also to their citizens" (C.C. Hyde, 1992).

79 The events of the last decades indicate attempts to "impose" the international community model of regulation of  
80 relations with states, leading political situation. Not accidentally nihilistic approach to the administration of U.S. President  
81 George W. Bush to international law (the so-called "foreign policy conception of the Bush", which envisaged the  
82 possibility of preventive war, regardless of the requirements of international law (The National Security Strategy of the  
83 United States of America, <http://nssarchive.us/NSSR/2002.pdf>, 2002) is associated with the fact that this administration  
84 was dominated by the so-called "neo-conservatives" whose religious worldview called "neo-Protestant". The essence of  
85 this neo-Protestant ideology lay in the fact that God supposedly gave USA with a special mission in the world, which  
86 allows to ignore the norms and principles of international law, and the President Bush was convinced in his being "chosen  
87 people", which is especially apparent in unauthorized by the UN Security Council war in Iraq (A.A. Merezko, 2010).

88 A similar hypothesis "That's what makes us exceptional" was used by Barack Obama during his address to his  
89 people on 10 September 2013 in connection with the situation in Syria (K. Tumulty, 2013). It is noteworthy that on the  
90 question of the beginning of the war in Iraq and Syria the collision of two concepts of international politics and  
91 international law, namely, the "neo-Protestant" (K.V. Gorian, 2013) and Orthodox Christian (Catholic and Orthodox), the  
92 members of which called for a peaceful solution of international conflicts were observed (D., Milbank, 2004; and M.  
93 Fisher, 2013).

94 Based on the foregoing, in the legal science in the framework of the theory of "Christian international law" is  
95 observed not so much a single, Christian international law but the three main concepts of this law: Catholic, Orthodox and  
96 neo-Protestant (A.A. Merezko, 2010), which is reflected in the actions of the respective states in the international arena  
97 and affect the effectiveness of international legal norms, especially, *jus cogens*.

98 Over the past decades, researchers have published a number of works on Islamic conception of international law  
99 (N.V. Zhdanov, 2013; and E.V. Gorian 2013). In its turn, the UN insists on dialogue of civilizations: in the period 2002-  
100 2007 such dialogue was declared by UNESCO as priority (UNESCO, 2007), in 2007, the UN General Assembly has  
101 proclaimed 2010 the year of the International year for the rapprochement of cultures (United Nations, 2007).

102 The term "civilization" began to be used in past 30 years in international legal discourse as a necessary category to  
103 describe the cultural diversity that is inherent in the global community (L. Kirsanova and O. Korotina, 2014). Although  
104 initially this term was used for qualitative determination of population (peoples) of the metropolitan countries and their  
105 satellites, emphasizing their higher status compared to people of the colonies. Therefore, international law was  
106 developing as a law of "civilized Nations" (see, for example, Art. 38 of the Statute of the International court of UN), who  
107 were the bearers of European, so-called "Western" culture, which displays the ideas and worldview of Western Christian  
108 civilization, according to the terminology of Huntington (S. Huntington, 1994).

109 The aforesaid allows us to pose the question about the necessity of using cultural method of studying international  
110 law, because the cultural identity (commitment to certain values) defines the government's approach to understanding the

theory and its practical application, in international relations.

Modern scholars increasingly argue on the need for use of an interdisciplinary approach to the study of international law, since the events of the last hundred years demonstrates "the failure of the positivist, rational approach to the regulation of international relations. The researchers who pay attention to the sociological (A.A. Merezhko, Law. [http://www.itsc.org.ua/sites/default/files/content/files/news/doklad\\_merezhko.pdf](http://www.itsc.org.ua/sites/default/files/content/files/news/doklad_merezhko.pdf), 2012; and Y.V. Kozhenko and A.G. Kravchenko, 2007) and conflictology (V.F. Antipenko and A.V. Antipenko, 2014) approaches in the study of the nature of international law talk in their works. In our opinion, the cultural approach deserves special attention, the cultural diversity is also reflected in the different legal systems of states, which, however, forms a part of the total legal family, and in different attitude of states to international law. The inability of modern international law to deal effectively, in particular, with international conflicts is explained by the presence of "conflict of civilizations" (Huntington, 1994) and the crisis of Western Protestant paradigm of Christian civilization (V.F. Antipenko and A.V. Antipenko, 2014).

In his study of Huntington defines a civilization as a cultural community of the highest rank, as the broadest level of cultural identity people (S. Huntington 1994). He distinguishes Western, Confucian, Japanese, Islamic, Hindu, Slavic-Orthodox, Latin American and African civilization. In his opinion, the most significant conflicts of the future will unfold along the fault lines between civilizations, explaining that by their dissimilarity in their history, language, culture, traditions, (S. Huntington 1994). Civilizations differ in the values, the principles on which are build the relations: interpersonal, social, public authority and, finally, the interstate. At first glance, these values are similar, they are supported, at least at the level of signing and recognition of the universal international legal instruments, the vast majority of states - human rights, rule of law, the state sovereignty and so on. But, as the practice of international relations shows, the understanding of the content of these values and, most importantly, their willingness to stand them, depend, not least, from the belonging of the state to one or another civilization, the characteristics of the legal culture of a specific legal system.

## 2. Research Methodology

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## 3. Findings and Discussion

Special attention deserves the Chinese concept of international law, which is the basis of so-called «Eastphalian Sovereignty» (A. Coleman and J.N. Maogoto, 2013). The basis of concept is in the Five Principles of Peaceful Co-existence (United Nations, <http://houston.china-consulate.org/eng/nv/t140964.htm>, 1958). Coleman and Maogoto remark the instructive role of these Principles - India, Asia's other rising power, also considers them (Panchsheel as they are

165 termed in India) important in how it approaches its foreign policy and diplomatic relations in the twenty-first century  
166 (Coleman and Maogoto 2013, p. 260). Other Asian states have not only adopted the Five Principles as being indicative of  
167 a broader Asian perspective on sovereignty and diplomatic practice, but also rely on these Principles in their dealings with  
168 one another. The Five Principles were confirmed at the Bandung Summit on Afro Asian Solidarity in 1955, an important  
169 precursor to the non-Aligned Movement. The essence of the Five Principles is not so much that they demarcate a new  
170 approach to international law and relations; rather they are elaborations of already enshrined ideas of sovereignty. Their  
171 importance is pegged on the rise of China (and India): 1) mutual respect for each other's territorial integrity and  
172 sovereignty; 2) mutual non-aggression; 3) mutual non-interference in each other's internal affairs; 4) equality and  
173 cooperation for mutual benefit; 5) peaceful co-existence (agreement) (United Nations, 1958).

174 Over the past 50 years, in the spirit of the Five Principles of Peaceful Co-existence, China settled border problems  
175 left over by history with Myanmar, Nepal, Pakistan, Afghanistan, and Mongolia and solved the problem of double-  
176 nationality of Indonesian-Chinese with Indonesia, thus setting up an image of peace in Asia and becoming an example for  
177 strengthening regional stability and consolidating unity of Asian countries. Statistics show that by 1976, the year in which  
178 Premier Zhou Enlai passed away, there had been more than 90 countries who recognized the Five Principles in the form  
179 of government documents jointly issued with China, and, on this basis, more than 100 countries established diplomatic  
180 relations with China. Thus, India also solved successfully its border disputes with Myanmar and Nepal according to the  
181 Five Principles.

182 Meanwhile, the Five Principles also crossed ideological gap and broke the barrier between western, oriental  
183 cultures by winning recognition from western countries. In 1956, Finland, Denmark, Sweden, France and Belgium  
184 introduced the Five Principles into related documents; after the 1970s, Japan, Britain, Holland, Western Germany,  
185 Australia and the United States accepted the Five Principles one after another and wrote them into friendship agreements  
186 or joint communique signed with China. During half a century, the Five Principles have been included into more than 160  
187 international documents. Just as former Indian President Kocheil Raman Narayanan put it, the fact that a principle  
188 agreement signed between two countries got accepted by most world countries is very rare in the history of international  
189 relations (The Five Principles...).

190 Why the Five Principles are so widely accepted by the international community? David Abel, former minister of  
191 Myanmar cabinet, gave his explanation in an interview. He believes that the Five Principles proposed by China included  
192 basic norms in international relations, and summarized the purposes and principles of the UN Charter in a succinct way,  
193 that's why they can be widely recognized.

194 The Five Principles stand for non-aggression, non-interference and peaceful co-existence, thus providing a  
195 practical way in solving border disputes and handling relations between big and small countries.

196 The Five Principles also lay stress on equality and recognition of the diversity of the world by advocating the norms  
197 of "seeking common ground while reserving differences" and "do not impose on others what you yourself do not desire",  
198 which demonstrate the democratic spirit in modern international relations and needs of the vast developing countries and  
199 therefore are in the fundamental interests of world people.

200 Former Australian Prime Minister Robert James Lee Hawke once emphasized that the notion of "mutual benefit"  
201 put forward in the Five Principles serves as a base for creating a safer world, which called for a spirit of cooperation, and it  
202 is where the vitality of the Five Principles lies(The Five Principles...).

203 Li has emphasized an existence of Chinese conception of international law: «Despite frequent references in and  
204 out of China to "Chinese international law", there is no such thing as "Chinese international law" any more than there is  
205 such a thing as "Chinese mathematics;" there can only be a Chinese theory and practice of international law» (Z. Li,  
206 2001).

207 Differences in Western and Chinese concepts of international law are observed at the level of interpretation of the  
208 principles of international law. Xue expresses doubts on the same approach to their interpretation: "When the rule of law,  
209 democracy, and human rights are being advocated at the international level, they often tend to represent essentially one  
210 type of ideology, one form of culture, and one kind of political system» (H. Xue, DOI: <http://dx.doi.org/10.1017/S2044251310000068>, 2011). What is the peculiarity of the Chinese approach? The researchers note that China's historical  
211 experiences tend to emphasize that the greatest threat to human rights take place during periods of instability, regime  
212 change, and threats to the authority of the ruling polity. The focus is on the more "fundamental" questions of maintaining  
213 equality, peace and security, and equal access to development. In all of this, Eastphalian sovereignty is merely seeking to  
214 find a path through norms of international law that truly are universal, rather than serving the interests of a few (A.  
215 Coleman and J.N. Maogoto, 2013; and S.F. Litvinova, 2014). China is «seeking to find the "legitimate" norms of  
216 international law that truly represent all the actors on the world stage» (A. Coleman and J.N. Maogoto, 2013). As  
217 Petersen notes: "Therefore, international law only sets up a framework, leaving room for different cultural conceptions of  
218

political order and different social circumstances, for which an autocratic rule might sometimes be more appropriate than an unstable democracy” (N. Petersen, DOI: <http://dx.doi.org/10.1017/S2044251310000342>, 2011).

A significant contribution to the study of the Chinese concept of international law made Judge Xue Hanqin (International Court of Justice), who published series of lectures for the Hague Academy of International Law (H. Xue, 2012). Xue continues work begun two decades earlier in a special Hague Academy course by Xue’s mentor, scholar Wang Tieya (T. Wang, 1990).

In her book Xue notes that, like other Third World countries that oppose imperialist and colonialist rules and principles of international law, China has never rejected international law itself. Indeed, the People’s Republic endorsed the purposes and principles of the UN Charter from the moment of its founding, along with the importance of the sovereign equality of all states (S.L. Seck, DOI: [10.1017/S2044251314000253](https://doi.org/10.1017/S2044251314000253), 2015, p. 209). China’s approaches to the recognition of states («Taiwan issue») and the settling of territorial disputes (Hong Kong) are also analyzed.

Xue first highlights the continuing importance for China’s approach to international law of the inviolability of sovereignty and the principle of non-interference. Sovereignty is “a claim about the way in which how different political and social systems, different forms of civilization and culture should correlate and treat each other in international relations”. For China, these principles and the idea of nationhood remain important, notwithstanding the influence of natural law in international human rights, environmental, criminal, and humanitarian law (S.L. Seck, DOI: [10.1017/S2044251314000253](https://doi.org/10.1017/S2044251314000253), 2015).

A special chapter focuses on China’s conception of human rights. She emphasizes the need to consider human rights from a notably the importance of the right to development, and the belief that collective and communal interests may at times prevail over those of the individual (S.L. Seck, DOI: [10.1017/S2044251314000253](https://doi.org/10.1017/S2044251314000253), 2015).

Chinese perspectives of the international law of sustainable development are inextricably linked to the right to development, and the need to address the “inequality and underdevelopment of the present generation”, a prerequisite to generational equity. Actions on climate change should thus accord with the principle of common but differentiated responsibilities, and account should be taken of historical emissions by industrialized countries - the pursuit of sustainable development should serve as the guiding principle for international actions on climate change’ (S.L. Seck, DOI: [10.1017/S2044251314000253](https://doi.org/10.1017/S2044251314000253), 2015).

Excluded from the United Nations prior to 1971, China was subsequently very selective about the international organizations with which it would engage, preferring those with technical, social, and cultural objectives that were less sensitive politically. Following China’s adoption of economic reforms, China ratified and acceded to many international treaties, and quickly joined all major UN institutions from human rights to nuclear non-proliferation to trade (A.P. Alekseenko 2014, p. 37). It also greatly increased regional co-operation, including with ASEAN and the Shanghai Co-operation Organisation (S.L. Seck, DOI: [10.1017/S2044251314000253](https://doi.org/10.1017/S2044251314000253), 2015).

Despite the dramatic change in China’s approach and engagement with international law over sixty years, China has remained deeply committed to the principles of sovereign equality, territorial integrity, and non-interference. To fully appreciate this stance, and thus the Chinese perspective on international law, requires an understanding of history, and of political, economic, and social context (S.L. Seck, DOI: [10.1017/S2044251314000253](https://doi.org/10.1017/S2044251314000253), 2015).

#### 4. Conclusion

Summarizing the abovementioned, we believe that the key aspects of modern Chinese concept of international law can become guidelines for the development and further improvement of international law. We should agree with Coleman and Maogoto, who think, that perhaps it is the West that needs to make an adjustment. It may be that the West can learn from China’s concept of “one state, two systems” and apply it on a global level: “one globe, different systems” (A. Coleman and J.N. Maogoto, 2013). International legal behavior of China tends to be more consistent and stable than its foreign policy behavior. While China’s practice in international law follows overall guidelines of its foreign policy, as most of the countries do, it never intends to act as it pleases outside the parameters of recognized international legal norms and rules (Z. Li, 2001). The more will increase China’s role at the regional level, the more successful will be its participation in peacekeeping initiatives, the more acceptable to the world community will be approaches to the regulation of international relations.

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## United States of America and Constitutional Guarantees

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### Abstract

*In different cases United States had limitations of human rights and civil liberties in the name of internal security and the problem of the relationship between freedom and security. This fact is present in the history of the United States from origins of Federation and is one of the arguments discussed by politicians and researchers. In 1787, during a discussion regarding the ratification of the new Constitution, Alexander Hamilton tipped off that the restriction of freedoms would always implication war and fear and stated that in some situations, the new Constitution will be ignored. In this way, the United States will have, according to Hamilton's tendency to destroy their civil and political rights. So, in order to be sure would run the risk to be less free. This prediction was verified in some circumstances and now is again discussion topic after September 11 and the adoption of the Patriot Act.*

**Keywords:** constitutional guarantee, United States, habeas corpus, civil rights, Constitution, civil war. II World War, I World War.

### 1. Introduction

Throughout history, in different cases United States had limitations of human rights and civil liberties in the name of internal security and the problem of the relationship between freedom and security. This fact is present in the history of the United States from origins of Federation and is one of the arguments discussed by politicians and researchers. In 1787, during a discussion regarding the ratification of the new Constitution, Alexander Hamilton tipped off that the restriction of freedoms would always implication war and fear and stated that in some situations, the new Constitution will be ignored. In this way, the United States will have, according to Hamilton's tendency to destroy their civil and political rights. So, in order to be sure would run the risk to be less free. This prediction was verified in some circumstances and now is again discussion topic after September 11 and the adoption of the Patriot Act. I have made a step back and to turn our attention to the historical periods in which the war and its fear have resulted in reactions of this nature. Historical analysis shows how to respond to periods of crisis by limiting freedom, has always been a common idea of all American governments, the Republicans and the Democrats, even those governments that we were in appearance and careful to freedom and individual rights. Historically, the American people have always supported government elections in this regard, asking strangle measures that at the same time to guarantee more safety: it even by those who have always believed in the inviolability of their individual rights. Basic orientation, however, was that the provisions should turn to a narrow number of individuals, identified by race, origin or political ideas. Also these measures should be taken only during the emergency, should therefore be temporary. In times of need some constitutional protections can be abolished, and can also sacrificed the rights of some individuals, although American citizen. This fact is always considered legitimate in more safety of all other American citizens. An essential role played systematically the fear and insecurity of the country. In moments of crisis issue is not whether the fear is well founded or not abstractly; sometimes cannot be, and can often be exaggerated, but the majority of cases is probably motivated. It was after the attack of Pearl Harbor, was during the Cold War and is probably today after the 11 September 2001 attacks.

The question to ask ourselves is whether the regulatory actions taken to respond to this fear or not needed. First criterion for assessing the restrictive provisions of the civil rights seems to be their effectiveness, efficiency in terms of the ability to limit risks to the country and to increase national security. Only after it is completed secondary evaluation of the effects of these measures most think that may be considered negative due to the freedom of citizens. If, before a real danger for the country, a law is unable to protect national security, he positively evaluated whether its due temporarily restricted the exercise of civil rights. This does not mean that the Constitution does not apply in time of war, but means that at the time of application of a constitutional standard applicable in every area of law is helpful to be taken into consideration conditions of war to decide whether the government owns or no excuses necessary to limit constitutional rights. But not always in American history has been so. In many cases has been answered critical situations with

56 inadequate measures and not proportional, other times of crisis and fears have been exploited by the American  
57 government for achieving political goals that had no relation to national security. The beginning of this paper with a brief  
58 historical analysis can be useful to evaluate the different measures taken in the past as a response to critical periods, to  
59 evaluate the specific effects and response of public opinion and media and finally to analyzing the important role that the  
60 Supreme Court had occasionally, overcoming governance policies or in resolving emergency situations.

61 It would be impossible to recall all the examples of restrictions of civil liberties in the history of the United States;  
62 possible, on the other hand, a short analysis of the most important legislative chains and analytically drop in three  
63 moments that seem to representatives. Alien and Sedition Act passed in 1798 (less than ten years from the adoption of  
64 the Constitution) represent the first laws through which Congress adopted strong measures freedom of speech against  
65 individuals suspected of anti-government position. Laws were torn down in 1802 when the Republican Party took power.  
66 Fifty years later, after the outbreak of civil war, President Lincoln and Congress allowed investigations, detentions and  
67 other actions against citizens suspected of anti-government actions. During the war Lincoln interrupted Habeas Corpus-in  
68 in different situations and established military court although contrary to the Supreme Court. They were arrested during  
69 the war a number of the involvement between 10,000 to 30,000 American citizens without due process of law and without  
70 any constitutional guarantees.

71 At the beginning of World War Congress began to take into account the possibility of adoption of a law which limit  
72 the freedom of expression during 1916 and adopted various legislative texts, but none of them ever reached a majority  
73 vote in both chambers. Only in the following year to June 15, 1917, was passed Espionage Act, in force even to this day,  
74 is further amended by the Sedition Act. These acts authorizing the use of force, to prevent the broadcasting of dangerous  
75 information for national security and allow the arrest of those explaining comments or opinions against the war. They  
76 banned the pronouncement of discussions and printing leaflets against the United States, the Government, the  
77 Constitution and Flag. These two laws brought in the period called the "Palmer Raids" or "Red Scare". At the beginning of  
78 1920 as a result of the explosion of a bomb before the house the Attorney General A. Mitchell Palmer, verified a series of  
79 arrests at the expense of suspected terrorists, above all foreigners. There were nearly 2,000 individuals detained  
80 because of the Espionage Act: half of these were convicted, but none on charges of espionage. During the war, the  
81 Supreme Court said there ever about Espionage Act and Sedition Act; in the coming years in six different cases judged  
82 legitimate laws and confirmed the sentences handed as American citizens. Only in 1920 Congress withdrew laws and  
83 given freedom to those who were convicted of Espionage Act and Sedition Act. Even Court returned to the steps in her  
84 and canceled all decisions taken earlier during the First World War.

85 One of the most important positions in the history of the United States in connection with the termination of  
86 constitutional guarantees in emergencies, expressed by Abraham Lincoln in a letter written in 1863 in justification of its  
87 decision on the suspension of habeas corpus's and jailed indefinitely for his opponents during the civil war. Lincoln in this  
88 paper deals with the main issue, namely whether the limitations of these guarantees in time of war, may cause  
89 permanent damage to constitutional guarantees. Lincoln says that, in its application, the Constitution cannot be  
90 considered in the same way in all cases. It formulates amending the Constitution itself; well, the Government may use  
91 coercive measures during the state of emergency on the basis of the fact that these measures are not used, since they  
92 are illegal, peace time. Another point on which we must reflect is the question of what these elections bring about the  
93 efficacy of the law at the time of completion of emergency. Lincoln reiterated that the termination of civil liberties in times  
94 of emergency not compromise the constitutional in peace. Many were those who supported the fact that temporary  
95 interruptions nature tend to become more sustainable and their application areas tends to be expanded. According  
96 Lincoln projections contained in the Constitution of the United States are more valuable than those provided by the new  
97 European ones, which contain a long list of assumptions for setting rates emergency in time of war and civil war. In 1863  
98 Lincoln defended the measures that were taken, among which is the suspension of habeas corpus statue, the fact that  
99 these measures, legitimate or not, are taken by observing what was the will of the people and public needs. There may  
100 be excluded from the executive to declare emergence, but after the declaration of emergency Parliament and the courts  
101 have the right and obligation to investigate the exercise of such emergency powers.

102 As mentioned above, Lincoln interrupted -it guarantee of habeas corpus in eight different situations. It extremes,  
103 which was applied to an entire state, stated that "all persons ..... guilty of any unfair action ... will be subject to court  
104 martial." Under this authority, the military agents arrested and detained at least 38,000 civilian without judicial  
105 proceedings or decision. State Secretary- William Steward commented before the British Minister in Washington: "We  
106 can pick a ring on my right and order the arrest of a citizen in Ohio. Can you pick a ring again and decide imprisonment of  
107 a citizen in New York, and no one on earth except the President cannot release them. Queen of the United Kingdom  
108 could say the same for its citizens?". Here noticed a simple sarcasm US State Secretary with the British Minister.

109 At the beginning of the Civil War judge Roger Taney, ruled that the termination of habeas corpus by Lincoln -it -it

110 represented an unconstitutional violation and abuse of that authority because under the Constitution, only Congress had  
111 the power. Lincoln simply ignored the ruling of Judge Taney, defending his action as necessary to save the US -we from  
112 destruction.

113 Most military arrests caused by the offense in opposition to military service, sabotage and agreements with the  
114 enemy. Few individuals were arrested for political rallies or demonstrations of ideas. An example of these arrests for  
115 controversial discussions, represented by Clement Vallandigham case, a former Congress MP -as Ohio who was an  
116 opponent of Lincoln -it extraordinary. Vallandigham was sentenced by a military court and subsequently by Lincoln after  
117 holding a discussion in Ohio in which described the Civil War by the White House.

118 In 1886, a year after the civil war, the Supreme Court ruled that Lincoln had exceeded its constitutional authority,  
119 supporting the fact that under the Constitution the President can not suspend the right of habeas corpus statue, nor in  
120 time of war, if juries civilian were open and functional.

121 Court noted: "The Constitution is a law for rulers and for the people, as in time of war as well as in times of peace,  
122 and protects all classes of the population, at any time and under any circumstance. Never been conceived by human  
123 intellect with a doctrine Such consequences it implies that any provision thereof may be terminated in the range of Riley  
124 with special needs to the government. Such a doctrine sends directly to anarchy and dispotic ".

125 These few lines explain that Lincoln us during the Civil War proved as if it were a dictator, while stopped for the first  
126 time in the history of United States constitutional guarantee of habeas corpus statue, an essential guarantee of the right  
127 anglossaction.

## 129 **2. Constitutional Guarantees during the First and Second World Wars**

130  
131 The history of civil liberties during the First World War is too scary. As in any conflict, even during the Great War have  
132 assisted in repeated restrictions of civil liberties in the United States. When the United States entered the war in April  
133 1917, had a strong opposition against the war as well as against military service.

134 Then President Wilson did not tolerate these objections. He stressed that the lack of loyalty "should be eliminated"  
135 and that she "did not constitute an argument over which is no room for discussion". Controversial subjects under Wilson  
136 had sacrificed their rights to civil liberties. Shortly after entering the war United States, Congress had approved  
137 Espionage Act in 1917. Although the direction of mass opposition is not general, prosecutors federal aggressive and  
138 federal judges, and transformed it into a general ban dubious expressions. The purpose of the administration in this  
139 regard became evident in November 1917, when Attorney General Charles Gregory, referring to the conflict opponents  
140 said: "God have mercy on them, in order that they do not expect from a nation of prejudice or by a vengeful government".  
141 In fact, the government worked convincingly to create "a nation of prejudice". Given that there was no direct attacks  
142 against the United States, and no threats against their security, Wilson administration should produce a sense of need to  
143 invite Americans were part of the army, the contribution with their finances and make sacrifices that the war demanded.  
144 For this purpose Wilson created the Committee on Public Information, which produced a series of discussions, editorials  
145 and movies, more frequently invention, all directed to oppose Americans a feeling of hatred against the Germans and  
146 against all those persons whose justice to be suspected.

147 During World War Government condemned over 2,000 individuals because of their opposition to be part of the  
148 army or to participate in war. In this atmosphere of fear, judges took serious decisions (from 10 to 20 years in prison) for  
149 those who were considered guilty of treason. Few were they judges you courageously resisted this trend repressive, the  
150 majority followed the lead of the moment. The result was the suppression of any debate on this topic, morality and war  
151 developments.

152 But anyhow it was not enough. Only a year after Congress passed the Sedition ACT in 1918 which expressly  
153 forbade any expression of controversial and offensive against the United States. Neither truce did not close this phase.  
154 Attorney General A. Mitchell Palmer sent a series agents aiming their infiltration in some radical organizations. In a span  
155 of two months only government arrested over 5,000 thousand American citizen, by deporting the various proceedings  
156 with a thousand foreigners suspected of being part of radical groups.

157 History of the Supreme Court in this period is too excruciating to tell. In a series of decisions between 1919 and  
158 1920 confirmed Court conviction of citizens who had resisted military service and war. Among these individuals might  
159 remember the case of a Russian Jewish immigrant, Mollie STEIMER, 20 years old, which was cast in Yiddish antiwar  
160 leaflets from the roof of a building in the East Side of New York - Regulation. Another case is that of Eugene Debs, who  
161 had received nearly a million votes in 1912 as the Socialist Party candidate for the presidency of the United States. Were  
162 decisions that have not left doubts about the position of the Supreme Court, while the nation was at war flak was not part  
163 of the constitutional protection. May affirm the decision of the Court -it was terrible.

164 In December 1920, as the situation calmed somewhat, the Congress without any problem attracted Sedition Act in  
165 1918. Between 1919 and 1923, the government released all those individuals who were arrested due to Sedition and  
166 Espionage Acts. Ten years later, President Franklin Delano Roosevelt decided an amnesty for all those individuals, by  
167 the return of their political rights and civil. In the next half century, the Supreme Court annulled all decisions made during  
168 the First World War, claiming that each of the individuals arrested or deported at that time because of their opposition,  
169 was convicted of statements that should be protected the First Amendment.

170 On December 7, 1941 Japan attacked Pearl Harbor base. Two months later, dated February 17, 1942 President  
171 Roosevelt signed an executive warrant 9066, which authorized the army to "find military area from which any person with  
172 American citizenship should be ruled it". Although the word "Japan" or "Japanese American" appear not ever in this  
173 order, was implicit reference the fact that the persons exclusively Japanese origin.

174 In this measure, 120,000 citizens of Japanese descent were forced to leave their homes in Washington, New York,  
175 California, Oregon and Arizona. Two-thirds of these individuals were American citizens and representing nearly 90% of all  
176 Japanese American. There were released charges against these citizens; they do not know the reason for which they  
177 were removed from their homes. They did not know where they were going and how long you will stay. Many families lost  
178 everything they had.

179 In order military police were transported in one of ten camps isolation occurred in isolated areas. Men, women and  
180 children were placed in overcrowded rooms. It was found surrounded by soldiers and plug wire and remain there for three  
181 long years.

182 One of the most obvious cases of deportation of Japanese nationals, was the Toyosaburo Korematsu. The court  
183 gave the following explanation:

184 *"We do not ignore the suffering caused to a wide group of American citizens. But suffering are part of the war, and war*  
185 *is a set of suffering. Korematsu not left the west coast because of race, but military authorities have decided that the*  
186 *urgency of the situation create required all citizens of Japanese descent were deported from that area. We can confirm*  
187 *that these initiatives were justified".*  
188

189  
190 In 1980, Congress created the Commission for the isolation of civilians in time of war, to review the Japanese  
191 American internment. In 1983, we concluded the Commission unanimously that the factors that provoked isolation "had e  
192 racial trials, and bankruptcy of policy's Leadership", rather than military necessity.

193 Soon after a federal court to a lower grade, decided an extraordinary principle in the case Korematsu, proving that  
194 government agents were aware at that time in terms of departure, that there was no military necessity, and that we 1944  
195 government agents had deliberately lied to the Supreme Court on this issue. We cancellation of conviction for Korematsu  
196 n 40 years ago as a result of a manifest injustice, Federal Judge Marilyn Hall Patel enfasis need of executive  
197 responsibility.

198 Korematsu shows a constant care whereby in time of war or military emergency should ensure institutions to  
199 protect constitutional guarantees.

200 This case demonstrates the care with which we wartime institutions executive, legislative and judiciary should be  
201 prepared to exercise their authority to protect the constitutional freedoms of individuals.

### 202 3. Conclusions

203  
204  
205 In the framework of a constitutional guarantee for individuals and States in general, the constitutional lawmaker United  
206 States of America should pay attention and utmost care case interruption that constitutional guarantees, namely in  
207 respect of freedom and happiness that expressed and proclaimed with such patriotism by the founders of the United  
208 States of America.

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# The Approaches to the Classification of Enterprise Sustainability Factors

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## Abstract

The reforms which are carried out in economic system of Russia and around the world, the fastening speed of globalization processes resulting in the processes of international market generation influence greatly the trends and the essence of development stages of national industrial enterprises. The priority of Russian enterprises development has been given to the matters of production structure, the matters of supply and demand in the markets of human resources, educational services, scientific research and development. But the prior matter is optimization process of industrial enterprise activity for their sustainable development in long-term period. The first step here is to analyze the main factors that may influence industrial enterprise sustainability. This task stipulates the goal of the research work presented in the article.

**Keywords:** sustainable development; sustainability factors; external environment; development potential.

## 1. Introduction

### 1.1 Background

The basic principles of the external environment assessment were set out in the research works where the whole environment was divided into macro level environment systems and the micro level which can be influenced by the enterprise. (Porter M., 2004) The groups of organization stakeholders are usually formed from the system of microenvironment and they define the enterprise policy according to their own interests, so the matters of relationship of the enterprise and its stakeholders are also thoroughly studied. (Sokolova Y., 2013)

The possibility of the enterprise to move in the direction of the set goal keeping its stable position at the market and possibility to develop even under the condition of unfavorable influence of some factors is understood as sustainable development. The concept of sustainable economic development was studied thoroughly and the result of the study was the idea that the aims of environment protection and economic development do not contradict (Barbier E., 1987). Some research work has been done in order to find out how the corporation can achieve sustainability and what changes should be implemented in it for this aim (Dyllick, T., Hockerts, K. 2002; Doppelt B., 2003; Dunphy, D., 2007).

### 1.2 Status of the problem

The sustainable development of the enterprise is characterized by the great number of factors. Their diversity, the absence of reliable system of their evaluation and the absence of possibility to make forecasts about some of them may lead to negative consequences for enterprise sustainable development. The research is planned to be the one that gives the grounds for trends and criteria of factor systematization. This research is also aimed at the study of international experience and Russian practices in order to formulate the principles, the basic and specific characteristics of sustainability model design both for separate industrial enterprises and for the whole industrial economy of the Russian Federation. The aim is to give the basis for future grounds for change implementation from the sustainability approach

57 and adjustment of interests of industrial enterprises and social and economic systems of different levels starting from the  
58 study of peculiar sustainability factors and classifying them.

## 60 2. External Environment Factor Analysis

61  
62 Taking the existing research works of the theory and practice of economic systems sustainable development the authors  
63 defined meaningful groups of factors that influence sustainable development greatly.

64 The factors of the external environment can be subdivided into two groups the factors of direct influence and the  
65 factors of indirect influence.

66 The environment of direct influence is the element of the environment which affects the enterprise immediately and  
67 specifically. The most dynamic among them are consumers and competitors. The consumers of the enterprise determine  
68 the demand at the market and as P. Drucker (1980) said "the only aim of each business is to generate the consumer". So  
69 the possibility of enterprise creation, its future activity and development is under direct dependence of the enterprise  
70 ability to attract the consumer and gain its respect. Another important factor of the enterprise development is  
71 competitiveness. The competitive struggle can greatly influence the internal environment of the enterprise especially the  
72 production organization process. That is why nowadays it is extremely important to raise the competitiveness of the  
73 produced goods in order to support not only the current existence of the enterprise but also its development. The  
74 suppliers as the external factor can support the efficient entrance of the system to the market by rhythmic and just-in-time  
75 delivery of production means, resources and materials including economy, information, energy, staff and other resources.  
76 This elements demands constant changes in the negotiations policy. Contact audience is the factor that forms the attitude  
77 of financial structures, regional state administration, mass media towards the enterprise.

78 The reaction of the enterprise at the transformation of the direct influence factors can be dual. It can change the  
79 inner structure of the organization in order to implement adjustment policy or it can mobilize all its resources and make an  
80 effort to implement contraction policy (either active or passive).

81 The environment of indirect influence includes the factors that do not influence immediately and directly but their  
82 impact should be taken into account. The economic entity may only adapt to such factors but cannot change them. The  
83 factors of this level may give opportunities and may also constrain the enterprise activity. Political situation affects the  
84 enterprise development greatly because the investment inflow of the country and the opening of external markets for  
85 domestic goods depends on it. Economy situation can influence the enterprise through the economy development  
86 phases. The quotation of domestic enterprises securities at the stock exchange, the prices for energy resources, national  
87 currency exchange rate, inflation level, interest payments for credits are the factors that reflect the condition of national  
88 economy. And if the economy is at its raising phase it affects positively the activity and development of the enterprises.  
89 Other influential factors of the indirect influence are scientific and technology progress, information supply, social and  
90 cultural factors, the global market, ecology factors.

91 The description, analysis and possibility to forecast the influence of the indirect factors is rather difficult and time-  
92 consuming process. It is rather difficult to formalize such factors because they cannot be evaluated from the point of  
93 quantitative characteristics but it should be taken into account that in some periods of humanity development  
94 characterized by the changes in society economy structure the role of these factors may increase.

## 96 3. Internal Environment Factor Analysis

97  
98 The internal environment is some definite interconnection of composite elements affecting directly the process of  
99 resource flows transformation into the flows of products. According to the functional subsystems the following factors can  
100 be highlighted.

101 Production – is a complex process which can be characterized by the applied equipment, technology, staff  
102 qualification. The quality of produced goods is directly dependable on the excellence of equipment and technologies and  
103 thus they influence the competitiveness of the organization (Ghemawat, P , 1999).

104 Finance. The process of financial resources planning influence the possibility to attract investment, circulating  
105 assets renewal, the use of the gained profit and the whole development of the enterprise.

106 Marketing is the instrument which helps to raise the foundation and logic of decisions made about production and  
107 sale policy, about financial and economic policy, about scientific and technology policy.

108 Staff is one of the main resources of the enterprise and its functioning is impossible without this resource. Staff  
109 qualification, its motivation incentives affect directly economic entities sustainability.

110 Innovation characterizes the enterprise inner environment which can either help its development or be an obstacle



111 in the way to sustainability. Innovation activity is a complex dynamic system of action and interaction of different  
 112 managerial methods, factors and structures.

113 Management of the enterprise lies in production and economic activity organization directed at sustainable  
 114 development which is determined by definite flexibility of applied management methods, sensible distribution of  
 115 production flows, right application of material resources, professional production process management, adaptable  
 116 organization structure and management system, stable information supply.

117 According to the sustainability degree of enterprise functional subsystems the following factors can be indicated.

118 Production sustainability is characterized by optimum production elements usage, the high level of production  
 119 organization, constant control over production efficiency improvement.  
 120



121  
 122

123 **Figure 1.** The classification of sustainable development factors of an industrial enterprise.

124

125 Production sustainability gives understanding of production management quality, it also affects labour productivity, the  
 126 quality of after-sale services, work standardization level improvement.

127 Financial sustainability is determined by the elaborated strategy of the enterprise, financial plans working out, the  
 128 definition of financing sources, financial structures and departments coordination. Financial sustainability is characterized  
 129 by the ability of the industrial enterprise to keep the planned level of profitability and paying capacity for the long-term  
 130 period. More than that the financial sustainability allows to optimize the basic financial indicators which influence on the  
 131 changes in economic condition of the enterprise, allows to find out all available sources of material resources and  
 132 evaluate the necessity of their attraction for gaining the profit.

133 Marketing sustainability reflects the complex of marketing strategies which are directed at enterprise aims  
 134 implementation. Specifically these aims are to get accurate and objective information about the demand at various  
 135 segments of the market, to decrease the risk of irregularity of orders, to increase plant capacity usage and to increase the

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enterprise rating.

Staff sustainability is characterized by staff qualification, its initiative, communicability, the level of organization culture, the existing motivation and incentives system.

Innovation sustainability is continuous work of creating and applying improved technological products and the ways of making business activity.

Management sustainability is characterized by the existence of efficiently organized management structure, inner coordination, regulated interconnection between the departments, ability of fast reaction to the changes.

The functioning of the enterprise nowadays is performed in the condition of constant rise of complexity and uncertainty of the exterior and interior environment. This is becoming one of the key problems for continuous and sustainable growth of enterprises. Contemporary managers have to make decisions under the conditions when the product life-cycle grows short, the production profitability falls, the technology systems change systematically. That is why the effective management of internal elements allows to minimize the external influence and support the continuous movement to the sustainable development. According to the stability of influence the authors defined the factors of constant influence such as consumers, suppliers, competitors, staff, production, marketing, innovation, information supply and management factors. The factors of periodic influence such as economy, legislation or culture factors. Aperiodic factors include political, technical, international, ecological influence and the influence of contact audience.

Taking the approaches to the sustainability factor analysis the authors elaborated the detailed classification of sustainable development factors (Figure 1).

#### 4. Conclusion

The research work allows to perform the following basic ideas:

At first, the enterprise is the open system and can function effectively only under the condition of interconnection with the external environment. The factors of external environment allow to develop, to gain profit and to meet the consumers interests.

At second, the detailed and systematic internal and external factor classification helps to state the influence of each factor on the enterprise effectiveness.

At third, the importance of external factors raises with the increase of the environment complexity because of the globalization process of social and economic relationship in the society.

At fourth, the indication and definition of internal environment factors allows to study the limits of production and sale abilities of the enterprise and to find out the necessary growth reserves and change trends which help to achieve the maximum effect for the long-term period.

At fifth, the study of theoretical foundation of the industrial enterprise sustainable development showed the necessity of further research in the sphere of sustainable development management in order to elaborate the basic principles and methods of industrial enterprise sustainability management.

#### 5. Acknowledgments

The authors thank all participants of the study for their kind cooperation.

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## Cost Effective Metrics through HRA

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### Abstract

In an organisation, human resource is the most important resource for organisation development. These resources (HR) are directing and controlling the other resource (Machine and material) for production and organisation profitability. Even though the human resource is very much important to an organisation, but still it is not recognising as an asset factor in the financial balance sheet (financial Statement). This is due to because; there is no proper measurement model for the cost and value of human resource in HRA under many organisations. The Human Resource Accounting will help the organisation for the better future development like, acquisition, expansion, diversification of the organisation. This research is mainly a conceptual paper, which deals with the theoretical aspects of Human Resource Accounting, its measurement on HRA in the organisation and it explains about the influence of HRA in organisation decision making.

**Keywords:** Human Resource Accounting, Human Resource, Cost and Value of Human Resource Accounting, Measurement and Valuation of Human Resource and Models of Human Resource Accounting.

### 1. Introduction

Human Resources are defined as: "The people that staff and operate an organization ... as contrasted with the financial and material resources of an organization." (William R. Tracey, in the Human Resources Glossary).

"Human Resource Accounting is the measurement of the cost and value of the people for the organisation." (Eric Flamholtz of University in California, Los Angeles).

According to the American Accounting Association's Committee on Human Resource Accounting (1973), Human Resource Accounting is nothing but "the process of identifying and measuring data related to human resource and communicating this information to interested parties". From this definition, Human resource accounting (HRA) means, the value and the cost occurred by the employees in an organisation, which includes the cost on, recruitment, selection process, hiring process, and training & development of the employees. Human resource accounting is the process of measurement, which will help the organisation on the decision making situation. There are two methods have been adopted in HRA, one is cost approach and second is value approach. Cost approach method contains two models are, acquisition cost model and replace cost model. Value approach method also contains three models they are, present value of future earnings method, discounted future wage model, competitive bidding model.

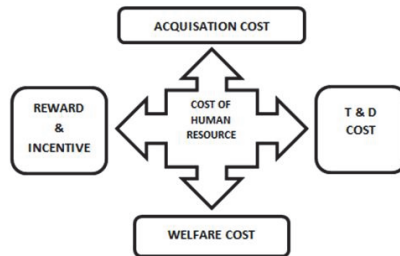
Nowadays, employees are considering has the valuable assets, than the physical and intangible assets in the organization. The HRA will help the organisation to frame out a clear cut financial detail to their management and their investor for predicting and analysing the future potential of the organisation. Moreover, the HR Accounting will help the organisation towards the expansion, Merging and diversification plans and also in tapping the market fund. HRA is not only maid for recognising the value of all resources in the organisation; it needs to provide reorganisation to the human resource which will ultimately increase the quality and quantity of the goods and services in the organisation. This research is basically on the theoretical definition of Human Resource Accounting and the measurement models of HRA.

### 2. Accounting for Cost and Value of Human Resource:

Human Resource Accounting provides the relevant information about the human resources cost and value to the interested peoples like, management, financial analysis and the employees in the organisation. The Human Resource Cost Accounting describes the cost occurred on acquire and develop the employee as well as replacement cost occurred

- 57 in the organisation. The cost of human resource occurred in the organisation will be on the following bases of, acquisition  
58 cost, training and development cost, welfare cost and Rewards and recognition cost.  
59 1. Acquisition cost mainly concentrated on the cost on recruitment, cost on selection and cost on interview  
60 (Campus & Organisation).  
61 2. Training & Development cost concentrated on the cost occurred on the Induction Training Program, on the job  
62 training, off the job training, Development Program to the new and existing employees in the organisation.  
63 3. Welfare cost is the cost which taken care of the employees in the organisation like, rewards, incentives,  
64 promotions and transfers.  
65

66 **Fig 1: Framework-Cost of Human Resource**  
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69  
70 **3. Theories of Human Resource Accounting**  
71

72 Human Resource Accounting is majorly concentrated on three theories. These theories of HRA focuses on the cost and  
73 values of Human Resource in the organisation like, Historical cost, Replacement cost and discounted cash flow. Based  
74 on these theories, many organisation start depending there profits from the Intellectual assets (Human Resources) than  
75 the Physical assets (Machine). This leads to develop the methods of measuring value of human assets. In India both the  
76 private and public sectors have adopted Human Resource Accounting in there organisation. LIKE BHEL, OIL, SAIL, HUL,  
77 TELCO, Infosys etc...  
78

Table 1 : Chronological Order of Human Resources Accounting  
Introduction in India

Sl. No.	Name of the Organisation	HRA introduced in year	Model
1	BHEL	1973-74	Lev and Schwartz Model
2	ONGC	1981-82	Lev and Schwartz Model
3	MMTC	1982-83	Lev and Schwartz Model
4	SAIL	1983-84	Lev and Schwartz Model with some refinements as suggested by Eric. G
5	NTPC	1984-85	Lev and Schwartz Model
6	INFOSYS	1995-96	Lev and Schwartz Model

Source: A Report on HRA from <http://www.indiamba.com>

79  
80  
81 **3.1 Measurement And Valuation Of Human Resource**  
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83 Basically, there are two major approaches to measure and value the human resource in the organisation under HRA.  
84 They are,

- 85 1. Cost Approach in HRA.
- 86 2. Economic Value Approach in HRA.

87  
88 **3.2 Cost Approach in Hra**  
89

90 There are two types of cost approaches has been occurs in human resource accounting. They are Historical cost and  
91 Replacement Cost.  
92  
93

94 3.3 Historical Cost

95  
96 Historical cost is also known as Original cost that occurs in the organisation for the development of Human Resource.  
97 Historical cost (or) Original cost is the cost that occurred for the process of recruitment, selection, placement, orientation,  
98 and training & development for the human resource to acquire and develop their skills and ability in the organisation.  
99

100 3.4 Replacement Cost

101  
102 As the name indicates, the replacement cost is occurred, for the replacement process of an existing employee in the  
103 organisation. Due to this replacement cost the organisation should face the historical cost to acquire and develop the new  
104 employee in the organisation.  
105

106 3.5 Economic Value Approach In Hra

107  
108 Economic value based approach will analyse, the future value of the employees merely based on their current  
109 performance and service in the organisation. There are two models in the economic value approach. They are, Monetary  
110 Measures and Non-Monetary Measures.  
111

112 3.6 Monetary Measures

113  
114 There are many models given by experts in HRA, to analyse the value of the employees (or) individual in the  
115 organisation. The models are Flamholtz's model – determining the Individual Value in the organisation, Flamholtz's  
116 stochastic rewards valuation Model and The Lev and Schwartz model. According to Flamholtz's model, (on determining  
117 the individual value of the employee) the value of an individual is basically based on the present service that he renders  
118 to the organisation. Based on his/her present service their future service will be determined in there organisation. There  
119 are two dimensions in this model.

120 1. Expected conditional value – It means the Productivity, performance, promotions, and transfer to the  
121 employee in the organisation.

122 2. Expected realizable value – Is to know the employee productivity service period in the organisation.

123 Flamholtz's stochastic rewards valuation model describes the measurement of individual conditional value and the  
124 expected realized value of an employee in the organisation. The Lev and Schwartz model According to this model, the  
125 value of an individual who is 'r' year old, is the present value of his future earnings from employment. It can be calculated  
126 by using the formula below:

127 
$$E(Vr)=I(t) / (1+R)^{t-r}$$

128 Where,

129  $E(Vr)$ =expected value of an 'r' year old individual's human capital

130 t = the individual's retirement age

131 R = discount rate

132 I = expected earnings of the individual in period I.  
133

134 3.7 Non – Monetary Approach:

135  
136 The Non-Monetary measures in human resource accounting describe the economic value of the intellectual assets, but  
137 not in the term of monetary. The Non-Monetary measures are,

138 1. Skills of the human resource in the organisation.

139 2. Individual performance – Evaluating the individual performance of the human resource and rating there  
140 performance level in the organisation.

141 3. Determine the job satisfaction level of the human resource in the organisation.  
142

143 4. Challenges of Human Resource Accounting in HR

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145 A) The life period of human being is uncertain. Therefore, its value is also uncertain in the organisation.

146 B) Human Resource is an Intangible asset in the organisation.

147 C) Implementing HRA in an Organisation will leads high cost. The Human Resource is unable to retain, utilised or

148 owned unlike the other tangible assets in the organisation. This makes the management to treat them as asset  
149 in the balance sheet.

150 D) Flamholtz approach is now become a popular model for measuring the contribution value of individual or  
151 group in the organisation. Hence, the contribution values of employees are difficult to measure. In Flamholtz  
152 approach the career path of the employee (like, promotions, incentives, retirement etc...) should be  
153 determined according to their life span in the organisation.

154

## 155 5. Objectives

156

- 157 • To expedite effective and efficient management with in an organisation and to know about the work of human  
158 resource of an organisation.
- 159 • To equip the cost value on effective management decision making about allocating, acquiring, merging and  
160 developing the human resource in the organisation.
- 161 • To provide the information and measurement about the human resource in an organisation.
- 162 • To evaluate the return on investment on human resource capital.

163

## 164 6. Research Methodology

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166 Research methodology is a methods used for solving the problem in a systematic way. It is the way to understand the  
167 process of research towards the solution on research problem. There is various logical ways for the researcher to adopt  
168 the methodology. The research design used in this research is to acquire the information based on the structure and to  
169 solve the research problem. A research design is there defined as" A plan, structure and strategy of investigation  
170 conceived so as to obtain answers to research question and control variance.

171 The sample population of this research is taken from the expertise view point on human resource accounting in the  
172 organisation. Sampling may be defined as the selection of some part of an aggregate (or) totality on the basis of which a  
173 judgment (or) inference about the aggregate (or) totality is made. Random sampling methods have been used in this  
174 research among the expertise person on human resource accounting.

175 Majorly, this research has been concentrated on the cost effective metrics on human resource accounting through  
176 the secondary data via. Available books, journals, articles, magazines, newspaper and also relevant websites.

177

## 178 7. Limitatons of the Study

179

180 Every research has certain specific limitation. The following are some of the limitations of this study.

- 181 • Although this research has been done among the expertise person on human resource accounting, this study  
182 does not have influence on primary data's. All the information's are gathered from the present employees but  
183 not from the past employees.
- 184 • The study being corporate sector and the company information cannot be generalized.

185

## 186 8. Historical Written Leaflets

187

188 Bhavin M Badiyani (2012) this article explains about the history of human resource accounting based on the value of  
189 human resource in the organisation. This study describes about the various concepts that occurs in HRA and also deals  
190 with various models like, Flamholts model - determinants of individual value, Flamholtz's model of stochastic rewards  
191 valuation, and the Lev and schwartz model under human resource accounting in the organisation. Various organisations  
192 will adopt various HRA models depends upon their economic growth or the management. This article describes the value  
193 of human resource in human resource accounting in the balance sheet of the organisation.

194 Raunak Narayan (2010) explains the empirical data's analysis regarding the human resource accounting in the  
195 organisation. this article briefly deals on the evaluation of human resource according to their performance, skills,  
196 motivation and contribution to the organisation and as well as it also concentrate on the organisational process like,  
197 recruitment, selection, training etc... The main objective of this study is to know the practise of human resource  
198 accounting in the organisation. This article is also deals with the various models, approaches, issues and challenges that  
199 occur in HRA practises. In this, the value of human resource is also measured in the terms of monetary approach.

200 Neha Seth (2009) this study is a conceptual review. It explains about the measurement of cost and value of the

201 employee in the organisation for the purpose of Human resource Accounting. In this study, they have discussed on  
202 concepts, various models, valuation, and measurement of human resource in HRA especially in Indian Enterprises. The  
203 aim of this article is that the organisation should denote the cost and value of human resource in the balance sheet. This  
204 article includes Lev and Schwartz model to calculate the human values and it also provide suggestion and improvements  
205 in the field of HRA.

206 Leyira Christian Micah, Clifford O. Ofurum, and John U. Ihendinihu (2012) have done an empirical study on firm's  
207 financial performance and human resource accounting in Nigeria. This study deals with the statistical data on the effects  
208 of firm's financial performance and the variation of HRA in the organisation. This article explains about the measurement  
209 and importance of HRA in the organisation among the investors, stakeholders, and interested people. Simple random  
210 sampling technique has been used in this survey. As well as other statistical techniques like, descriptive, correlation, and  
211 regression is also used in this survey for analysing data.

212 Naveed Iqbal Chaudhry (2010) this paper examines the exploratory study on Accounting for the development of  
213 human capital in manufacturing organizations under textile industry in Pakistan. In this study convenience sampling has  
214 been used for data collection and the sample size as been taken from 30 different textile industries in Pakistan. It majorly  
215 describes how investment should be made on development of human resource and to measure the financial return of the  
216 organisation. It also focuses on the employee training and development to increase the organisation development.

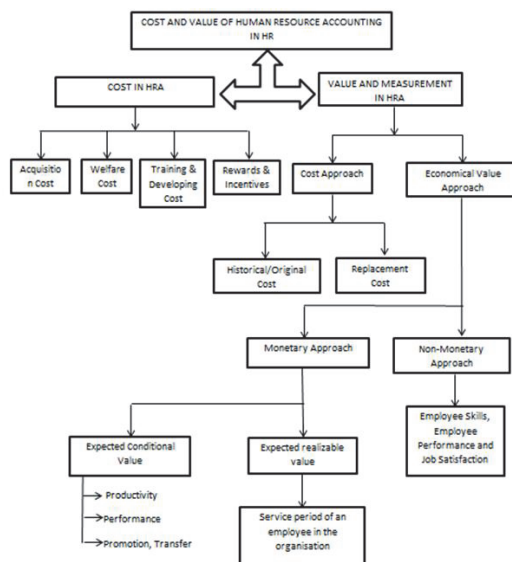
217 Dr. Munivenkatappa, Jagadeesh S.R, and Bharathi. K.V (2013) this study focuses on the Human Resource  
218 Accounting system in it and manufacturing sector. It is an empirical study paper and percentage analysis is used for data  
219 collection. This study explains about the performance and profitability of human resource and considering it on Human  
220 Resource Accounting. This research is mainly concentrated on it and manufacturing sectors. It leads on the concept of  
221 HR, replacement cost, and the economic value of people in the organisation.

222 Jacob Cherian & Sherine Farouq (2013) explains the review of human resource accounting and organisation  
223 performance. It also deals with the theoretical aspects of HRA and implementation of HRA models in the organisation.  
224 The main objective is to know about the HR practises in the firm. This article describes about the HR practises,  
225 challenges in HRA implementation, measuring the employee performance in the organisation. This study includes the  
226 adaption process of HRA technology and can be extended to evaluate the different types of intellectual property.

227 Khaled Jamal Jaarat (2013) explains an empirical study on the Recognition and Measurement of human resource  
228 accounting in the organisation. This research paper adopts qualitative and descriptive study for data analysis. This study  
229 mainly concentrated on the recognition, measurements, intangible assets, and employee benefits in the organisation.

230 The sample size is 390 for this analysis. In this study they describe the recognition and measurement of employee  
231 values in Human Resource Accounting.

232 **Fig.2:** Theoretical Framework – Cost And Value Of Human Resource Accounting In Hr



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## 9. Conclusion

The employees are the greatest assets of an organisation. The success and failure of the organisation is merely depends upon the performance and service quality of an employee. But this valuable human asset (or) intellectual asset was missed in the traditional accounting method. This HRA will help the organisation to monitor the use of human resource and increase the awareness on human value in the organisation. And it also enables the long-time prospect for planning and budgeting. The HRA implementation helps to improve managerial decisions like layoffs, better performance evaluation measures of the firm and also acts as a guide during buying, selling and merger transactions in the organisation.

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## Web Link

- [Http://Aridayam.Wordpress.Com/2012/06/14/Hra/](http://Aridayam.Wordpress.Com/2012/06/14/Hra/)  
[Http://En.Wikipedia.Org/Wiki/Human\\_Resource\\_Accounting](http://En.Wikipedia.Org/Wiki/Human_Resource_Accounting)



## The Role of ECOWAS on Economic Governance, Peace and Security Perspectives in West Africa

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### Abstract

The West African States are known as States with endowed natural and human resources that ought to have an enlargement in the area of economic growth and development. This will help yield results to the countries in West Africa through economic cooperation among states within the region. It is therefore, the goal and objective of the Economic Community of West African States (ECOWAS) to promote regional integration and co-operation for the purpose of ensuring economic growth and development in the sub-region. The endowed resources in West African states are mostly untapped due to challenges that face the region such as lack of technological know-how, bad governance, political instability, lack of adequate diversification, infrastructure problem, lack of political will and the inability to involve the private sector adequately. Therefore, the objectives of this study is to firstly, create an enabling environment where peace and security is sustainable for West African states to engineer economic governance through regional integration and economic co-operation among the countries in West Africa, and secondly, to enable partnership with the private sector. The methodology used in this research is review of previous literature and the use of content analysis which will also provide useful information on the region. The findings from this study reviews that, peace and security sustainability can only be maintained when the West African States employ the measures that would lead to economic growth and development of the region through provision of job opportunities to the youths, employing the early-warning mechanism, transparency and accountability in governance and good leadership to foster growth of ECOWAS community.

**Keywords:** ECOWAS, Economic governance, Peace and Security perspective, Partnership.

### 1. Introduction

The West African sub-region is endowed with human, agricultural and natural resources which the states in the said region sought to cooperate and to promote economic integration. The Economic Community of West African States (ECOWAS) was established for this reason in 1975 for the purpose of engineering economic growth and development of the region given her endowed resources. Among others, the region contributes to the growth of the African economy as well as the global economy through her resources which are exported from the region to other parts of the world.

It is therefore, a region that needs to be studied in resolving some of the conflicting issues that surround the West African States, so as to provide suitable solutions to such issues as we look at the bases of setting up the sub-regional organization known as ECOWAS. This will take us to understanding the role of ECOWAS in ensuring and enhancing good economic governance, and the role of sustaining peace and security in the region so that the main purpose of its establishment would be achieved. This study has also focused on revealing some of the issues that could affect the region when the said economic governance is not taken into consideration in relation to transparency, accountability, financial management, fight against corruption, fight against poverty, unemployment, health related issues, and

58 importantly, to relate such with security issues.

59 Terwase, Abdul-Talib and Zengeni (2014), relate their work to the endowed resources in Nigeria that are still  
60 untapped while many people are in search of job opportunities in the case of Nigeria. In the said country which is the  
61 most populated state in West Africa and the host of ECOWAS Headquarters in Abuja, the country is richly blessed with  
62 both human and natural resources; however, her overdependence on oil has left other resources untapped while her  
63 people in the rural communities live within endowed resources but die of poverty. This work has looked into such issues  
64 as it affects the security of the people when government neglects functional economic governance.

65 For the European Union (EU) as a regional body, it looks at the preventive measures that can seek to foster  
66 economic growth and stability, while tackling issues that could make or result into economic problems. As such, it has  
67 agreed to ensure policies that would lead to economic growth and development of the region (European Union, 2014).  
68 When these issues are not taken care of, it may then have some negative effects on the political life of the state which  
69 may also lead to insecurity of the said environment and region as the case may be. This paper has reviewed the  
70 relevance of economic governance as well as security issues as it relates to poor governance as well as the role of  
71 ECOWAS in ensuring regional economic governance, the security of the people and region through transparency,  
72 accountability, early warning mechanism, conflict prevention, conflict resolution and post-conflict reconstruction in West  
73 Africa.

74 The objective of this study therefore, is to bring to the fore some of the major issues that can bedevil the  
75 development of the ECOWAS community and to take measures that would lead to the growth of the region, promote the  
76 development of the West African States as well as employ the missing link. Like other countries in Europe, Asia, and  
77 America, they target at economic growth and development of their countries in order to enhance the overall wellbeing of  
78 their citizenry. As such, this paper focuses on the issues that need to be addressed in the West African region in order to  
79 promote peace and security of the sub-region, promote both economic integration and cooperation of the said states so  
80 as to bridge the gaps therein through good governance and good leadership in West African States.

## 81 2. Literature Review

82  
83  
84 Deas, Hincks and Headlam (2013) argued that, changes can affect a regional geographical establishment which also  
85 relates to local, national as well as international economic development. This becomes very important to this study as  
86 countries within the West African sub-region established ECOWAS as a body with the aim of promoting economic  
87 development and international integration. But after many years of its establishment, there are still many challenges  
88 facing the West African countries. Thus, the issue of economic governance becomes relevant to this study as well as the  
89 security implications therein. Benit-Gbaffou, Didier and Morange (2008) reveals how private-public partnership can be  
90 used as a tool in economic and security governance as they studied city improvement scheme in Cape Town and  
91 Johannesburg, South Africa. Therefore, they sought to balance access to equal security opportunities and treatment of  
92 the people.

93 In the view to seeking out issues affecting economic governance, Verdun (2013) relates it to the role of the  
94 European Union as a regional organization in Europe that reveals how democratic accountability can affect economic  
95 governance when it is lacking within the countries therein. This also reveals a major issue that is affecting not only the  
96 ECOWAS community but other regional bodies and countries even in Africa especially the sub-region under study.  
97 Adams and Mengistu (2008) in their work, focused on how privatization can be implemented yet it does not have  
98 significant impact on economic growth as well as income inequality, but the major substance is good governance.

99 Economic problems such as highlighted previously, can then be prevented through the process of ensuring stability  
100 and growth of economic policies that would gear towards the advancement of such countries involved. It can also be  
101 done through sound public finances which can thus, boost job opportunities leading to economic development and  
102 national growth (European Union, 2014).

103 What then is the linkage between economic governance, peace and security? Lindberg (2001) argued that, trade  
104 can be seen as a main function of states which can be conducted by the private sector in negotiation with the state; it is  
105 then expected of the state to provide the needed strategies that would enhance economic governance towards services  
106 that can be provided to the people as well as public governance leading to the security of the people. Issues such as  
107 unemployment, poverty, illiteracy, as well as poor governance are the main challenges that may lead to youth's  
108 engagement in activities such as militancy and insurgency against the government of a given state like in the case of  
109 Nigeria, Mali, Niger, and Liberia (Dike, 2014; Olaiya, 2014; Yusuf, 2013; Aghedo, 2012; Salaam, 2012; Jackson, 2007).

110 In the case of Nigeria, Dike (2014) and Olaiya (2014) observed that, the youths who are involved in the activities  
111 of the Boko Haram militancy against the Nigerian government do so as a result of unemployment, some as a result of

illiteracy and driven by poverty, they find themselves engaging in the Boko Haram activities such as bombing of private and public facilities and killing of innocent lives. Thus, it is the responsibility of the West African states to focus on good governance in order to improve on the social conditions of their people and citizenry. Johnson (2007) argued that, ECOWAS countries suffer setbacks in relation to economic growth and development due to poor governance, weak institutions as well as issues relating to security challenges which are factored in unemployment, corruption, poverty, and failure on the part of the government to provide basic services to the people.

### 3. The Challenges of Economic Governance, Peace and Security in West Africa

What do the people expect from their leaders? How can such expectations be accomplished? Here we are looking at the issues that affect economic governance leading to unanswered questions that the people expect from states within the sub-region to be answered. Since the establishment of ECOWAS in 1975 as a regional organization in the West African sub-region, the expectations of the people goes beyond having a government in place in their respective countries, but seeing results for the purpose of its establishment. Within the sub-region, there are countries that went through civil war, had conflicts within states, and had military regimes as well as democratic governance. There are challenges that arose from lack of transparency and accountability, mismanagement of public funds, poverty, as well as unemployment of the citizenry. The role of states here covers not only signing of treaties but ensuring good economic governance where the people are well taken care of in relation to proper management of resources in order to promote national economic growth and development.

As such, the stability and growth of the economic policies that would ensure both the development of the people through provision of services such as jobs for the people, infrastructure, and accountability on the part of the government towards her role in developing the state, is what the people expect from their leadership. Furthermore, failure on the part of the government to meet the expectations of its citizens creates an environment for insecurity. This shall be discussed in order to relate to how it affects the West African states, and the role of ECOWAS therein on how to prevent such occurrences.

#### 3.1 Unemployment

Unemployment of the youths as a result of bad governance had its untold effects on the wellbeing of countries that went through war. These unemployed youths were used during the war and these were periods of political conflicts due to the availability of the youths who were basically unemployed and were taken advantage of. They become available to be used at any given time since the value for their lives was no longer placed. This is one way of ensuring sustainable development through provision of job opportunities to the youths within the countries under the ECOWAS body (ECOWAS Commission, 2014). As in the case of the insurgency in Nigeria, most of the people who are directly involved are the youths who found themselves virtually uneducated as well as unemployed either by way of acquiring skilled or unskilled jobs.

#### 3.2 Poverty

The communities and villages in the West African states especially in the sub-region are basically endowed with resources but the people living in such environments continue to suffer untold hardship as a result of their poverty driven environments. This kind of environment tends to be useful in the hands of actors to fight the government during conflict periods. To some, they leave on less than one dollar a day where they expect the government to intervene in their situations and provide economic policies that would lead to the development of such communities. However, when solutions to such issues are not sought after, the people living therein become tools in the hands of warlords and conflicts mount against the government.

#### 3.3 Transparency and Accountability

This is one of the most important areas of focus which some countries tend to neglect. In any government, the leadership in place is being watched by the people irrespective of whether it is a democratic, military regime, monarch or even authoritarian government that are in leadership. In most cases, the people may tend to ignore for a while, but a time comes when they fight back against a seating government when the leadership in place is not accountable to the people on how the resources are being managed, and evidence of corrupt government may tend to face security challenges.

166 Good governance therefore, would ensure transparency and accountability in management of the available resources  
167 where economic policies that would lead to the development of such country can be enhanced.  
168

#### 169 **4. The Role of Ecowas in Sustaining Economic, Peace and Security Governance**

170 There are mechanisms that can be put in place to monitor the development of West African States, be it economic  
171 cooperation between states, economic integration, peace and security sustainability, the fight against corruption, control  
172 of small arms and cross-border crime by ECOWAS. These are some of the issues that would be discussed in order to  
173 understand ECOWAS' role in ensuring economic, peace and security governance within the sub-region.  
174

##### 175 *4.1 The Early-warning Mechanism:*

176 Through the provision of an early-warning system by the ECOWAS Commission, it will enable the development of a  
177 monitoring system where issues that may affect any of the member states, will then be looked into before it would lead to  
178 any form of conflict (ECOWAS Commission, 2014). Conflict prevention mechanism in this case should be applied so as to  
179 enhance a resolution of issues that if not resolved may escalate into war. It could even be economic or political issues  
180 due to bad governance. As a result, jobs should be provided to the youths, provision of educational facilities through  
181 establishment private-public partnership to focus on eradicating all forms of illiteracy in the West African sub-region,  
182 creating an enabling environment for foreign direct investment to boost the utilization of the untapped resources in the  
183 sub-region so as to eradicate poverty, enhance both job creation and economic development of the states in order to  
184 solve the problems that are related to unemployment and security challenges.  
185

##### 186 *4.2 Economic Cooperation and Integration:*

187 The most significant issue that brought the idea of establishing ECOWAS was based on member states to cooperate  
188 among themselves for the purpose of promoting economic cooperation and integration. However, after many years the  
189 sub-regional establishment is still facing challenges in relation to such development and sustainability to which it was  
190 established. ECOWAS' role therefore, can be focused on resolving such challenges through ensuring transparency and  
191 accountability in governance from the political point of view to economic face amongst the member states. This will go a  
192 long way in fostering growth and development in the region. Hence, issues such as corruption should be highly fought by  
193 encouraging and campaigning for zero tolerance on corrupt practices in dealing with public issues, thereby putting the  
194 interest of the state first rather than personal interest. This would promote good governance within the sub-region and  
195 when the interest of the masses comes first, national interest is then placed and it then discourages personal interest.  
196

#### 197 **5. Conclusion**

198 In conclusion, the endowed resources in the West African sub-region can be developed through the cooperation and  
199 integration of the states involved. The issues that can lead to the underdevelopment of the region are traced to bad  
200 governance, corrupt practices by the leadership in government, negligence of the masses needs, placing of personal  
201 interest first above national interest especially those in leadership at any level, these are the problems that are truly facing  
202 the states. These issues need to be resolved for the countries within the sub-region to move forward. Therefore,  
203 ECOWAS should apply the early-warning mechanism in relating with the states or else face the consequences therein  
204 when the people are neglected. This negligence will then provide an avenue for insecurity of both the states and the sub-  
205 region. Examples of countries that have witnessed such crisis in the region are Liberia, Cote d'Ivoire, Mali, and Nigeria.  
206

207 It is therefore the role of ECOWAS to see to it that early-warnings are passed to the states when there are effective  
208 monitoring systems within the regional body. This will encourage good governance, zero tolerance to corrupt practices,  
209 ensure transparency and accountability in governance be it political, economic and socio-cultural dimensions in order to  
210 eradicate all forms of challenges facing the sub-region such as poverty, illiteracy, unemployment, economic  
211 backwardness, and poor leadership at all levels. This would lead to the transformation of the sub-region through  
212 promotion of economic growth and development where private-public partnership could be encouraged and engaged, as  
213 well as partnership among other countries within and outside Africa for the purpose of engineering production and  
214 enhancement of the available resources therein.  
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## The Convergence of Law: The Diversity of Discourses

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### Abstract

The problem of understanding of the essence of the convergence of law is always in one or another form observed in the Western and Russian legal science. Converging process always had an objective basis of its origin and development, was determining the content and features of the development of many national legal institutions, and also norms and principles of international law. Today, the convergence of law takes place in the framework of political and economic globalization, which, of course, stimulates the interest of researchers to this multidimensional phenomenon. Of a particular interest in this aspect are mixed legal systems, the research of which is conducted in the framework of the theory of legal convergence and has a high level of complexity due to the inevitable involvement of a wide range of different factors. The impacts of various factors, contributing to the convergence of the Romano-Germanic and Anglo-Saxon law are taking place, processes of "infiltration" of law institution are happening at the regional level and so on. The article covers key aspects of the evolution of the discourses of convergence of law from the Ancient to modern theories of mixed legal systems. The author's findings are of great importance for the development of the theory of law, comparative law and political science at the beginning of XXI century.

**Keywords:** convergence of law, legal framework, mixed jurisdictions, legal doctrine.

### 1. Introduction

Unfortunately, in the Soviet social science in 60-80-ies the western theory of convergence (in the legal and political variant of this theoretical and practical education) immediately received so called "registration" in the scientific officiality, and naturally, here took place its ideological reading, and as a result it was considered to be «bourgeois» и «anti-Marxist».

Convergence in the Soviet humanitarian discourse was limited mainly to the sharp criticism of the possibilities of approachment of the socialist and capitalist worlds, the acquisition of similar traits and characteristics. This kind of interpretation was develop also in monographic studies of those years, in dictionary articles and academic literature (M. Dictionary, 2013).

"The theory of convergence (from lat. converge - converge) - socio-philosophical and political concept, according to which the internationalization of economic, political, cultural activity and the presence of some common structural and functional aspects of industrial society... bring to approach of politically and socially divergent systems - capitalism and socialism with the possibility of their merging in the future in mixed society, synthesizing a positive side of each of them" (Modern Western philosophy, <http://elar.urfu.ru/handle/10995/971>., 2013).

At the turn of XX-XXI centuries, researchers have already gone from the data-ideological understanding of the nature of convergence in general and legal convergence in particular and consider the essential aspects of this phenomenon and process in the other dimensions. In particular, many Western legal scholars draw attention to the fact that any "update", "edit" or "modernization" of legal norms and institutions, disturbing during the coming convergence of individual elements of the national legal system, as well as different legal systems always has *risk-causing character* (V.V. Palmer, 2011): causes in legal practice different law-making, law enforcement and law – interpretative risks,

57 especially in the so-called "mixed jurisdictions" (W. Tetly, 2012).

58 In this respect, it is no coincidence that the theory of convergence in the XX century became one of the main  
59 concepts of modern Western jurisprudence, political science, sociology, Economics, and has had a significant impact on  
60 comparative legal studies, in many ways, extending their subject and the theoretical and methodological base.

61

62

## 2. Literature Review

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64

### 2.1 Antique approach

65

66

67 Turning to the historical aspects of convergence in the legal field it should be noted that in the ancient world, the notion of  
68 "convergence" was absent, however, beginning with Plato, different philosophical theories were built, in which the content  
69 and meaning of this concept was discussed at an intuitive level. In particular, Plato in his most recent work "Laws" laid the  
70 philosophical and legal foundations of interest of subsequent European thinkers to the problem of political-legal  
71 "heterogeneity", the question about the nature, objective or subjective nature of the converging processes at the earliest  
72 age of Western civilization. In general - theoretical terms, ancient Greek thought was moving in the direction of the search  
73 for political and legal ideals ("right form"), but eventually went on thinking of the state and legal realities.

74

75 Aristotle, staying, of course, in the same philosophical and legal traditions, goes even further in understanding the  
76 importance of converging processes in politics and law. His state-legal ideal, as it is known, is a mixed model of  
77 organization of public authorities. "Political system as a whole is not a democracy and oligarchy, but is the average  
78 between them, it is called politija... So better is the judgment of those who mixes several kinds, because that political  
79 system, which is a combination of many species, is really the best" (Aristotle, [http://publ.lib.ru/ARCHIVES/A/ARISTOTEL'/\\_Aristotel'.html](http://publ.lib.ru/ARCHIVES/A/ARISTOTEL'/_Aristotel'.html), 2012).

80

81 For the Romans the universe no longer seems being endless, it is narrowed to the limits of the state, and the  
82 Imperial society, on the contrary, is extended to the scale of the Cosmos, which, of course, already plays an important  
83 existential-philosophical premise in relation to the occurrence of legal-converging processes.

84

### 2.2 West European Middle Ages

85

86

87 The formation of national states and legal systems of Western Europe in the period of decay of the Roman Empire and  
88 later are closely involved with multidisciplinary and polivector converging processes, approaches and synthesis of the  
89 most different in their nature methods and forms of norm - forming legal systems. Christianity in this period was a special  
90 spiritual basis for converging-acculturating state and legal processes. Legal norms and institutions of various Christian  
91 Nations are beginning to converge, slowly, but still happens their particular synthesis, on the basis of the new European  
92 Christian philosophy and world vision.

93

94 The first result of legal convergence in the framework of this social-spiritual (permeated with biblical precepts,  
95 ideas about Last Judgment and standards of Christian ethics) paradigm was, of course, the reception of Roman law, the  
96 institutions of which did not immediately replace from the Western regulatory space the feudal customary law and  
97 neutralized available in the early middle Ages desire to build a Christian nation on "Apostolic pattern". It is clear that all  
98 these processes occurred only after a very long and complicated converging phase.

99

100 «To build a society based on Roman law, to take it for a sample – was it a violation of the divine law, search for  
101 justice for the account and at the expense of mercy?... Thomas Aquinas in the early XII century put an end to this  
102 criticism. His works, using the works of Aristotle and showing that pre-Christian philosophy based on mind, largely  
103 conformed to the divine law, has contributed to the "expulsion of devils" from Roman law" (R. David, Jean-Christophe  
104 Spinosi, <http://sudru.com/>, 2013).

105

### 2.3 Modern Age

106

107 So, for many centuries in Western political and legal space took place very tangible converging processes. However, their  
108 results did not become a "homogeneous" jurisdiction, was happening not a merger, but namely the harmonization of  
109 different legal forms, which of course did not go unnoticed by researchers of XVIII-XIX century.

110

111 In this regard, of course, are important works of CH. L. Montesquieu, in particular, significant in his creation work "On the spirit of laws", in which he justifies the value of empirical and social methods of legal research, has made a significant contribution to the definition of the subject of comparative law, as well as in the identification of evaluation criteria of objective, taking place in the global political-legal environment converging-divergence processes, and not "in

111 general", at the level of some scientific and philosophical abstractions, but in relation to specific (and contemporary)  
112 states.

113 Montesquieu took into account "the nature of things" in the study of state legal institutions and structures arising  
114 from certain nations in a certain historical era, he noted the necessity of taking into account many climatic and cultural  
115 factors that affect various legal and political reception, determining the principles of interaction of national legal systems.  
116 He very carefully approached the analysis of the specifics of state-legal reality of different nations - Roman, Greek,  
117 French, African, Persian, English, Chinese and others.

118 In General, W. L. Montesquieu created an original context field for not only theoretical, but also practical  
119 understanding of the legal processes of convergence and divergence, as well as their results.

120 For example, he notes that "thanks to the Italian scientist the right of Justinian penetrated into France, where  
121 previously only the Code of Theodosius is known, as the laws of Justinian were drawn up after the settlement of the  
122 barbarians in Gaul. This law was met with some opposition; however, it was held contrary to the exclusions of the Popes,  
123 patronized their canons. The St. Louis tried to spread respect for him with the help of made in his possession translation  
124 of the books of Justinian..." (Ch.L. Montesquieu, <http://www.livelib.ru/work/1000460404>, 2011).

125 It is important that Ch. L. Montesquieu drew attention and showed clearly that the functional convergence of law  
126 (as well as political systems) is dialectical and includes regulatory, innovative, instrumental (varies tools of legal practice),  
127 communicative (creates new legal conditions of interaction of subjects of legal relations), prognostic features, however, at  
128 the same time converging processes can be of destabilizing and contentious character, i.e. adversely affect prevailing in  
129 a particular state and society the mechanism of maintaining the legal order and the preservation of the rule of law.

130 G.V.F. Hegel, obviously, did not in see motion, convergence of different national legal systems important to create,  
131 for example, a single Western legal space of expressions regarding changing (in his eyes) of the European world.  
132 Although, some converging legal aspect he saw in colonization, the main problem of which, in his opinion, was to  
133 underestimate the importance of full integration of the legal space of colonies and the mother countries. In particular, he  
134 wrote: "In the modern time the colonies were not given the same rights as the population of the metropolis; it has led to  
135 wars and in the end to the independence of the colonies, as evidenced by the history of the English and Spanish  
136 colonies" (G.V.F. Hegel, <http://psylib.ukrweb.net/books/gegel03/index.htm>, 2013).

#### 137 138 2.4 Convergence in Western doctrinal-legal state of XX century

139  
140 Generally, in the Western world of the twentieth century has developed a wide range of views on the nature and limits of  
141 political-legal and socio-economic convergence: from attempts to justify the inevitability of "assimilation" by capitalism the  
142 socialist countries, which must inevitably follow after the development of market economy, the democratization of the  
143 legal and political life, the liberalization of state legal regimes and subsequent rejection of ideological confrontation, to  
144 judgments based on some interpretation of the objective changes (O. Kononova and Z. Yakimova, 2013), taking place in  
145 both the political and legal systems (for example, the development of institutions of state-monopoly regulation and  
146 planning of socio-economic life in several Western states, a joint decision of the socialist and capitalist states of a number  
147 of important human tasks, and so on).

148 In this respect, is not a coincidence that at about the same time, among some representatives of Western legal and  
149 political science the idea of "negative convergence" is spreading (Marcuse, G., Habermas Y. and others), according to  
150 which both socio-economic and politico-legal systems master from each other not so much positive as negative elements.  
151 (L. Kirsanova and O. Korotina, 2014).

### 152 153 3. Methods and Materials

154  
155 Namely in XX the issues of convergence and divergence of legal systems get a new theoretical and methodological  
156 sound that largely is associated with increasing trends of convergence of the Romano-Germanic and Anglo-Saxon legal  
157 families, the convergence of which (in addition to the above situational pragmatic-utilitarian reasons), no doubt, is  
158 connected with the General history of the Protestant-Catholic Christian culture, relative proximity (while saving some  
159 logico-structural differences) of legal thinking, legal philosophy and basic ethical and legal values of legal practices,  
160 political ideologies in Western European and North American States, etc.

161 During this period it is possible to speak about the origin, mainly in Western legal and political discourses of  
162 several *methodological directions* of comprehension of the phenomenon of convergence of law:

- 163 1) systemic-functional;
- 164 2) cultural-anthropological;



165 3) political.

166 Namely these directions focus the attention of researchers on *legal-doctrine*, *legal-practical* (including the content  
167 and form of legal policy), *state ideology* and *legal-cultural* aspects of the problem.

#### 169 4. Results and Discussions

170 Of particular interest in theoretical and in practical terms are mixed legal systems, a study of which is conducted in the  
171 framework of the theory of legal convergence and has a high level of complexity due to inevitable involvement of a wide  
172 range of very different (in fact legal, and political and social) factors.

173 In this case, fully justified is the fact that Western scholars, first of all, conduct a comprehensive analysis of such  
174 categories as "mixed legal system" and "mixed jurisdiction". Thus, W. Tetly proposes to use the concept of "mixed  
175 jurisdiction" to mean "the country or territorial unit with mixed legal system" (W. Tetly, 2012).

176 Generally, in modern Western legal literature, these concepts are often used interchangeably, and "mixed" refers  
177 to such a legal system in which the elements characteristic of different legal families, systems, traditions are *absent* or are  
178 mixed in a special way. In the framework of the theory of convergence namely mixed legal system, on the one hand, are  
179 the result of a convergence of different (relatives or not) legal worlds, and on the other, create the necessary framework,  
180 socio-legal preconditions for escalation of converging processes (not only in legal but also in the economic, political and  
181 cultural spheres of life).

182 As for the relationship between the concepts of "mixed legal system" and "mixed jurisdiction" in Western European  
183 and American literature have already gathered sufficient number of "doctrinal" material to the present time, because the  
184 conceptualization of this issue takes place already at the turn of XIX-XX centuries. In particular, F. P. Welton offers the  
185 following definition: "Mixed jurisdiction is a legal system in which the Romano-Germanic tradition was filled to some extent  
186 with Anglo-American law" (W. Tetly, 2012). Much later, Evans-Jones R believes that the mixed legal system "to some  
187 extent demonstrates the characteristic features of both civil continental and English general law traditions" (Evans-Jones  
188 R., 2008).

189 Modern English comparatist Palmer V.V. in "Mixed jurisdictions worldwide: the third legal family" uses the category  
190 of "mixed jurisdiction" with the same meaning, namely the jurisdiction in which the common and civil law are the main  
191 components of legal doctrine" (V.V. Palmer, 2011). On the basis of this approach, as a rule, such mixed legal systems, as  
192 South Africa, Scotland, Louisiana, Quebec, the Philippines, Israel and other are distinguishing.

193 It should be noted that these (and many others) definitions, in general, are very indicative for the traditional  
194 European understanding of mixed legal systems: in Western comparativistics the main focus has for a long time been  
195 done specifically on the result of the convergence of the Romano-Germanic right tradition and Anglo-American law, on  
196 the combination of their elements, which of course corresponds to objectively caused vector of development of political  
197 and legal processes in the second half of the XX century, however, the theoretical-methodological and practical positions  
198 does not correspond to the real situation and should be substantially revised.

199 In relation to the process of convergence of the Romano-Germanic and Anglo-Saxon law M. Marchenko proposes  
200 several groups of factors contributing, or vice versa, preventing their convergence.

201 So, as the *primary factors* of convergence of the Romano-Germanic and Anglo-Saxon law, should be considered  
202 "all that common - in the form of similar economics, social and political structure of society, the same type of machinery of  
203 government, legal culture, and other similar in nature and in potential orientation of the components, that unites these  
204 legal families" [9].

205 As primary factors, hindering the convergence of the Romano-Germanic and Anglo-Saxon law, it is necessary to  
206 identify and consider all that special - in the form of historical and national traditions, customs, peculiar to each legal  
207 family, and others similar in nature phenomena, institutions and establishments, - that separates the given legal family.

208 In general, the primary factors are the basis, which do not only determine the nature, internal structure and content  
209 of each of the two legal families, but also determines the nature and tendencies of development of relations between  
210 them, i.e., includes a specific evolutionary-functional component.

211 Secondary factors, of course, are derived from primary, express, or rather "reflect inherent in the Romano-  
212 Germanic and Anglo-Saxon legal families of the underlying potential and trends, as to their convergence and divergence.

213 Among the secondary factors - elements that contribute to the convergence of the legal families - should be  
214 allocated primarily those that occur at the regional level, the relationship and interaction of the Romano-Germanic and  
215 Anglo-Saxon law" (M. Marchenko, [http://ukr-pravo.at.ua/Materialy/biblioteka/Evropeskoe/marchenko\\_m\\_deryabina\\_e\\_](http://ukr-pravo.at.ua/Materialy/biblioteka/Evropeskoe/marchenko_m_deryabina_e_pravo_evropeyskogo_soyuza_voprosy_is.pdf)  
216 [pravo\\_evropeyskogo\\_soyuza\\_voprosy\\_is.pdf](http://ukr-pravo.at.ua/Materialy/biblioteka/Evropeskoe/marchenko_m_deryabina_e_pravo_evropeyskogo_soyuza_voprosy_is.pdf), 2007).

217 Of course, the secondary factors that contribute to the convergence of these legal families, being in close  
218

219 connection with the primary factors, in particular are observed also at the global level (on the level of legal families) and at  
220 the local level (in relation to specific national legal systems). For example, in the legal system of the USA, where the legal  
221 system of Louisiana, being in nature and character of the Romano-Germanic phenomenon, is in direct connection with  
222 the Anglo-Saxon legal world.

223 Most clearly the nature of the impact of secondary factors contributing to the convergence of the Romano-  
224 Germanic and Anglo-Saxon law, as these factors themselves, are manifested at the regional level, in particular at the  
225 level of the European Union.

226 J. Beatson believes that soon after the accession of the UK to the European Union "The English law is increasingly  
227 began to resemble the European continental law, law of the European Union" (J. Beatson, 2010). Moreover, in his  
228 opinion, the influence of continental European law on English common law in the course of time does not only weaken,  
229 but on the contrary, even more increases as its development and improvement, as evidenced, in particular, numerous  
230 decisions of several institutions of the European Union, "coming from the traditions of the Romano-Germanic civil law"  
231 and directly related to British common law.

232 In general, at expansion of the legal regulation, which is implemented through the help of norms of the acts of the  
233 institutions of the European Union, the process of "Europeanization" of English law, the process of "infiltration" and  
234 adaptation of many of the norms and institutions of the European (continental) law in Anglo-Saxon (common) law are  
235 increasingly growing. (J. Beatson, 2010).

236 As a result, and under the influence of some other factors, according to some researchers, "English law is  
237 gradually becoming less English" (R. Cooke, 2008) in both practical and theoretical point of view. This meant, in  
238 particular, the fact that British membership in the European Union increasingly has an impact not only on law-making and  
239 enforcement activities of the relevant English authorities, but also on the traditional view of the English legal  
240 establishment, in particular, about the constitutional and municipal law. (V. Bogнар, 2006).

241 Of great importance, among the factors contributing to the convergence of the Romano-Germanic and Anglo-  
242 Saxon law in the Western, mainly American literature, is such phenomenon, as Americanization, or reception of  
243 American, general in nature, rights in European continental law (W. Wiegand, 1991).

244 "Calling the reception of American law his great influence after the Second World War on European law, and in  
245 some cases, also on the right of other regions of the world, the authors with excessive exaggeration of the significance  
246 of this phenomenon, spend even some parallels between American reception and reception of Roman law" (M. Marchenko,  
247 [http://ukr-  
248 pravo.at.ua/Materialy/biblioteka/Evropayskoe/marchenko\\_m\\_deryabina\\_e\\_pravo\\_evropayskogo\\_soyuza\\_voprosy\\_is.pdf](http://ukr-pravo.at.ua/Materialy/biblioteka/Evropayskoe/marchenko_m_deryabina_e_pravo_evropayskogo_soyuza_voprosy_is.pdf),  
249 2007).

250 Overly exaggerating the influence of American law in the European in post-war, and even more in subsequent  
251 periods and without any reason, equating the "Americanization" of European law to the reception of Roman law,  
252 researchers, however, are right that the common law, represented by the American legal system has had a certain  
253 influence on the Romano-Germanic civil law.

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## 255 5. Conclusion

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257 The convergence of law is polivector process of rapprochement and interpenetration of the individual components of  
258 different national legal systems on the basis of the global socio-cultural, political and economic factors, the universal legal  
259 principles and standards, as well as the specifics of their implementation in domestic legal relations, the result of which is  
260 the internationalization and harmonization of the legal regulation of public relations.

261 The main converging risks at present are followings: a) approval of necessity of borrowing, by different civilizational  
262 nature states of legal institutions, ideals and images of Western civilization as a means of "saving" the world and  
263 overcome dangerous threats; b) the leveling of differences between national legal systems, which leads to narrowing and  
264 gradual elimination of own socio-cultural and spiritual foundations, to rejection of the principles of multiculturalism and  
265 pluralism in the public law sphere, and as a result - to protracted legal anomie; c) increasing trends of abolition of national  
266 sovereign states, the nature and function of which cease to be incurred (implemented) and operating within the national  
267 legal system of international legal subsystem and the challenges of the new world order".

268 The "mixed legal system" and "mixed jurisdiction" categories relate to each other as a whole and part, since the  
269 latter reflects predominantly publicly-power component of the national legal system, the specifics of the exercise of  
270 judicial power, the totality of the powers of other government structures for the resolution of various legal conflicts and  
271 cases of violations in a particular area, whereas under mixed should be understood the legal system, including a wide  
272 range of items specific to the different legal and political traditions, coexisting and interacting in a single mechanism of

273 legal regulation of social relations.

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# The Concept and Properties of the Economic Form of Time in Terms of General Scientific Conceptions

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## Abstract

*The aim of this work is to systematize the concepts of the economic form of time in the context of general scientific concepts and to identify its specific properties. The study proposed a general scientific conceptual system of the unity of time concepts, which is reflected in the aggregate of concepts and specific properties of its economic form and causes the study of economic time as interdisciplinary scientific category.*

**Keywords:** time, general scientific concept of time, economic times, methodology, economic theory, synergetic.

## 1. Introduction

Time in the economy - is a special economic category, which reflects the diversity of types of human transformative activity and time of relations inherent in economic activity. Complexity and contradictory of the nature of economic time is reflected in the general scientific concepts of time and should be taken into account in the analysis of the evolution processes of the economic system, forming an adequate for the reality methodology of economic theory.

Modern economic theory has no unified methodology for the study of economic time, which allows to reveal the mechanism of economic self-organization, and to synthesize the ideas of different general scientific areas. Searching for paradigms allows us to reduce the heritage of scientific knowledge to a single whole; it leads to the need to put the economic time and its unique properties at the center of the study of the processes of self-organization of the economic system.

Multivariant and multilayer character of events development, the complex interlacing layering of the variety of processes, inconsistency and asynchronous of changes will inevitably lead to an increased tension and instability in the development of the socio-economic system and the society as a whole. The more complex are social and economic processes of society, the more vital is the need to study the time as the best candidate for coordinating communication between the different elements, parts and subsystems in the mechanism of self-organization of the economic system.

## 2. Analysis of the Current State of Studying the Problem of Time in Economics

The economic theory has not yet considered time as an object of research. The formulation of the problem of time extended beyond the boundaries of the objective field of economic knowledge. Studies of the essential aspect of time, its nature are not widely known in the economic theory, which is explained by the philosophical and natural scientific context of the problem

At the same time, the development of scientific approaches to the study of time in philosophy and natural sciences has traditionally set the direction of development of the methodology of economics. Until recently, reflecting the indifference of classical science to the time, the history of economic knowledge is represented by the change of learning, the basic positions of which were changed and supplemented, inheriting the concepts of time as a homogeneous duration and a parameter of quantitative changes that characterize the economic activities of man and the society. This limited attitude to the time was built into the foundations of modern economic theory by such outstanding representatives of various directions as Adam Smith [12], Ricardo [Ricardo, 1955], Marx [Marx, 1983, Marx and Engels, 1955-1981] A. Marshall [ Marshall , 1993] J. Keynes [Keynes, 1978] M. Friedman [Friedman, 1957], and others.

The relational view of the dependence of time on the properties and structural organization of a particular matter led in the XX century to the birth of the concept of multiplicity of time that carried out the raising of the problem about the diversity of time forms, including the economic ones. Thus, the practical study of biological time is associated with the

56 names of such scientists as T. Detlaf [Detlaf 2001], G. Backman [Backman et al., 1943], K. Thornthwaite [Thornthwaite  
57 1953] et al. The study of sociological form of time can be found in such works as ZH. Gurvitch [Gurvitch, 1958], Sorokin  
58 and R. Merton [P. Sorokin and RK Merton, 2004, Klineberga S. and T. Cottle [Cottle and Klineberg, 1974], and others.  
59 Historical time is being analyzed in the works of Fernand Braudel [Braudel, 1958], Toynbee [Toynbee, 1996] and others.  
60 Psychological aspects of the development and activities of the individual during life are presented in the works of SL  
61 Rubinstein [Rubinstein, 1946], KA Abulkhanova-Slavskaya [Abulkhanova-Slavskaya 1990] and others

62 20-30-ies of XX century are connected with the creation and rapid development of many theories of cycles and  
63 fluctuations in the works of such eminent scientists as ND Kondratiev [Kondratyev, 2002], Joseph Schumpeter [  
64 Schumpeter, 2007], O. Toffler [Toffler, 2008, 2010], Immanuel Wallerstein [Wallerstein 1998], E. Hansen [Hansen, 1997]  
65 R. Lucas [Lucas, 1976], F. Kydland and E. Prescott [Kydland and Prescott, 1982], and many others who have  
66 demonstrated the priority of relational-dynamic views on an irreversible and heterogeneous nature of time, came to the  
67 recognition of the time factor affecting the formation of a qualitatively different stages and phases of the development of  
68 economic system by the economists.

69 The most profound and multifaceted study of time in the modern economic science was due to institutionalism that  
70 arose in the early XX century as a synthesis of economics, psychology, and biology. In the works of such bright its  
71 representatives as D. Nort [Nort 1997], Veblen [Veblen, 1984] and others, economic time acts not just as a certain period  
72 of economic dynamics (short, medium or long-term), but as a subjective factor in the formation of social and  
73 psychological foundation of the society - institutions or practices, habits and rules that define not the rational economic  
74 behavior of a person or a group of people. Institutionalism characterizes long evolution of the economic system, when  
75 there are multiple random and irreversible changes in its institutional and technological structure.

76 In the second half of the XX century a substantial modernization of the ideas of neoclassical direction about the  
77 behavior of the participants of the economic activity appeared due to the writings of such scientists as G. Becker [Becker,  
78 1996], Dzh. Mincer [Mincer, 1963], E. Dean [Dean, 1963], J. Owen [Owen, 1964] and others, who firstly investigated the  
79 problem of distribution and effective use of economic time as a scarce resource that has a value.

80 The end of XX century is associated with the development of evolutionary economics, which is an application of  
81 the ideas of biological evolution to the dynamic analysis of nonlinear and stochastic economic processes. The founders of  
82 evolutionary economics: T. Veblen [Veblen 1984] Y. Shumpeter [Schumpeter, 2007], R. Nelson, S. Winter [Nelson and  
83 Winter, 2000] and others, have developed a methodology, based on the account of the majority of general scientific  
84 notions of time, allowing to develop a universal mechanism of the evolution of the economic system based on the  
85 processes of heredity, selection and adaptation of its elements; to conduct a microeconomic analysis of changes in the  
86 behavior of economic agents; not excluding short-term equilibrium in the system, to focus on non-equilibrium states and  
87 qualitative changes in the evolution of the system.

88 Since the second half of the twentieth century to the present, there has been a rapid development of one of the  
89 main directions of evolutionary theory - Synergetic - a science, that deals with the mechanism of self-organizing of any  
90 system as a work of a complex and open body, developing due to its ability under the impact of irreversible and  
91 multivariate time to make a qualitative transition to a new more sophisticated level of development. As time is the object  
92 of study of many sciences, each of which generates its own concept of time, it is synergy and its methodological  
93 principles that allow us to consider economic time in the manifold of manifestations of economic reality as an integral part  
94 of the surrounding world.

95 Methodological studies of the evolutionary nature of the economic system are carried out in the conceptual  
96 framework of synergy, in particular, one of its areas in the social sciences - synergetic economy. General laws of self-  
97 organization of the economic systems within the synergetic economy, where the main source of evolution is  
98 disequilibrium, instability, non-linearity and irreversibility as the basic properties of time, can be found in the works of  
99 Haken [Haken, 1980], W.-B. Zhang [Zhang, 1999].

100 Among the representatives of national economic science who have devoted their works to the study of various  
101 aspects of economic time, it is necessary to allocate such modern scientists as V.I. Majewski [Majewski, 2000, 2010],  
102 S.Y. Malkov [Majewski and Malkov, 2014], E.V. Balatsky [Balatskiy, 1999], V.V. Biryukov [Biryukov, 2000], A.D.  
103 Levanov [Levanov, 1994], A.I. Baskin [Baskin, 2006], E.L. Tolokina [Tolokina, 2012], V.V. Demin [Demin, 2011] and  
104 others.

105 The control function of the economic time, which is the basis of the cost and value indicators of the economy, has  
106 been proven in theory of switch modes of reproduction of the main capital of V.I. Majewski. The joint idea of V.I. Majewski  
107 and S.Y. Malkov about an open-closed nature of the economy gives an idea of the time as a natural mechanism that  
108 provides two forms of commodity flows in the switching mode of reproduction: circular and linear.

109 One of the first studies in the national science devoted to systems analysis of time and its functional role in the

economy, are the works of V.V. Biryukov, where time is considered as a space of the development of the economic system, A.D. Levanov, who focuses on the value aspects of time in microeconomics and Al Baskin, who studied time as an economic resource of postindustrial society.

Proceedings of E.V. Balatsky, E.L. Tolokina, V.V. Demina and others are devoted to theoretical and methodological aspects of the study of free time. So, E.V. Balatsky proves the ability of free time to affect the economy, acting as a factor of its equilibrium, but E.L. Tolokina and V.V. Demina consider the category of work time as the basis of the law of value, and the category of free time as a goal of social production.

With the variety of theories and approaches there is a limited number of works devoted to a complex research of multiple manifestations of economic time as an interdisciplinary scientific category on the basis of methodological principles of synergy, generalizing general scientific concepts of time and allowing the penetrate into the essence of the extremely complex and dynamic processes of self-organization of the economic system.

With the variety of theories and approaches there is a limited number of works devoted to a complex research of multiple manifestations of economic time as an interdisciplinary scientific category, on the basis of methodological principles of synergy, reflecting the views of general scientific concepts of time and allowing the penetrate into the essence of the extremely complex and dynamic processes of evolution of the economic system.

### 3. General Scientific Concepts of Time as the Basis of Interdisciplinary Approach

Until recently, science has not considered time as an object of research because of the complexity of its nature. We only integrated time into a simple form for the science. However, since the 70-80's of the twentieth century, this became unacceptable for the scientists themselves, which can be noticed in the change of views on the current methodologies of science, in the understanding of the need to combine different disciplines to study such phenomenon, as the time, which goes beyond the boundaries of particular science.

In this regard, we believe that the first step towards the integration of the existing sciences on the basis of mutual understanding and cooperation to achieve a common objective - studying of time, is not so much to reveal its nature and essence, but to define the general notions of time in the frameworks of the existing concepts.

Obviously, the most profound ideas about the essence and nature of time firstly belong to theologians and philosophers, who in their thinking, intuitively based on the ratio of time and consciousness, guided by philosophical approaches. This led to the formation of two general scientific concepts of time: objectivist and subjectivist. The first one, in turn, includes the substantial and relational theory.

Conceptual ideas of time in the subjectivist and objectivist conceptions are significantly different, which indicates its contradictory nature and heterogeneous structure. According to the subjectivist conception, time - is an elusive essence, comprehend due to human's sensory perception. According to the objectivist conception, time - is an objective reality, which is independent of the mind of the subject. This view is reflected in two opposing statements: in the substantial direction, time - is self-contained matter, independent of the nature and space; relational direction defines time as an inalienable property of the material body, which characterizes its movement and change.

Contradictions in the mentioned above approaches, to identify the nature and essence of time, caused the emergence of problems of relations between the categories of time and variability, or problems of reversibility of time, for the solution of which the static and dynamic concepts were used.

Static concept, based on the substantial approach and classical mechanics, did not take into account the serial passage of time, expressed in the change of the past, present and future. Indifferent attitude to the formation processes of this concept has led to the formation of the idea of the existence of universal physical laws, which are actual in all times, ideas of the absence of the passage of time, of the possibility of principle reversible of the processes in time. This provided an opportunity to consider any no simultaneous events or process as the present moment of time and to measure them quantitatively.

In a dynamic concept that has arisen on the basis of the relational approach and the theory of relativity, there is a clear distinction: past has realized and transformed into present, present is based on the past and it exists here and now, and the future, arising from the past and the present, will only be existing. Strict sequence of events in the same direction "past-present-future" is due to the action of the law of causality of relations, and determines the irreversibility of time, when each event or process changes over time and qualitatively transforms. The last statement also allows you to classify the dynamic concept as a successor and subjective view of time, since all the qualitative changes in the chain of the past, present and future are sensually perceived and analyzed by the subject.

Despite the diversity of opinions, it is possible to make a general conclusion that opposite in their perceptions of time, objectivist substantial and relational, subjectivist, as well as static and relational concepts, have a common ground

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that can be expressed in the following statements:

1. Time - is the only universal natural phenomenon, which is the basis of any processes occurring in nature and society;
2. Time provides communication between different processes, while maintaining the integrity of the system.
3. Time is the bearer of changes and is capable to measure these changes.

The relational view of the dependence of time on the properties and structural organization of a particular matter led to the birth of a new concept, assuming the existence of a special internal time in every form of matter - the concept of multiplicity of time. In addition, the basis for the formation of the main ideas of this concept is also the subjectivist philosophy, in which each individual subject as a psychosocial biological system, has its own time-feeling, it exists and operates in different space-time coordinates. Thus, the concept of multiplicity of time, partly combining objectivist and subjectivist general scientific concepts of time, considers time as an essential attribute and objective determination of the existence of living and nonliving systems, each of which has a specific time, which reflects its quantitative and qualitative changes. In this interpretation, time is universal in terms of quantitative measurement and the possibility of synchronization and coordination of various events in the system, and is relative in terms of the quantitative changes in the status of various system objects.

The concept of multiplicity of time, taking into account the ambiguity of interpretations of the essence and nature of time in the above concepts, and absorbing their basic regulations, determines time and as an objective definition of being, and as a parameter to measure the quantitative and qualitative changes, and as a subjective entity, which reflects the specificity of biophysical, psychological and social organizations of human, and most importantly - as irreversible condition of the evolution of any system. Multiplicity of times is due to the fact that each area of the material and immaterial reality is different in its specific feature of time properties, which cannot be described only in terms of common astronomical time. According to I.R.Prigozhin: "Unavoidable multiplicity of points of view on the same reality means the impossibility of the existence of a divine point of view, which overlooks the whole reality" [Prigogine and Stengers, 1986, p. 358].

Plurality of own times of any system generates in science an idea of its inhomogeneous structure, which had an opportunity to spread thanks to a new interdisciplinary science - synergy, in the context of it time has a heterogeneous structure, where along with the concept of external time, there is a concept of internal time of the system, which is related to the character of the processes occurring in it. One of the pioneers of the concept of "internal time" of human consciousness is the French philosopher Henri Bergson (1851-1941). He believes that the bearer of continuous internal time or "pure duration" is human: « Pure duration is a form that is accepted by the sequence of our states of consciousness, when our" I "simply just lives, when it does not establish differences between the current state, and those which preceded it ... "[Bergson, 1992, p. 93]. As time of outside world while he considers the time of human environment. Bergson also talks about two forms of time: into the multiple periods of time - "time-quality", and into the multiple number of continuous length - "time-quantity": "If we distinguish two forms of multiplicity, two forms of duration, it is obvious that every state of consciousness, taken separately, should be manifested in different ways, depending on whether we will consider it in a separate multiplicity or within a combined multiplicity - in the time-quality, where it appears, or in the time-quantity, where it is projected. ... Sensations and tastes appear to me in the form of things, as soon as I isolate them and give them names ... "[Bergson, 1992, p. 105-106]. The presence of internal and external, quantitative and qualitative time results in the formation of the idea of non-uniform structure of time and the multiplicity of its forms.

4. The system of ideas about the economic time from the standpoint of general scientific concepts The aforementioned general scientific concepts of time are the basis for determining the set of concepts and identifying the properties that are common for different forms of its manifestation. Let us unite the general scientific conceptual notions of time and the resulting properties in table 1.

**Table 1 - The system of concepts and properties of time in general scientific concepts \***

The concept of time	The notion of time	The properties of time
Subjectivist	Time-feeling; a form of human perception and cognition; is objective and does not exist outside of man; is perceived as a sequence of memorable events, the rate and duration of which is measured subjectively.	Subjectively, subtle
Subjectivist: substantial	Time-substance; exists independently from matter; outer scale for measuring changes.	Objectively, completely, reversible, homogeneous, equally
relational	Time-report; system of relations; exists as an attribute of matter; a standard for measuring quantitative changes, an internal indicator of qualitative changes.	Objectively, relatively, irreversibly, homogeneous, equally

static	Time-existence; the absence of flow and direction of time; the possibility of fixing any moment and measurement of interval duration.	Universally, completely, reversibly, homogeneous, equally
dynamic	Time-formation; linear order of sequences of events; indicator of qualitative changes.	Subjectively, relatively, irreversibly, heterogeneous, unevenly
The concept of multiplicity of forms	Time-multiplicity; a proper time for each level of organization of matter; incommensurability of different times.	Subjectively, relatively, irreversibly, heterogeneous, unevenly, multidimensional.

\*Compiled by the author

Notions and properties of time in the mentioned concepts demonstrate a unity system of opposite characteristics of time formed over several millennia of human thought and society development and society. That is, we start from the position that all general scientific approaches by studying the category of time based on various forms of its manifestation in the mind, matter, volatility, etc., do not oppose, but complement each other. In this case, time being as a complex scientific category, is considered as a contradictory unity of general scientific concepts and properties: the essence and feeling, which correspond to the properties of universality and uniqueness; substances and communiq es, which are characterized by absoluteness and relativity; existence and formation with the properties of reversibility and irreversibility; multiplicity, generating properties of a multidimensionality and the idea of the existence of local and global times, whose principle irreducibility is manifested in the property of latency.

Thus, the economic time can be considered as the result of interaction and transformation of various economic and other processes, defined by the laws and specifics of motion of the economic system. Such an understanding of economic time allows presenting it as an economic category, which objectively reflects and summarizes the economic reality, which characterizes complex relationships of economy with natural physical world, society, human in the context of past, present and future.

Complex and contradictory nature of time and its properties eliminates the need for highlighting economic time in relation to other specific forms. On the contrary, we must reveal the specific of concepts of the economic time, depending on the interaction and merging with other forms, which reflect the natural physiological, social, personal and biological links of the economic system: astronomical, social, historical, psychological and biological. These forms are well known in science and reflect the characteristics of temporal organization of the system that corresponds to the sphere of knowledge. However, in terms of the unity of opposite characteristics of time, we believe that various conflicting manifestations of economic time are results of its synthesis with the above mentioned forms (Table 2).

**Table 2 -** The system of ideas about the economic time from the standpoint of general scientific concepts\*

Forms of time Results of synthesis	Astronomical	Social	Historical	Psychological	Biological
Conceptions of the economic form of time	Time-essence, time-substance, time-existence: Metrized duration (intervals of time) , parameter of quantitative changes (speed, rhythm, amplitude)	communiq�e: a qualitative indicator of the level of life and well-being of the society	Time-formation: the order of the sequence of events	Time-feeling and time-multiplicity: measure of the personal time of the individual, a measure of the immersion of the human's psyche in the economic activity	communiq�e: limited-refundable resource, value
measurement Scale	Astronomical units: seconds, minutes, hours, days, etc.	Socio-economic units: absolute and relative	Chronological units - small and large duration events	Subjective units of distribution of the "budget" of lifetime	Economic units of efficiency and productivity of use
Properties in accordance with general scientific concepts	Universally, objectively, completely, reversible, homogeneous, equally	Uniquely, objectively, relatively, irreversibly, homogeneous, equally	Uniquely, subjectively, relatively, irreversibly, heterogeneous, unevenly	Uniquely, Subjectively, subtle Relatively, irreversibly, heterogeneous Nonlinear, multidimensional.	Uniquely, objectively-subjectively, relatively, irreversibly, heterogeneous multidimensional.

\*Compiled by the author

Manifestations of the economic form of time relations are diverse, which is due to the difference in the results of their interaction with the attendant (complementary) forms of time organization of the economic system. In general, this leads to a multiplicity of describing and measuring of the economic time, and allows us to interpret it as coexistence with



241 astronomical, social, historical, psychological and biological forms.

242 The study of economic reality is inseparable from the coexisting with it, natural, social, and personal systems forms  
243 in economics a multiple notion of economic time. Changing the meaningful cover in the transition from one count system  
244 to another, economic time gets a series of specific properties while retaining common ones, defined by general scientific  
245 concepts (Table 3).  
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247 **Table 3 - Conceptions of economic time and its specific properties \***  
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Conceptions of the economic time	The specific properties of economic time
Dynamic parameter of quantitative changes in the economic system	Asymmetry as a mismatch of the duration and speed of economic processes
Qualitative indicator of the level of development of the economic system and its components	Non-linearity as a multiplicity of non-additive elements of the economic system, different in metric and topological characteristics Multidimensionality as a manifestation of multiple forms and inhomogeneous structure of time
Factors of the formation and evolution of the economic system	Unidirectionality as a sequence and order of economic events Irreversibility as inability to return to the original state of the economic system and its elements Controllability as an opportunity to the implementation of influence on the time parameters of the economic system and its elements in order to move to a qualitatively higher level of development
Regulator of economic ties and relations	Synchronous / asynchronous as matching / non-matching in the direction, speed, frequency, rhythm, etc, various economic processes (events)
Limited non-renewable resource	Value as an indicator of the effectiveness of the use of time units in the implementation of economic processes

\*Compiled by the author

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251 As a result of the synthesis of economical and astronomical forms of time the idea of time as a universal parameter of  
252 quantitative changes in the system are born. At the merger with the social form, the economic time is converted into the  
253 index of qualitative changes in the socio-economic relations and relationships of the society, and in conjunction with  
254 the historical time - into the factor of the formation and development of the economic system, whose complex causal  
255 relationships get reflected in the temporal parameters. In the transition to a psychological form of time, there is a  
256 subjective "timing" of the economy, and the economic time acts as a regulator of economic behavior of the subjects. In  
257 the co-existence with the biological form, the economic time - is a unique irreplaceable resource, and because of its  
258 limitedness, economic entities seek to get the greatest results in time saving.

259 The variety of the manifestations of the economic time during the interaction with complementary forms reveals a  
260 number of its specific properties: asymmetry, nonlinearity, multidimensionality, unidirectionality, irreversibility,  
261 manageability, synchrony / synchronicity and value.

262 Acting as a parameter of the duration and rate of changes in the processes the economic times is characterized by  
263 asymmetry - the length and speed of the processes does not match. Being invariable in the same coordinate system,  
264 relatively to another economic system, the economic time can accelerate or decelerate: private processes of the  
265 economic system are implemented relative to each other and the system itself at different rates and duration, as well as  
266 the proper time of the system, differently from the time of the external environment. Such discrepancy of rhythms,  
267 tempos, time duration of different processes leads to instability situations, manifested in cyclical fluctuations of the  
268 economic system.

269 Economic time as an indicator of the level of socio-economic development of the system is expressed in the  
270 properties of nonlinearity and multidimensionality. On the content, the non-linearity is characterized by different direction,  
271 duration, tempo, the frequency of many private processes that are parts of a single system process. Multidimensionality  
272 of the economic time is reflected in the fact that along with the internal economic time of the system, an individual time of  
273 the economic subject is allocated.

274 The time of the economy as a factor of its development and evolution has the property of ordering or  
275 unidirectionality, which is used to identify the qualitative cause-effect relationships in the economic system. For example,  
276 the economic time of cyclical fluctuations, which is characterized by the "repeat" of various stages of system  
277 development, supposes a series of processes that occur due to social, political, economic, environmental and other  
278 reasons.

Invariable sequence of events means that there is a difference between the past, present and future state of the system, which leads to the formation of the most important property - the irreversible of the economic time of the processes and the system in general. This property allows us to assert the impossibility of a return to a certain initial situation in the economy. In terms of synergy, irreversibility of the process leads to a dual result: to the formation of order or disorder in the system. Both of these conditions are integral parts of the evolutionary process. According to I. Prigogine, in a complex no equilibrium dynamical system, order is the least probable state, and disorder - is the most probable state. The last one is the source of a concerted action of many elements, and their collective behavior, which allows the system to make self-organization - a transition to a higher stage of development. The process of self-organization of the system is associated with time (duration) of destructions, required to achieve a better level of organization of the system: the more prolonged and intensive is the chaos, the deeper is the transformation of the system, and vice versa: a short-term disorder leads to slight transformations of the system. Thus, the economic time of the system has a very important property - controllability, both from the time itself, and from the time of self-organizing of the system. Changing time parameters of the system, namely- the intensity of the processes of interaction of the elements, it is possible to initiate a process of controlling the system and to move to a new, more sophisticated level of development [ Rezhabek 1991 ].

The presentation of the economic times as a regulator of economic ties and relations reveals a specific property, which is no less important for the study of self-organization of the economic system - synchrony or asynchrony of time. The principle of synchrony, the essence of which is the coincidence of events separated in time and space, was firstly described by the eminent psychologist and philosopher CG Jung [Jung, 1997], who contrasted this phenomenon with the linear principle of causality, which is widely used in scientific researches.

Synchrony / asynchrony of the economic time manifests in its ability to provide / disrupt time correspondence in the flow of certain economic processes and its particular parts. Time correspondence means the ensuring of consistency and parallelism of economic events or processes. The most common way to synchronize various processes through time - is to establish a single count system in astronomical units, a single mode of labor and the work of technical means etc.

Various degrees of time synchronization is reflected in the cyclical fluctuations of the economic system: during the period of lifting and qualitative leap to a higher level of development, growth of production is synchronized, as well as the consumption, employment, money supply, etc., and one of the causes of the crisis is the asynchrony of the listed processes.

The last notion of the economic time as a unique limited and non-renewable resource reveals the key property of time for the economic study - value. Value of the economic time is determined by its costs, or more precisely - by the intensity or productivity of its use, when it is necessary to have time to make more actions in the time unit (get more products).

Within the frameworks of the economic laws, the misspent time is inefficient - it will not bring the expected returns in the future. These new behavior principles are formulated in the XVIII century by Benjamin Franklin: "the one who could earn ten shillings daily, but he walks or lazy at home half-day, should - if he spends on himself only six pence - to take into account not only this consumption, but he should think that he has spent or rather, moreover threw away five shillings » [Weber, 1990, p. 71].

Money is the reflecting of the effectiveness of the spent time in conjunction with its usefulness in the economic system. There is a close relationship between money, expressing the exchange value of the goods and time, because through money that embodies the value of goods in the exchange, the correlation of economic time value, spent on their production and consumption is expressed. Therefore, we can talk about the utilitarian value of time, which can produce results in terms of money (due to its ability to grow over time). In fact, the money that a person decides to spend or save - is the time of person's life, concentrated and converted into special papers that are a kind of imitation and substitute of his lifetime in the economic system. Money - is the ability to buy lifetime of other people, and to save your own lifetime.

Thus, these properties of the economic time reflect the specific of fundamental economic relationships between subjects, they characterize the organization and the rhythm of their lives, the time structure of the economy, the direction and tempo of the economic development, they reveal the ability to control and regulate the process of self-organization of the economic system.

#### 4. Conclusion

The study of economic time in a complex and contradictory structure of its internal and external interactions, which is supported by general scientific concepts of time, leads to the following conclusions:

A lot of concepts of time in philosophy and natural science cannot be reduced to a single description, this indicates

an ambiguous and contradictory nature of time. In general, we can distinguish six concepts - objectivist and subjectivist, substantial and relational (as directions of the objectivist one), static, dynamic, and the concept of multiple times - which are different in the features of the relationships between time and different categories. Ambiguity of relationships of the categories of time and consciousness resulted in the formation of the first two concepts, where time for the objectivist approach - is an independent of human consciousness form of matter existence, and for the subjectivist direction time - is the result of sensory perception of human consciousness. Contradiction of views on the relationship between time and matter led to a corresponding binary division of the objectivist concept: the substantial view considers time as an essence that is absolutely independent of the matter, but the relational - sees in time an essential attribute and a condition of the existence of a material object. Reflections on the relationship between time and variability determined the origin and development of the fundamental areas of scientific knowledge - statics and dynamics: for the static concept time is - an illusion of changes, because it is ubiquitous and consistently, but in the dynamic concept time is identified with formation, movement and development;

According to the discussed general scientific concepts, time has a heterogeneous structure: objectively and subjectively, universally and relatively, statically and dynamically in terms of the ability to preserve and change, it is an indicator of quantitative and qualitative changes, and finally, it is inherently intrinsic of any objects, and externally - of their environment. Numerous multi-level systems: from the objects of nature, social structures, biological organisms to human beings and their moral and cultural values - have their own internal time. The relative nature of time and its heterogeneous structure leads to the existence of the economic time in the system of the coordinates of the economy;

Contradictory conceptions of time in the system of scientific knowledge, heterogeneous structure and multiplicity of forms of time requires the use of enhanced interdisciplinary methodology of the study of economic time, which allows to study the evolution of the economic system on the basis of the existing concepts. Synergy is such a field of knowledge based on the experience of interdisciplinary research processes of self-organization of the system in time, it which provides big opportunity to study the categories of time as a direct object of study in the methodology of economics.

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# The Relative Importance of Internal Factors for Bank Performance in Developed and Emerging Economies

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## Abstract

This study empirically explored the relative importance of bank-specific factors on the profitability of banks operating in developed, advanced emerging, secondary emerging and frontier markets (based on the FTSE Group's classification) from 2002 to 2008. The sample consisted of 6,926 banks in developed countries, 556 banks in advanced emerging countries, 2,103 banks in secondary emerging countries, and 563 banks in frontier markets. As a result of this study, employing multivariate analysis of covariance (MANCOVA), empirical support was provided for the theoretical proposition pursuant to which the importance of bank-specific factors goes countercyclically with the business cycle. This can be explained by a reduction in agency problems and by the convergence of expectations of all market participants with respect to the overall economic situation in the periods of high economic growth. In contrast, in periods of financial distress, the level of uncertainty increases sharply, which leads to a substantial squeezing in profit margins.

**Keywords:** bank performance, profitability, bank-specific factors, emerging markets, developed economies, economic growth, CAMEL, capital, liquidity, operational efficiency, earning ability, risk, MANCOVA

## 1. Introduction

The main purpose of this study is to examine the effect of bank-specific (internal) factors on performance of banks operating in economies characterized by different levels of regulatory, financial system, and economic development. The level of financial system, regulatory and economic development are mentioned together following the idea proposed by Levine (1997) and Rajan and Zingales (1998) pursuant to whom "a well-functioning financial system contributes to investment and growth" (Jonson, McMillan and Woodruff 2002, 1335) while strong regulatory basis along with high protection of investors' rights is essential for proper functioning of financial system and availability of external finance (La Porta et al. 1997).

This study argues that due to the global tendency towards the standardization of banking practices triggered by elaboration of the Basel requirements, the level of importance of internal factors for bank performance is mostly associated with the business cycle than with anything else. The effect of these factors is countercyclical to the level of economic activity due to divergence of expectations of market participants, an increase in agency problems and default rates in periods of economic downturn.

Based on the foregoing the theoretical proposition that *the relative importance of bank-specific factors goes countercyclically with business cycle* is to be tested.

Understanding of how bank performance is determined by internal factors contingent upon the stage of the economic activity in any market can serve as a guide for regulators concerning when any regulatory requirements should be imposed on banking organizations to ensure at least stability of the banking sector in particular and the whole economy in general.

## 2. Literature Review

The issues of the effect of capital adequacy, liquidity, and geographical/activity diversification on bank performance received the most attention in the literature.

Demirgüç-Kunt and Huizinga (1999), for instance, found a positive and significant impact of capital ratio (used as a proxy for capital adequacy) on the return on assets (ROA). This direct correlation is in line with other studies. A possible explanation is that "well capitalized banks face lower expected bankruptcy costs and thereby reduce their costs of funding" (Beckmann 2007, 6).

56 In contrast, Goddard, Molyneux, and Wilson (2004) provided the theoretical reasoning for a negative capital-  
57 earnings relationship. Since banks with a high capital ratio are risk-averse, they “ignore potential [risky] investment  
58 opportunities” and, as a result, “investors demand a lower return on their capital in exchange for lower risk” (Beckmann  
59 2007, 10).

60 Diamond and Rajan (2000, 2431) highlighted how the capital structure of banks affect their credit-creation and  
61 liquidity creation functions. In particular, banks provide liquidity to depositors upon their demand (on the liability side) and  
62 to “difficult, illiquid borrowers” on the asset side of the balance sheet), “thus enhancing the flow of credit in the economy”  
63 (Diamond and Rajan 2001, 287). They also noted that “deposits are fragile and prone to runs”(Diamond and Rajan 2000,  
64 2431). As a result, illiquidity may be created by banks as a defense mechanism. The first natural response of banks  
65 which are subject to liquidity shortages is that they may ration financing, providing it only to good-quality borrowers (Webb  
66 2000, 69) which, overall, could negatively affect profits.

67 There is long history of debates about benefits and costs of activity and geographical diversification. One of the  
68 most common and most important benefits of diversification for banks is a lower cost of capital. Kotrozo and Choi (2006,  
69 7) noted that because external capital is more costly than internal, well-diversified banking organizations can take  
70 advantage of transferring internal capital “from less efficient operations to areas where its use will be most beneficial to  
71 the organization.” They also emphasized that the availability of internal capital may also alleviate underinvestment  
72 problems that could arise from foregoing good investment projects (if no internal financing is available) due to the  
73 asymmetry of information between the organization and investors. Kotrozo and Choi (2006, 7) noted that in diversified  
74 banking organizations either across activities or geography, employees have the opportunity “to apply their skills and  
75 abilities to other products, or can transfer knowledge to other locations to improve performance across the organization.”  
76 In other words, economies of scope could be achieved through activity diversification and economies of scale could be  
77 achieved through geographical diversification. In both cases costs would be reduced substantially.

78 Deng and Elyasiani (2008, 1219), Lewellen (1971), and Boot and Schmeits (2000) stressed the importance of  
79 geographical diversification for diminishing earning volatility through the “coinsurance effect” by “spreading operations  
80 across areas with different economic environments” (Kotrozo and Choi 2006, 9).

81 The literature has also analyzed the effect of bank size on overall performance. Overall, the empirical results with  
82 respect to the impact of size on the profitability of banks are mixed. Banks can benefit from a size effect through  
83 achieving economies of scale or through being perceived as more competitive internationally. The latter goes back to the  
84 issue of to the community’s trust of large organizations. At the same time, there is empirical evidence that larger banks  
85 are less efficient (Fries, Neven, and Seabright 2002, 21-23).

86 Even though the direction of the association between different factors and bank profitability received great attention  
87 in the literature, this issue is not the focus of this study.  
88

### 89 3. Materials and Methods

90  
91 To achieve the purpose of this study:

- 92 1. A set of bank-specific variables will be defined to be included into the analysis based on the literature review  
93 and sound judgment.
- 94 2. In order to test this study’s hypotheses, all banks will be divided into four different groups based on the type of  
95 market in which every bank operates following FTSE Group classification;
- 96 3. All tests will be conducted on an annual basis;
- 97 4. Along with all tests, the results of the descriptive statistics for all variables will be provided.

98 This study will proceed by providing the rationale for choosing the bank-specific factors evaluated herein.

99 The choice of bank-specific factors is driven primarily by the CAMEL rating system (whereas C stands for capital  
100 adequacy, A- assets quality, M – management quality, E – earning ability, and L- liquidity) developed by the US Federal  
101 Deposit Insurance Corporation (FDIC) for “early identification of problems in banks’ operations” (Hunjak and Jakovčević  
102 2001, 150) and which is used by many banking analysts in analyzing the performance of banks (Balteş and Rodean  
103 2014, 134).

104 **Capital Adequacy.** The ratio of equity to earning assets (ETE) as a proxy for “the equity cushion available to  
105 absorb losses on the loan book” (Bankscope) will be used in this study to assess the effect of level of capital adequacy on  
106 bank performance. A high ratio will reflect more protection for banks, which will influence the overall stability of banks.

107 In periods of high economic activity, the probability of default on the part of the real sector (clients of banks) is  
108 lower, and the effect of the level of bank’s capitalization on banks’ profitability (with respect to expected bankruptcy costs)  
109 should be less pronounced. In contrast, in periods of economic downturn, banks have to be ready for to absorb losses on

the loan book, which come from higher default rates of the real sector than in periods of economic growth. Therefore, this study argues that the importance of total capital base for banks' profitability goes countercyclically to the business cycle.

**Asset Quality.** This study will employ the ratio of Loan Loss Provisions to Net Interest Revenue (LLP\_NIR) as a proxy for asset quality. This is a measure of how risk is remunerated by margins (here "margins" refer to net interest revenue). Thus, in well-run banks this ratio is low. The lower this ratio, the better. The deterioration of this ratio means that the increase in risk is not remunerated by higher margins.

Insofar as during the periods of high economic activity borrowers are less likely to default on their obligations there is less attention paid to them than in periods of financial distress which results in a decrease in consideration of the level of loan loss provisions in the periods of economic growth.

**Management Quality.** Duygun-Fethi and Pasiouras (2009) reported that indicators of management quality in CAMEL are rarely used in empirical studies due to difficulties associated with the proper assessment of management quality. In essence, the assessment of management quality is aimed at the determination of the capability of banks' management "to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial institution's safe, sound, and efficient operation in compliance with applicable laws and regulations" (Federal Register 1997, 755).

Based on the foregoing, management quality in banking organizations could be gauged based on *risk management expertise, operational efficiency, and the ability to get relatively cheap financing and sell banking products*. In fact, these elements form the core business of banking organizations.

The risk management is a cornerstone for the success of any financial intermediary due to high risk exposure, while the inability to "identify, measure, monitor, and control the risks of an institution's activities" will lead to bank's default. The ratio of *Impaired Loans to Gross Loans (ILGL)* will be used in this study as a proxy for the quality of risk management. As the value of this ratio tends towards zero, the higher is the level of risk management expertise of the bank. Theoretically, this ratio could be equal to zero. However, this does not mean that a bank takes no risk, because no one bank can avoid risk once it has provided financing to any entity or individual. Instead, it will indicate very strong risk management in place.

A *cost to income ratio (CIR)* will be used as a measure of *operational efficiency* (as a second component of management quality). This ratio measures "the overheads or costs of running the bank, the major element of which is normally salaries, as percentage of income generated before provisions" (BankScope Database 2009).

The difference between the ratio of interest income to total customer loans and ratio of interest expense to total funding (hereinafter *Spread*) will be used as the proxy for ability of banks to run their core business (as a third component of management quality).

$$\frac{\text{Interest\_Income}}{\text{Total\_Customer\_Loans}} - \frac{\text{Interest\_Expenses}}{\text{Total\_Funding}} = \text{Spread}$$

where

*Interest expenses* – interest that the bank pays on its own loans;

*Total Funding* = *Total Deposits*

+ *Total Money Market Funding*

+ *Total Other Funding*

Due to the intensive global integration of financial markets, there was a tremendous process of knowledge sharing. This should serve as a trigger factor for the improvement of the risk management expertise of banks across-the-board. The period covered in this study includes periods of economic growth and economic recession. Thus, how the performance of banks has been affected by changes in risk management expertise of banks contingent upon the stage of economic development can be explored. This study argues that the level of risk management expertise per se is not able to explain the performance of banks, due to banks' high level of dependence on the real sector. In particular, any improvement in banks' performance, if it is associated with improvement of risk management, should have a strong economic foundation. In essence, in periods of economic recession when default rates in the real sector become higher than in the periods of economic growth, in order to rescue a bank, special attention should be paid to the risk management practices in place and, probably, they should be reviewed. Therefore, this study hypothesizes that the importance of the level of risk management expertise in periods of economic recession is higher than in periods of economic growth.

In periods of high economic activity, there is a process of expansion of the real sector. As a result, there is also an increase in the number of market participants and banks' clients. Due to this, banks experience a substantial increase in total revenues (and, therefore, an increase in income generated before provisions) during periods of high economic growth, while the increase in overheads is increasing at a decreasing rate in comparison with the increase in total

revenues. Thus, in periods of high economic growth, the decrease in the cost to income ratio does not necessarily reflect improvements in the operational efficiency of banks. In turn, in periods of economic distress, the gap between total revenues and overheads is diminishing. Due to this, the importance of cost to income ratio as a measure of banks' operational efficiency should be higher during periods of financial distress.

With respect to the third component of management quality explored in this study, namely spread, this study argues that during periods of economic downturn, earning a spread sufficient enough to survive for banks becomes a crucial issue. This is due to a deterioration of the risk profiles of banks in periods of economic recession, which leads to an increase in the costs of financing banks' activities from a shrinking of the real sector that makes the selling of banking products more difficult. Therefore, the importance of running the core business of banks is to be inflated in periods of economic slowdown.

**Earning Ability.** As a proxy for the earning ability of banks, this study will use *the ratio of post-tax profit to total share capital*. Here, total share capital includes issued and fully paid common and preferred shares. The rationale for including the ratio of post-tax profits to total share capital in this analysis as an independent variable (while it is in nature a profitability ratio that indicates a return on shareholding capital) is as follows.

In assessing the earning ability of banks, the sources and quality of earnings along with the "ability to provide for an adequate capital through retained earnings" are assessed (Federal Register, 1997). In the normal course of economic activity, banks generally have three main sources of funding available: retained earnings, debt instruments and equity. In contrast, in periods of economic downturn, after retained earnings vanish and debt financing becomes unavailable due to a dramatic deterioration of the risk profiles of banks, the only source of funding in adverse circumstances is the issuance of common and preferred shares.

A bank's capacity to generate a higher level of post-tax profits on equity provides profound insight into its performance. It is due to the fact that in financial distress, while all financial intermediaries have lower credibility and some even do not have access to borrowing, the issue of equity is very likely to be effectuated with a substantial discount, since no investor is willing to become a shareholder (and being paid last in worst case scenarios since government and debt-holders have priority) of a doubtful business entity, unless he gets high premium. This is especially true for less developed countries with a higher level of divergence of expectations among market participants and bigger agency problems and where the financial system is characterized by a lower level of regulation which, in turn, indicates that the protection of investors' rights is desired to leave much better. "Going concern" status is carefully assessed by the market and a bank faces three alternative scenarios:

- Raising equity capital without a discount for shares → few shares give good financing (rare);
- Raising equity capital with a discount for shares → substantial number of shares needed for even modest funds;
- The issuance of heavily discounted stock → an extreme case of a large stock exchange for small amount of funds.

These three scenarios demonstrate that a decent level of the ratio of post-tax profits to total share capital is less likely to result from operating revenues (highly profitable deals or something like this), but instead from maintaining the same level of equity – not being squeezed out from over-suspicious, in crisis times, debt capital markets (for such reasons as a having risky portfolio). The key to staying a good bank in the inter-bank borrowing market is to have customers that are companies working in real sector (in this section, the "real sector" means companies focused on metals and mining, car manufacturing, chemical industry, agriculture) that are less subject to fluctuations (they generate more or less stable net cash flows), making the owner of such a portfolio a reliable counterparty.

In a distressed economic environment, very few banks make extraordinary profits. Therefore, when after-tax profit is not significantly increasing, the ratio of after-tax profit to total share capital can be improved almost exclusively via the stability of the amount of equity in the denominator. The maintenance of a stable level of equity demonstrates that the bank has good financials, enabling it to raise money through borrowing and not resorting to increasing equity. The evaluation of a bank's eligibility for borrowing by financial markets is based on good-quality assets and performance. In a situation where one bank has customers in the real sector and another bank mainly takes risks by providing loans to customers with a lot of intangible assets on their balance sheet (internet companies, technological start-ups, R&D boutiques), financial markets favor the first-type of banks, since, as the history of last decades shows, the cash flows and assets of the "real sector" are much more stable and substantial.

Thus, if financial markets like the 1<sup>st</sup> type of banks, they will give them more debt, if needed, and the equity of such favored banks remains at the same level. Since there are only two ways that the ratio of post-tax profits to total share capital could be changed (these are either through changes in post-tax-profits or in equity), ensuring that the denominator (total share capital) is not growing is 50% of the solution to making sure that the overall ratio of post-tax profits to total



217 share capital is at decent a level.

218 This demonstrates that banks with conservative policies will have a better ratio of post-tax profits to total share  
219 capital. This is mainly due to remaining with the real sector, as well as the ability to avoid the pitfall of being allured by  
220 some high growing intangible-based businesses (e.g. tech and dot com).

221 Paying attention to changes in this ratio may, in fact, give a stimulus to the market to abstain from any further deals  
222 with such a bank. Hence, the ratio of post-tax profits to total share capital should act as one of the most appropriate  
223 variables for defining which banks are in more trouble.

224 Based on the foregoing discussion, this study argues that the ability of banks to earn profits (as a return on share  
225 capital) and to maintain the ratio of post-tax-profits to total share capital at decent level is crucial for banks in the periods  
226 of financial distress.

227 **Liquidity.** One of the heavily discussed causes of financial crises where banks play central role is the inability of  
228 banks to cope with liquidity shortages. Pursuant to Diamond and Rajan's (2005) bank failures are contagious and are  
229 caused by liquidity problems arising from "delays in the generation of project cash flows by borrowers" or from the "earlier  
230 termination of projects." In essence, their argument is that liquidity shortages can come from the asset side rather than  
231 from the liability side. Given that aggregate delays in the "generation of project cash flows by borrowers," which leads to  
232 the creation of an aggregate real liquidity shortage, is inherent in the real sector during periods of economic downturn, the  
233 ability of banks to cope with such liquidity shortages becomes highly important. This is in line with the idea of  
234 Bronfenbrenner (1945, 424), who stated that "an increase in real income ... would be expected ... to decrease the  
235 importance of liquidity." Thus, in periods of economic growth characterized by an increase in real income, the real sector  
236 is not supposed to generate real liquidity shortages which negatively affect the liquidity of banks and as a result their  
237 profitability.

238 *The ratio of net loans to total assets* will be used as a proxy for the liquidity of banks. This ratio indicates what  
239 percentage of the bank's assets is tied up in loans. The lower this ratio is, the more liquid the bank is (BankScope  
240 Database, 2009).

241 In addition to that, this study considers the importance of diversification and the size of banks for banks'  
242 profitability.

243 **Diversification.** This study will explore how both income and geographical diversification affect the profitability of  
244 banks operating in countries with different levels of financial system development at different stages of business cycle.

245 To define the level of *income diversification*, following Kotrozo and Choi's 2006 study, the Herfindahl-Hirschman  
246 Index (HHI) will be computed in the following way:

$$\begin{aligned} 247 \text{HHI}_{\text{Income}} &= (\text{Interest Income}/\text{Total Operating Income})^2 \\ 248 &+ (\text{Commission Income}/\text{Total Operating Income})^2 \\ 249 &+ (\text{Fee Income}/\text{Total Operating Income})^2 \\ 250 &+ (\text{Trading Income}/\text{Total Operating Income})^2 \\ 251 &+ (\text{Non-Interest Income}/\text{Total Operating Income})^2 \\ 252 &+ (\text{Other Operating Income}/\text{Total Operating Income})^2 \end{aligned}$$

253 Herfindahl-Hirschman Index can take value from 0.17 to 1 whereas:

- 254 ○ "1" indicates that a bank is not involved in income diversification, since its income is concentrated in one  
255 activity; and
- 256 ○ "0.17" indicates that the bank's income is highly diversified, since it is uniformly distributed over all activities  
257 (As long as bank will earn its income in at least one of six activities listed the lowest possible value is  
258  $6 \times (1/6)^2 = 0.16(6) \approx 0.17$ ).

259 With respect to *geographical diversification*, first- and second-type geographical diversification will be incorporated  
260 into the model by the means of including dummy variables ("1" - bank is diversified; "0" - bank is not diversified).

261 A bank is viewed as diversified geographically based on the first-type geographical diversification if it is  
262 represented in at least one foreign country.

263 A bank is viewed as diversified geographically based on the second-type geographical diversification if its main  
264 domestic country differs from where a bank operates.

265 Given that income from non-interest activities is not correlated (at least not perfectly correlated) with income from  
266 lending activities, activity diversification "gives rise to a more stable stream of profits" (Chiorazzo, Milani, and Salvini  
267 2008). As long as the volatility of earnings increases in periods of financial distress, the importance of income  
268 diversification is supposed to be more pronounced in such times rather than in periods of economic growth.

269 In terms of geographical diversification, this study focuses on the issue of opening up domestic markets to foreign  
270 banks. The research interest of this study is driven by the fact that the opening of a domestic market to the participation of

foreign banks triggers the process of integrating these countries into the global financial system. The opening of domestic markets allows for the further development of the domestic banking industry by bringing knowledge and technologies. This means that banks' main domestic countries, which are characterized by a higher level of financial system development, can have superior knowledge of how a bank should operate, especially with respect to risk management. Dages, Goldberg, and Kinney (2000, 19) noted that because of their superior knowledge and technology, such banks are able to catch clients from the most profitable businesses with the best risk profiles in the markets which they penetrated. Because of this, this study supposes that the impact of second-type geographical diversification should be more pronounced for the profitability of banks operating in less developed countries where the process of opening the domestic market to participation of foreign bank is a relatively recent phenomenon. Further, this effect becomes more important with a decrease in the level of economic activity. This is mainly due to the availability of internal capital (to be provided by the parent company) and human resources whose skills and abilities could be directed from parent companies to support the operations of banks following the second-type diversification in difficult times.

With respect to the first-type geographical diversification, it is expected that the importance of this factor is also more pronounced during periods of financial distress. This is due to the availability of internal capital that could be transferred from less efficient operations to more efficient ones, which is vital in periods of economic downturn.

#### 4. Size of the Bank

The main concern of this study is to explore the extent to which banks' size *per se* matters for profitability through the business cycle. It is expected that, like other bank-specific factors, size has a more pronounced effect in times of financial turmoil. The main reasons for such an argument are that larger banks have more resources, allowing them to be sustainable during a longer time period than smaller banks could. At the same time, larger banks have better access to external financing, including government support, which basically makes them "too big to fail." The availability of a bigger capital base and better access to additional financing is crucial for dealing with the severe liquidity problems that occur during periods of financial distress.

In this study, the logarithm of total assets (Log (TA)) will be used as a proxy for the size of banks.

This study's data set covers a period spanning between two major crises: since 2002, the end of high-tech bubble burst lasting 1999-2001, till mortgage-driven one in 2008. The bank-specific data used in this study was obtained from the Bankscope database provided by Bureau van Dijk.

The following classification of countries developed by the FTSE Group is used in this study:

*Developed countries:* Australia; Austria; Belgium; Canada; Denmark; Finland; France; Germany; Greece; Hong Kong; Ireland; Italy; Japan; Kuwait; Luxembourg; Netherlands; New Zealand; Norway; Portugal; Singapore; Spain; Sweden; Switzerland; United Arab Emirates (UAE); United Kingdom (UK).

*Advanced emerging countries:* Brazil; Israel; Mexico; South Africa; South Korea; Taiwan.

*Secondary emerging countries:* Argentina; Chile; China; Colombia; Czech Republic; Egypt; Hungary; India; Indonesia; Malaysia; Morocco; Pakistan; Peru; Philippines; Poland; Russia; Thailand; Turkey.

*Frontier countries:* Bahrain; Bangladesh; Botswana; Bulgaria; Croatia; Cyprus; Estonia; Jordan; Kenya; Lithuania; Mauritius; Nigeria; Oman; Qatar; Romania; Serbia; Slovakia; Slovenia; Sri Lanka; Tunisia; Vietnam

The following assumptions have been made in order to come up with this categorization (based on FTSE classification), which has been used in the whole time period of study:

- Israel was promoted from advanced emerging countries to developed status in June 2008. Since this event occurred in the middle of 2008, Israel is considered as an advanced emerging economy through the whole time period.
- Hungary and Poland were promoted from secondary emerging markets to advanced emerging countries in June 2008. Following the same logic as with Israel, these countries are kept in the group of secondary emerging countries for the year 2008 as well.

The sample in this study consist of 10,148 banks, with 6,926 banks in developed countries, 556 banks in advanced emerging countries, 2,103 banks in secondary emerging countries, and 563 banks in frontier markets.

The analysis of the performance of banks will be based on an estimation of the model in the following linear form:

$$P_{it} = \alpha + \beta_1 ETEA_{it} + \beta_2 LLP\_NIR_{it} + \beta_3 ILGL_{it} + \beta_4 CIR_{it} + \beta_5 SP_{it} + \beta_6 PTP\_TSC_{it} + \beta_7 NLTA_{it} + \beta_8 HHI_{it} + \beta_9 S_{it} + \varphi D_{1t} + \vartheta D_{2t} + u_{it}$$

Where  $P_{it}$  denotes profitability of bank  $i$  in a year  $t$  based on the chosen measure of bank's profitability. Bank's

profitability will be measured using nominal rates of return as typical measures of profitability of banks (Antwi and Apau 2015, 77), in particular:

- Return on average assets (ROAA);
- Return on average equity (ROAE);

and using risk-adjusted rates of return. The prevailing risk-adjusted accounting measurements of performance are return on assets and return on equity (Sharpe ratios / SHROA; SHROE). Sharpe ratios (Stiroh 2004a, 10; Stiroh 2004b, 875; Chiorazzo, Milani, and Salvini 2008, 186) are estimated in the following way:

$$SHROA_{it} = ROA_{it} / \sigma_i$$

$$SHROE_{it} = ROE_{it} / \sigma_i$$

Where  $\sigma_i$  is the standard deviation over the entire sample period. Higher Sharpe ratios indicate higher profits.

Assessing a bank's performance in this way is simple and transparent. Most important, it considers overall risk exposure.

1.  $E_{TEA}_{it}$  - Ratio of Equity to Earning Assets of bank  $i$  in a year  $t$ ;
2.  $LLP\_NIR_{it}$  - Ratio of Loan Loss Provisions to Net Interest Revenue of bank  $i$  in a year  $t$ ;
3.  $ILGL_{it}$  - Ratio of Impaired Loans to Gross Loans of bank  $i$  in a year  $t$ ;
4.  $CIR_{it}$  - Cost-to-Income ratio of bank  $i$  in a year  $t$ ;
5.  $SP_{it}$  - Spread of bank  $i$  in a year  $t$ ;
6.  $PTP\_TSC_{it}$  - Ratio of Post-tax Profits to Total Share Capital of bank  $i$  in a year  $t$ ;
7.  $NLTA_{it}$  - Ratio of Net Loans to Total Assets of bank  $i$  in a year  $t$ ;
8.  $HHI_{it}$  - Herfindahl-Hirschman index of bank  $i$  in a year  $t$ ;
9.  $S_{it}$  - Log of total assets as a measure of size of banks of bank  $i$  in a year  $t$ ;
10.  $D_1$  - First-type geographical diversification of bank  $i$ ;
11.  $D_2$  - Second-type geographical diversification of bank  $i$ ;

Given that this study has more than one dependent variable and the aim of the research is to determine the interaction between variables by defining the level of importance of one variable over another, a multivariate analysis of covariance (MANCOVA) will be used.

In this study, to understand the relative importance of independent variables (covariates, bank-specific factors) dependent ones through their interaction, Pillai's trace (also called the Pillai-Bartlett trace,  $V$ , which is viewed as the most reliable out of multivariate tests, Warne 2014, 6) and its level of significance are used. This answers the question: "is each effect significant?" or "is each effect significant for at least one of the dependent variables?" and can take a value from "0" to "1". The larger the Pillai's trace, the more it is significant, and the more the given effect contributes to the model.

In terms of the type of MANCOVA, the *Type IV* model of MANCOVA was used. This model is specially designed to deal with a dataset in which there are missing data. Absence of some data is common to micro data. Utilization of a method which takes this into consideration is important.

## 5. Empirical Findings

The results of descriptive statistics measured as a mean values with respect to bank-specific characteristics and banks' performance expressed in nominal and risk-adjusted rates of return are reported in Annex 1. Stylized Facts.

It is revealed that even though banks in emerging markets (including frontier economies) outperform those in developed countries based on the nominal rates of return (return on average assets and return on average equity), they substantially underperformed in risk-adjusted measures of profitability (Annex 1. Stylized Facts, Fig. 1-4). This result questions the general idea that emerging markets are more attractive for investments than developed ones.

An economic growth-banks' performance nexus was also explored, the results of which suggested that banks' profitability is generally procyclically driven by economic growth (proxied by the real GDP growth rates, Annex 1. Stylized Facts, Fig. 1-5).

The results of analysis of mean-values for bank-specific factors Annex 1. Stylized Facts, Fig. 6-14), overall, demonstrate that in terms of capital adequacy, asset quality, earning ability, and management quality with respect to the risk management expertise of financial intermediaries, banks in developed countries clearly outperformed those in emerging and frontier economies. In regard to liquidity, management quality expressed as a cost to income ratio and spread, emerging markets outperformed those in developed countries. However, this should be taken with caution because the cost-to income ratio is likely to be low in emerging markets due to the relatively cheap means of production instead of more efficient cost management.

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In order to test study's hypotheses in regard to the importance of micro factors for profitability of banks operating in different economies through time comparative analysis the multivariate results has been performed.

The results of a comparative analysis of Pillai's Trace values with respect to the importance of all bank-specific factors for performance of banks in emerging and developed economies are presented further below (Fig. 1 through 9).

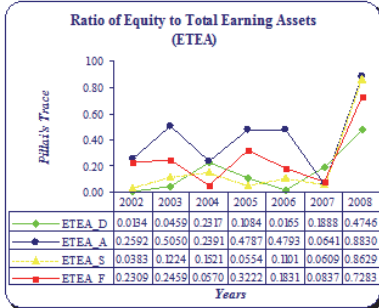


Fig. 1. Pillai's trace values for the ETEA ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier markets (F) from 2002 to 2008.

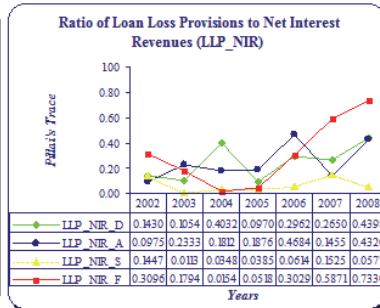


Fig. 2. Pillai's trace values for the LLP\_NIR ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets over from 2002 to 2008.

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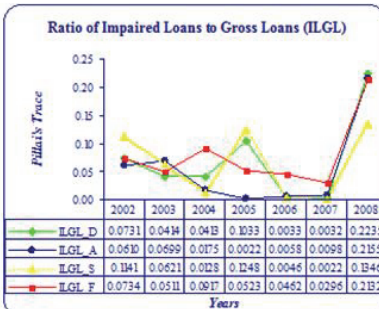


Fig. 3. Pillai's trace values for the ILGL ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

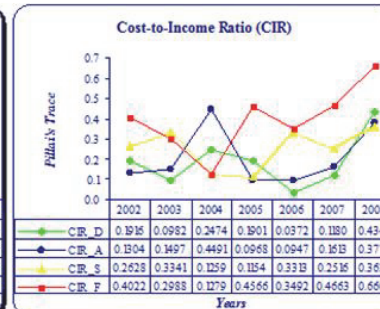


Fig. 4. Pillai's trace values for the CIRs of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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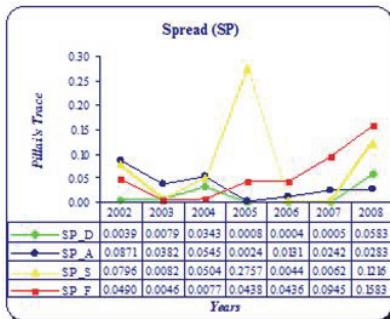


Fig. 5. Pillai's trace values for the spread of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

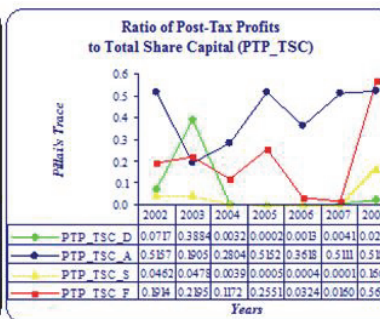


Fig. 6. Pillai's trace values for the PTP\_TSC ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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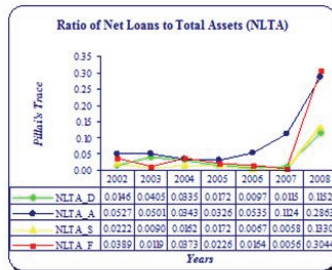


Fig. 7. Pillai's trace values for the NLTA ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

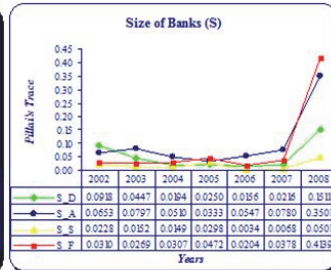


Fig. 8. Pillai's trace values for the size of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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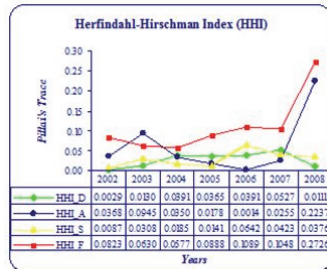


Fig. 9. Pillai's trace values for the Herfindahl-Hirschman Index (HHI) of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

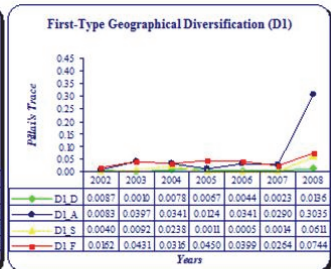


Fig. 10. Pillai's trace values for the first-type geographical diversification of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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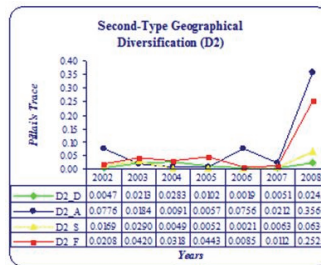


Fig. 11. Pillai's trace values for the second-type geographical diversification of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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The outcomes of Pillai's trace values are supportive of the main theoretical proposition of this research and demonstrate that the relative importance of all bank-specific factors goes countercyclically with the business cycle and during the times of financial distress the importance of all-bank-specific factors increases sharply.

## 6. Conclusion

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This study empirically explored the relative importance of bank-specific factors on the profitability of banks operating in developed, advanced emerging, secondary emerging and frontier markets (based on the FTSE Group's classification) from 2002 to 2008.

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The empirical findings, overall, support the theoretical proposition that all internal factors matter more in periods of financial distress than in recoveries. This confirms an intuition that a divergence of expectations of all market participants with respect to the overall economic situation, an escalation in agency problems and increase in default rates of the real sector in downturns make banking organization to strengthen internal controls and improve management practices to

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406 mitigate overall risk exposure and ensure stability in the periods of economic recession.

407 With respect to policy implications, the results of this work, overall, suggest that the central issues for regulators to  
408 look at are the level of banks' capital base and liquidity. It means that regulatory requirements in regard to capital  
409 adequacy should be strengthened but not overnight, because the amount of capital held by banks cannot be increased  
410 that quickly.

411 Further, one has to be realistic and accept that banks are service organizations. The amount of financial resources  
412 they have is related to the amount of financial resources they get from real sector. If the real sector has nothing to share  
413 with banks, this will negatively affect the banking sector. The danger of a real aggregate liquidity shortage for the banking  
414 sector lies in the inability of banks to satisfy all requests from companies in trouble while at the same time satisfying  
415 requests to withdraw deposits. Depositors are also representatives of the real sector and have the same problems as  
416 corporate clients, but in terms of scale, they are less.

417 Thus, it is not recommended imposing tighter requirements neither for the level of capital nor for the amount and  
418 quality of banks' liquid assets during a period of economic crisis, since this will not help diminish ongoing problems.  
419 Instead, these requirements could be introduced once the period of any financial turmoil is over which will allow to  
420 mitigate the negative consequences of further crises.

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Annex 1. Stylized Facts

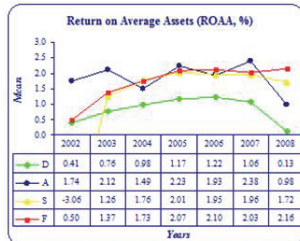


Fig.1. Mean values of the ROAAs of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

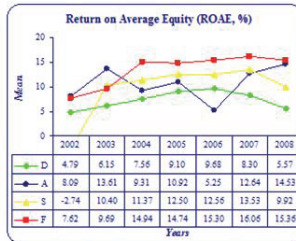


Fig. 2. Mean values of the ROAEs of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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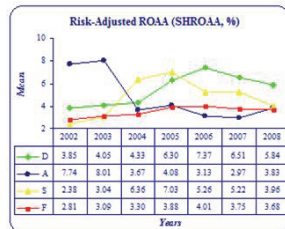


Fig. 3. Mean values of the SHROAAs of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

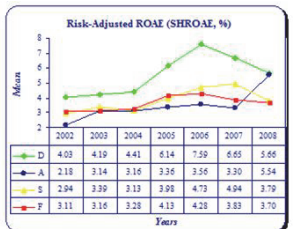


Fig. 4. Mean values of the SHROAEs of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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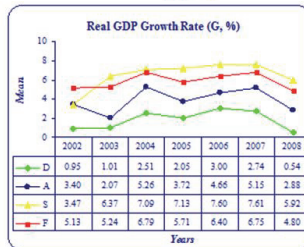


Fig. 5. Mean values of the real GDP growth rates in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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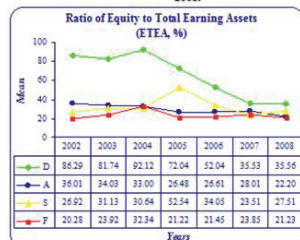


Fig. 6. Mean values of the ETEA ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

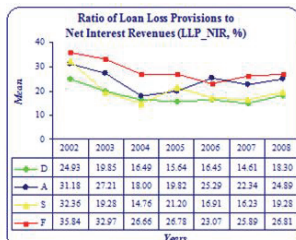


Fig. 7. Mean values of the LLP\_NIR ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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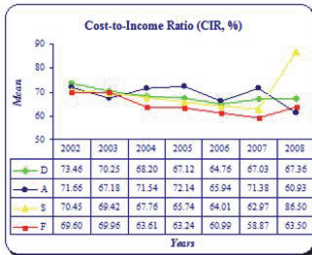


Fig. 8. Mean values of the CIR ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

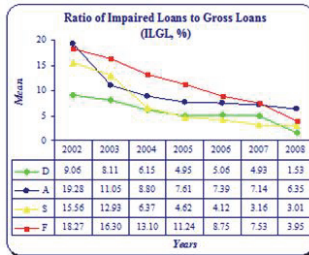


Fig. 9. Mean values of the ILGL ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

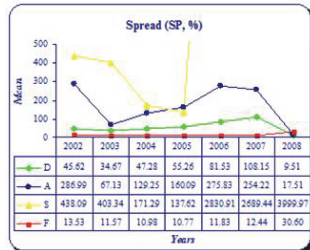


Fig. 10. Mean values of the spreads of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

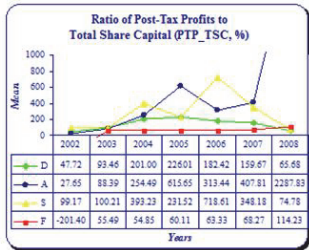


Fig. 11. Mean values of the PTP\_ISC ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

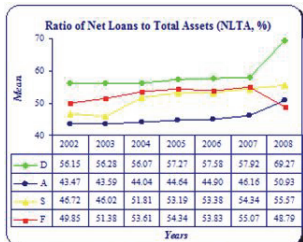


Fig. 12. Mean values of the NLTA ratios of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

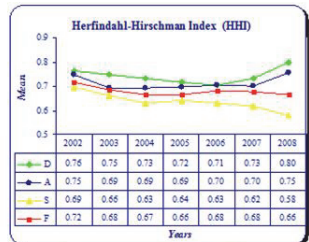


Fig. 13. Mean values of the Herfindahl-Hirschman Index (HHI) of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

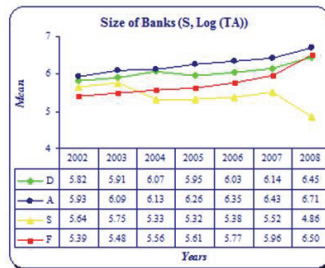


Fig. 14. Mean values of size (log (TA)) of banks which operate in developed (D), advanced emerging (A), secondary emerging (S), and frontier (F) markets from 2002 to 2008.

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## Albanian Economic Policies on Foreign Direct Investments during 1990-2009

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### Abstract

Attracting FDI is top priority to Albania not only to finance its budgets, but moreover to improve the economic development and standard of living. High inflow of FDI can increase efficiency of the production and introduce new products on the markets. Experience has shown that foreign direct investment has had a major impact on the economic growth of a country. Some of these benefits are: a) increase in competitive potential between domestic production enterprises. b) the entrance of advanced technology c) progress in knowledge of various fields of production resulting from contacts with foreign customers d) possibilities for the optimal utilization of human resources and help to increase their professional skills etc. In this paper we will analyze FDI on a national introducing three models: the first model is going to analyse the monetary policies, then fiscal policies and in the end we are going to take into consideration all the figures on a national scale taking into account the corruption, as well. We will confirm the important role of the monetary and fiscal policy to attract foreign investments in Albania aiming to serve the economic growth. Based on economic results, we easily observe the dependency of foreign investments on profit tax, on immigrants' shares, on interest norm and on the monetary aggregate M3. The most unexpected result is that no important index exists between FDI and corruption.

**Keywords:** foreign direct investments, fiscal policies, monetary policies, GDP;

### 1. Introduction

The ability to attract foreign direct investments (FDI) has become, the last decade a focal point of the economic policies of many developing countries. This strategy is based on the view that FDI flows increase the production potential of the country and of course the productivity level. Furthermore it assumed that the foreign capital can play a deep role in simulating local investments activity, both upstream and of the production chain and also in the acquisition level, in the development and the dissemination of technology. In line with these considerations, there has been a steady increase in the weight of developing countries on global FDI flows, interrupted only during the period 1997-2000, following the spread of the Asian crisis. In this context the Mediterranean area is highlighted for its weak performance, both on worldwide and also within the developing countries. In fact, while in the last decade, the rate growth of FDI in the world has been steady and very strong, and in particular those directed to developing countries, the Mediterranean countries appear to have remained at the edge of such processes. Albanian FDI level remains a major problem since the advent of Albanian democracy; their flow in recent years has just surpassed the 30 million dollars annually, ranking the country among the last places in Europe of attracting FDI. Few years ago the Democratic Prime Minister Berisha during a cabinet meeting appeared elated to present the solution. He baptized "Albania-1euro" his initiative to make the country more attractive to the foreign investors. Despite this Albania doesn't look like an attractive country to foreign investments for a number of reasons:

- Strong institutional weaknesses (inefficiency and bureaucracy)
- Corruption,

- 58 - The uncertainty of the transaction rules for foreigners (e.g. property rights)
- 59 - Infrastructure and networks problems
- 60 - The delay in the process of privatization of many sectors of the economy etc.

## 61 2. Empirical Analysis

62 To serve this study, we are going to draw the official information from these institutional sources:

- 63 • Ministry of Finance
- 64 • Directorate General of Taxes
- 65 • Central Bank of Albania
- 66 • Ministry of Economy
- 67 • INSTAT Albania

68 Simultaneously, we are going to make use of studies performed by the International Monetary Fund, European  
69 Bank for Reconstruction and Development as well as other International Institutions.

70 To serve our empirical analysis, we are going to use two data groups; data taken from INSTAT and information  
71 drawn from the Directorate General of Taxes. At the same time, we are going to develop the same econometric model  
72 using information from the above mentioned international institutions. Furthermore, we are going to analyse the fiscal  
73 incomes of 1990-2009, the flow of foreign investments for the same period and the economic indicator.

74 Greater importance will be shown to:

- 75 • Year-round fiscal incomes paying more attention to those years of fiscal reforms with new taxes.
- 76 • Fluctuation along with the flow of Foreign Investments in Albania (FDI) (or precisely the increase of fluctuation  
77 after the fiscal reforms have been made at the same time), as well as the foreign investments regionally based  
78 for the same period of time.
- 79 • The rate of economic growth (GDP) in Albania after the change of political system from the existing collective  
80 system being exercised during the communist period, where everything belonged to people.
- 81 • The newly democratic system accompanied by mass privatizations and the birth of private property.
- 82 • Simultaneously, we are going to take into consideration the standard fluctuation such as: import, export, and  
83 the increase of GDP, the immigrants' savings, the norm of interest for investments and the norm of interest for  
84 savings.
- 85 • The monetary aggregates M1, M2, M3 to understand how short-termed and long-termed monetary policies  
86 influence the flow of foreign investments, being also based on the figures of inflation and the corruption level.

87 The data drawn from INSTAT and the governmental institutions of the Albanian state have continuously had a  
88 series of wrong values. This pattern has been followed by all the Albanian governments taken into consideration to  
89 improve their performance during the electoral elections as well as to grow the credibility in the face of international  
90 institutions regarding the obligations they pretend towards reforms. To eliminate the inaccuracy in elaborating the  
91 following information, we will correct no data of INSTAT or The Directorate General of Taxes but we will compare them  
92 with those data drawn from the International Institutions.

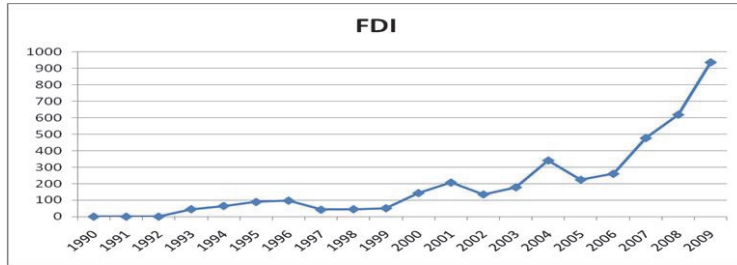
93 The greater part of them is taken from the International Institutions such as: *World Bank, International Monetary  
94 Fund, and International Transparency Agency*. In order to realize an empirical analyse at the following models, we also  
95 based ourselves on data having been elaborated by authors. Unfortunately, information on regional unemployment is  
96 accurate only for years 2002, 2003 published from INSTAT, and for the years 2007, 2008 published by the Ministry of  
97 Work, Social Affairs and Equal Opportunities. Regarding other years, we are going to consider the average number of  
98 unemployment for all the regional municipalities.

99 The fiscal system of the Republic of Albania underwent an entire reform during the period 1990-2009. Worth  
100 mentioning are the most crucial reforms of 1992, 1996, 1999, 2005 and 2008. Their results are felt a year after the  
101 implementation. Worth mentioning is also the increase of FDI flow excluding here the reform of 1996 which was slightly  
102 felt because of 1997 when we experienced the financial Albanian decline because of the financial pyramids invented by  
103 Carlo Ponzi.

104 The financial reform of 2008 aimed at tempting the foreign investors to transform Albania into an attractive country  
105 for foreign investments. This reform came to fruition and we can observe it at the graph nr 1.1. It shows the level of  
106 Foreign Direct Investments in Albania from 1990 to 2009. Based on the data analysis, we notice that the tendency of FDI  
107 goes up in a swing with the culminating point the years 2008-2009 (we should underline that this tendency is due to mass  
108 privatizations committed by the government of Berisha and not to the willingness of foreign investors to invest in our  
109 country).

111 country).  
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**Chart 1.1:** Flow of foreign investments in Albania during 1990-2009 (million euro)



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 117 **Source:** IMF, WB and ITA

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 119 **2.1 General Administrative data**

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 121 Albania consists of 12 Regions. Each region is composed of 3 categorized Municipalities where one of them belongs to  
 122 the regional centre. Information drawn at the region is not so reliable because we have simply available data taken from  
 123 the Albanian institutions and not from International Institutions. The information related to regional FDI is elaborated data  
 124 not 100% accurate. Viewing these data, it is noticed a higher concentration of FDI in Tirana, the capital city of Albania  
 125 with a population of more than 800 thousand inhabitants. Meanwhile, we notice a concentration of FDI along the coastal  
 126 and border towns like Durrësi and Vlora. In the following econometric models we will try to make use of all the available  
 127 data. The first problem being faced is the lack of information in 1997 because of the reason stated above. We hold the  
 128 opinion that it is more efficient to present 2 model groups. In the first group we are going to make use of information on a  
 129 national scale, available for the majority of International Institutions. While in the second group, we are going to mainly  
 130 use regional information, available in the greater part only by Albanian Institutions.

131  
 132 **3. The Factors Determining the Flow of Foreign Investments in Albania**

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 134 To estimate the effect of FDI on a regional scale, we will consider: the flow of FDI, the population, the unemployment and  
 135 the flow of FDI per person. In order to make use of all the data altogether, we are going to launch our study on the  
 136 correlations between these varieties.

137  
 138 **Table.1.1.** The coefficient of correlation, using observer 1:001 - 2:120, Critical value5% (per twice) = 0, 1267 per n = 240  
 139

FDI_per_Region	N_Unempl_Region	FDI_P_Per_Region	Pop_per_Region	
1,0000	0,0225	0,8598	0,1488	FDI_per_Region
0,0225	1,0000	0,1446	-0,2594	N_Unempl_Region
0,8598	0,1446	1,0000	-0,1036	FDI P_per_Region
0,1488	-0,2594	-0,1036	1,0000	Pop_per_Region

140  
 141 The matrix of correlation points out a good figure of correlation between the parameters of unemployment and FDI on a  
 142 regional scale, precisely a negative correlation between unemployment and FDI on a regional scale. It is therefore the  
 143 negative correlation which allows us to follow such parameters on the same regression model.  
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145 **3.1 The first model.**

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 147 
$$FDI_{per_{region}} = \alpha + \beta_1 Pop_{per_{region}} + \beta_2 N_{unempl_{Region}} + \beta_3 FDI_{P_{per_{Region}}} + \beta_4 Exp + \beta_5 GDP_{per_{pers}} + \epsilon$$

148 Let's mark with  $\alpha$  distance from the main cities being a statistic variable which does not change in relation with  
 149 time,  $\epsilon$  is the term of mistake,  $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$  are the coefficients of the model.  
 150

151 **Table 1.2**  
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<b>Model 1: Occasional effects (OLS), based on 240 observations.</b>				
Including 12 units cross section				
The length of historical series = 20				
Depending variable : FDI_PER_REGION				
	Coefficient	Standard mistake	Report t	p-value
Constant	-11,873	12,2983	-0,9658	0,3352
Pop_per_Region	3,36756e-05	1,64485e-05	2,047	0,0418 **
N_Unempl_Region	-0,203455	0,172886	-1,177	0,2405
FDI_P_Per_Region	117639	4194,41	28,05	3,56e-076 ***
Dis_Dr	-0,0371027	0,0870231	-0,4264	0,6702
Dis_Tr	0,0768883	0,0870073	0,8837	0,3778
Dis_VI	-0,0176679	0,0568452	-0,3108	0,7562
Dis_Gj	0,0219237	0,0408072	0,5373	0,5916
GDP_Per_Pers	-360,283	81,3661	-4,428	1,47e-05 ***
Export	0,000329108	5,40153e-05	6,093	4,63e-09 ***

154 Generally viewed, the first model shows an important result. The depending parameters of FDI on a regional scale are  
155 clearly illustrated by the GDP variable per person (p-value: 1,47e-05). Other important figures are the export (p- value:  
156 4,63e-09) and the population parameters on a regional scale (p-value: 0,0418).  
157

158 GDP per person and the export parameters are an easy example to interpret. FDI per region gives a considerable  
159 contribution to the increase of GDP and the export diagram. It means that a considerable part of FDI in Albania are  
160 addressed to only transfer the process of production (thus, to exploit the cheap labour of the working class) and  
161 afterwards they export the readymade product to the original country where they have first set up and initiated their  
162 business and operation. At the same time, we could emphasise that the product being produced in Albania is not  
163 destined for the Albanian market.

164 The unexpected result of the first model gives us the impression that the geographic position where FDI is  
165 addressed is not an important factor. This result can be explained on the basis of the model we used. It was an OLS  
166 model with occasional effects bearing in mind that the distance is constant when it is perfectly surveyed by this model. If  
167 we try to have the same model OLS, not with occasional effects but with continuous ones, we notice that we get higher  
168 figures which are excused (as we already mentioned about export); it can also be explained by the reason that the  
169 Albanian state has its main commercial partners Italy and Greece, therefore those border countries which transfer in  
170 Albania only a part of their production process (the clothing industry).  
171

172 **3.1.1 Divergent determining possibilities of FDI in Albania during 1990 until 2009**

173 We observe heterogeneity in distributing FDI to many regions. There has been a noticeable concentration of FDI in  
174 Tirana. It is because of its population which is more than 800.000 inhabitants, which means a better and wider market for  
175 public consumption. As being mentioned above, the geographical position plays a strategic and important role. The  
176 Albanian borders, especially the coastal ones play a decisive factor to the economic growth. We have a dense  
177 concentration along the border and coast. As we mentioned above, FDI is addressed to Albania mainly to exploit the low  
178 cost of the working class and the Albanian fiscal system which is profitable especially for the first three years of activity.<sup>1</sup>  
179 We also observe not an important correlation (despite the negative sign) between the norm of unemployment and FDI on  
180 a regional scale. It is because of the fact that a part of FDI have not been *greenfield* ones but investments on purchasing  
181 and developing the existing businesses. It goes without saying that employment has not always been on the increase,  
182 despite the high level of FDI.  
183

184 Model 2 is the same with the first with the only exception that in this case the estimation is made by OLS *Pooled*  
185 taken as a depending variable of national FDI.

186 
$$FDI_{per\ region} = \alpha + \beta_1 Pop_{per\ region} + \beta_2 N_{unempl_{Re_{gion}}} + \beta_3 FDI_{P_{per\Re_{gion}}} + \beta_4 Exp + \beta_5 GDP_{per\ pers} + \varepsilon$$

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191 **Table 1.3.** The result and the number of observations followed at model 2  
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<b>Model 2: Pooled OLS, based on 240 observations.</b>				
Including 12 units cross section				
The length of historical series = 20				
Depending variable : FDI				
	coefficient	Standard mistake	Report t	p-value
constant	-49,4083	41,4774	-1,191	0,8830
Pop_per_Region	-8,08019e-06	5,48500e-05	-0,1473	0,0418 **
N_Unempl_Region	-3,65747	0,895623	-4,084	6,11e-05 ***
FDI_P_Per_Region	46884,3	22778,7	2,058	0,0407 **
Dis_Dr	-0,0726466	0,308103	-0,2358	0,8138
Dis_Tr	0,123060	0,297941	0,4130	0,6800
Dis_VI	0,0206406	0,194432	0,1062	0,9155
Dis_Gj	0,111945	0,140999	0,7939	0,4280
GDP_Per_Pers	-360,283	81,3661	-4,428	1,47e-05 ***
Export	0,00606005	0,000198254	30,57	3,88e-083 ***
R-current	0,827874	R-current frame		0,821912
Test F	F(8, 231)	P-value(F)		8,48e-84

195 Stimulating OLS *pooled*, following the same parameters except the change of the depending variable which is moved  
 196 from regional FDI to national FDI. The results are practically the same with the first model. Even though we encourage a  
 197 *panel* with sustainable effects, the same results are given regarding the geographical position, but knowing that this  
 198 model might not be 100% efficient and econometrically accurate because all variables are dynamic in time and  
 199 meanwhile we are given prevailing data drawn from Albanian Institutions.  
 200

201 We would not like to comment the results of this model, we would like simply to observe if it were any difference  
 202 when we moved from regional FDI to national FDI. Possessing the results drawn from the first two models mentioned  
 203 above, they provide confirmation of all the hypothesis made by International Institutions<sup>1</sup> as well as by many articles  
 204 published by the Albanian Agency of Investments (Albinvest)<sup>2</sup>. In conclusion, we could point out that it is being invested in  
 205 Albania with the mere goal to reduce the production costs, despite being a small country with a limited market.  
 206

207 **3.1.2 The decisive factors of FDI in Albania**

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 209 To analyse FDI on a national scale and to verify the results of different international reports, such as *Doing Business* of  
 210 *World Bank* or *Albanian New Investments Strategy* and *International Monetary Fund*, we are going to introduce three  
 211 models.

212 The first model is going to analyse the monetary policies, then fiscal policies and in the end we are going to take  
 213 into consideration all the figures on a national scale taking into account the corruption, as well. At the first model, we will  
 214 use as depending variable FDI and as other variables we will consider the monetary policy: GDP, the free international  
 215 market (The report of export and import depending on GDP), the immigration incomes, and the norm of inflation, the norm  
 216 of interest, the exchange rate, and the monetary aggregate and last but not the least corruption.  
 217

218 **3.2 FDI and the monetary policy**

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 220 Based on international reports and the policies of the Bank of Albania, we could say that Albania is not the exact  
 221 matured country regarding the commitment of monetary policies.

222 We will be guided by a simple model as follows:

$$FDI = \alpha + \beta_1 N_{Exchange\ rates} + \beta_2 N_{Int_{in}} + \beta_3 E_{rate} \frac{L}{\$} + \beta_4 E_{rate} \frac{L}{euro} + \beta_5 Immigrant_{incomes} + \beta_6 Agr_{M3} + \varepsilon$$

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**Table 1.4**

Model 3: OLS, based on observations. 1990-2009 (T = 20)				
Depending variable FDI				
	coefficient	Standard mistake	Report t	p-value
N_Exchange Int_	16,0676	6,59381	2,437	0,0313 **
N_fin Int	-9,77856	5,26593	-1,857	0,0880 *
Exchange Rate L/\$	-0,181833	0,585306	-0,3107	0,7614
Exchange Rate L/€	0,468544	0,590488	0,7935	0,4429
Immigr. incomes	-0,468963	0,126320	-3,713	0,0030 ***
Agr_M3	0,00185294	0,000814842	2,274	0,0421 **
R-current	0,963975	R-current frame		0,942960
Test F	40,13746	P-value(F)		1,67e-07

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We have profited an important coefficient regarding the immigrants' cash (pvalue: 0,0030). It is almost the same according to our expectancy that a good share of the immigrants' incomes goes to different investments among the Albanian territory. In addition to, we are experiencing pleasing assessments regarding the savings norm, the financial norm along with that of the monetary aggregate M3. All the above mentioned norms are approved by The Central Bank of Albania. Therefore, we could point out the importance of the monetary policy of Albania. The more reliable and matured the policies are the more appealing it becomes to investments. Urged by this motive, we could say that the primary objective of The Central Bank of Albania is to stabilize prices, to get the norm of interest under control and at lower figures. We observe that the exchange rate of lek/euro has a coefficient of positive index but not so important. However, we could not exclude the contribution of this parameter to the explanation of FDI.

3.3 FDI and the fiscal policies

$$FDI = \alpha + \beta_1 P_{Tax} + \beta_2 \Delta_{Fisc_{Income}} + \beta_3 Corrupt. + \beta_4 P_{Power} + \beta_5 Technical_{Govern} + \epsilon$$

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**Table 1.5**

Model 4: OLS, based on observations 1990-2009 (T = 20)				
Depending variable: FDI				
	Coefficient	Standard mistake	Report t	p-value
Const	-6,78967	68,1833	-0,09958	0,9229
Profit tax	0,0125781	0,00273034	4,607	0,0013 ***
Δ_Fisc Incomes	0,00203349	0,000710152	2,863	0,0187 **
Corruption	-0,645295	10,3508	-0,06234	0,9517
Party_Power	20,2159	33,0716	0,6113	0,5561
Technical governm	36,1908	65,3412	0,5539	0,5932
R-current	0,868572	R-current frame		0,795557
F (5, 9)	11,89576	P-value(F)		0,000944

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At the above mentioned model, we are mainly trying to find out the reason why The Ministry of Finance in Albania is seeking with all possible means to bring Albania close to "the fiscal paradise" with very low taxes with the aim of increasing the number of foreign investors in Albania.

This philosophy is proved at model 4, where we are given a better index concerning the Profit Tax, a low tax if we compare it with our neighbouring countries. It is also one of the most important taxes regarding FDI. Besides, there are encouraging figures concerning the differences at fiscal incomes compared with the previous year. It results from the fact that increasing the state incomes means providing more opportunities to encourage the foreign investments. Worth mentioning about this model is corruption which according to International Institutions influences negatively on FDI.

At the above model we notice that corruption is not an important index although the coefficient is negative.

At this model we decided to have two variables dummy, the party in power and the second the technical government of 1997. We referred to the last ones because we lack the data of 1997. We did not find a reliable conclusion. We notice at the above model that R<sup>2</sup> has got a relatively high value which shows that this model is very reliable.

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#### 4. Foreign Investments in Albania

The last model we are going to take into consideration is a model with sustainable effects counting the most important economic figures.

$$FDI = \alpha + \beta_1 \Delta_{M_3} + \beta_2 Corruption + \beta_3 P_{Power} + \beta_4 Inc_{GDP} + \beta_5 N_{Exch_{Interest}} + \varepsilon$$

Table. 1.6

Model 5: OLS, based on observations 1993-2009 (T = 17)				
Dependent variable: FDI				
Perfect correlation Dis_VI Dis_GJ				
	Coefficient	Standard mistake	Report t	p-value
Const	832,560	778,961	1,069	0,3971
N_Exch_Interest	18,0759	5,07832	3,559	0,0707 *
Agr_M3	0,00227894	0,000594502	3,833	0,0618 *
Inc_GDP	1228,90	405,013	3,034	0,0936 *
Party_Power	20,2159	33,0716	0,6113	0,1561
Corruption	1,30483	15,3490	0,08501	0,9400
F (5, 9)	11,89576	P-value(F)		0,000944
R-current	0,998619	R-current frame		0,988949

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The only novelty of this model is that we have a very small value ( p-value) of the variable party in power. During the last years, the Democratic Party which came in power in 2005 has always asked to increase the flow of FDI in Albania. It is easily understood if we analyse the fiscal reforms after 2005. Besides, we have progress even with the variable AM3 which gives the difference value of monetary aggregate of M3 in relation to the last year. It shows the credibility of The Central Bank of Albania

We are given R<sup>2</sup> with a close value to 1 at this model. On one hand, it proves the reliability of this model but on the other we could say that this model has got simply 17 observations which is less than other observations.

#### 5. Conclusions

At this study, the analyse confirms the important role of the monetary and fiscal policy to attract foreign investments in Albania aiming to serve the economic growth.

Based on economic results, we easily observe the dependency of foreign investments on profit tax, on immigrants' shares, on interest norm and on the monetary aggregate M3.

We observe a concentration of FDI close to borders, even though when we use the data on a regional scale it is not felt.

The most unexpected result is that no important index exists between FDI and corruption. This result is against the reports of International Institutions even though the missions of European Union and the International Monetary Fund do never speak their minds about the corruption which prevails in the Albanian political class, but they state that the government could better the fight against corruption.

In summarising this piece of work, we could highlight that monetary and fiscal policies are important instruments to attract foreign investments.

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# Stock Market Liquidity and $O/N$ LIBOR Rates: A Study for PIGS Countries and Turkey

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## Abstract

During the mortgage crisis in 2008 there was a significant demand increase in the LIBOR market due to the shrinkage in commercial paper market and liquidity crunch. This study examines the relationship of stock market price movements and liquidity with the overnight LIBOR rates for PIGS countries and Turkey. In the first section of empirical analysis we determined the stationary levels of data and tested long term relationship through Maki (2012) cointegration test with structural breaks. Following the verification of the relationship between stock market liquidity and overnight LIBOR rates, we conducted Fully Modified OLS, Canonical Cointegrating Regression and Dynamics Least Squares tests to estimate the parameter of LIBOR variable and identify the direction of relationship. This parameter was only significant for the Turkish and Spanish stock markets and the sign of this parameter was negative. Results showed that when the overnight LIBOR rates increased, the bid-ask spreads of the Turkish and Spanish markets expand indicating a decrease in liquidity of the market. A possible reason for this finding was the decoupling process of Turkey and Spain, especially during the mortgage crisis. EU defined debt stock/GDP ratios also supported that explanation.

**Keywords:** Liquidity crisis, overnight LIBOR rates, stock market liquidity.

## 1. Introduction

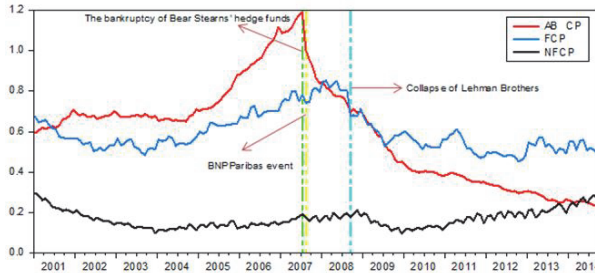
Many macroeconomic variables can affect prices or returns of stocks. A broad range of literature exists which comprehensively examines the effect of currency rates, inflation and interest rates on stock returns. It is widely accepted that stock returns are negatively related to the changes in interest rates. Xu et al. (2012) explains why interest rates affect the stock returns negatively: First, as increasing in interest rates make it difficult for the companies to find funds, managers are obliged to decrease the scale of production and the stock returns decline in accordance with the fall in future income. Second, the increase in interest rates raises the discount rate in the stock valuation and the price determined in the valuation of investor drops. The result will be reflected as a decrease in the stock prices in conjunction with a change in demand. Finally, due to the fact that some funds shift to national debt instruments and bank savings following the increase of interest rates, stock prices fall in conjunction with the decreasing demand in stock market. On the other hand, the rises in interest rates put a precarious position in terms of liquidity. The funding sources for companies can be classified as direct and indirect sources. The first is credit facility via banking system and the second is funding via commercial papers and business bonds to reach funders directly. Although the lower cost of the commercial papers and bonds comparing banking credits leads firms to the indirect financing option, this market is not open for all firms because of credibility issues.

As stated by Kacperczyk and Schnabl (2010), before the mortgage crisis in 2008, commercial papers were considered safe and risk-free securities thanks to their high credit ratings and short maturities. However, two important events completely altered this paradigm. The first event was the collapse of two Bear Sterns' hedge funds on July 31, 2007 which invested in subprime mortgage credit related instruments. In addition, on August 07, 2007, BNP Paribas suspended withdrawals from three investment funds on which they could not assess the value of their mortgage portfolios. The second important event was the loss announcement of Reserve Primary Fund concerning the holdings in commercial papers of Lehman Brothers on September 16, 2008.

As banks generally fund their long term investment projects, mortgages and mortgage linked instruments with the short term liabilities such as deposits, the same maturity mismatch risk is transferred to the "shadow" banking system consisting of off-balance-sheet. Commercial banks funded these structured instruments using the Asset-Backed Commercial Papers (ABCP) with an average maturity of 90 days. Asset-Backed term is the toxic part of this name and it means that this security is backed by the pool of mortgages or other credits as collateral. In case of default, a holder of

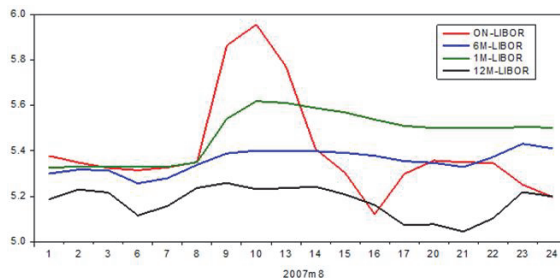
57 ABCP has the right to seize or sell the underlying assets of ABCP.

58 This off-balance-sheet instruments strategy exposes banks to funding liquidity risk as investors may suddenly stop  
59 buying ABCP and banks cannot roll short term sources (Brunnermeier, 2009). Thus, similar events occurred in the early  
60 stages of the mortgage crisis. In conjunction with the outstanding volume of ABCP, Financial CP and Non-financial CP,  
61 the three aforementioned important events are presented in Figure 1 below. As seen, the heaviest shrinking volume  
62 occurred in the ABCP market, whereas the reflection of crisis to the Financial CP market transpired with a delay following  
63 the collapse of Lehman Brothers. Non-financial CP market, on the other hand, remained stable during this period.  
64



65  
66 **Figure 1.** Path of ABCP, FCP and NFCP

67  
68 According to the information released by FED, outstanding value of ABCP in July 2007 was \$1.189.463.486.600. This  
69 number fell to \$697.969.615.800 on the day Lehman Brothers collapsed. This decrease continued in the subsequent  
70 period. One of the most important reasons for these declines was the successively defaults which posits the question;  
71 who is the next? Due to the fact that the actual magnitudes of toxic assets in balance sheets were unknown, hence the  
72 inability to estimate the risks of these assets, during the mortgage crisis ABCP market was closed even for the credible  
73 firms. These firms turned to LIBOR market in order to roll their debts and cover cash requirements. Many hedge funds  
74 also started to finance their CDS tranches through the LIBOR market. However, considering the fact that LIBOR market  
75 already had its own clients, the excess demand over the same source caused serious increments especially in over-night  
76 LIBOR rates. Figure 2 below demonstrates the over-night, one month, six months and one year LIBOR rates during the  
77 period of August 01-24, 2007. The sharp rises in over-night LIBOR rates, exhibit the demand intensity of overnight  
78 funding requirements. Such developments affect price movements significantly.  
79



80  
81 **Figure 2.** Path of Different LIBOR Rates in August 2008

82  
83 As seen in Figure 2, the rising trend of ABCP market volume began falling in 2007 and this downtrend has yet to abate.  
84 Under these circumstances, we examine the long term relationship of stock market price and bid-ask spreads (as a  
85 liquidity indicator) with the over-night LIBOR rates for the PIGS countries: Portugal, Italy, Greece and Spain. By  
86 considering potential structural breaks during the time period we examined, the long term relationship was analyzed using  
87 the Maki (2012) cointegration test. Following the Maki (2012) cointegration analysis, the value and sign of the parameters  
88 in the long term relationship were determined using Fully Modified OLS, Canonical Cointegrating Regression and  
89 Dynamics Least Squares methods. Although there is a great deal of interest in the relationship between stock market  
90 and interest rates, we have seen that some studies fail to take structural breaks into account. Distinct from the previous  
91 literature, we also examined the connection of stock market liquidity and over-night LIBOR rates using bid-ask spreads of  
92 stock indexes.

**2. Literature Reviews**

In one of the earlier studies in literature, Fama and Schwert (1977) revealed a negative relationship between short term stock returns and short term interest rates for the period of 1953-1971 in the USA market. Schwert (1981) examined the reaction of stock index prices to new data concerning inflation for the Standard and Poor index and demonstrated that stock prices react negatively to the announcements of unexpected inflation but with relatively small reactions. Geske and Roll (1983) stated that American stock returns respond nominal interest rates and changes in the expected inflation. Solnik (1983) analyzed the relationship between inflationary expectations and stock returns within the context of nine countries for the period of 1971-1980 and used the interest rates as proxy for expected inflation. According to his results, price movements of stocks signal (negative) revisions in inflationary expectations. Campbell and Ammer (1993) explained the movements in stock and bond returns in terms of future dividend expectations, inflation, short term real interest rate and the excess returns. The results showed that the postwar excess returns of stocks and bonds are almost uncorrelated. Choi and Jen (1991) used two-factor model to demonstrate how interest rate risk premium significantly explains the changing rate of expected return in the NYSE and AMEX. Fama and French (1993) concluded that five common risk factors explain stocks and bonds mean returns; overall market factor, firm size, book-to market equity factor, maturity and default risk factors. Concerning France, Germany and UK stock markets, Peiró (1996) showed that stock returns are affected by current changes in interest rates and future changes in production, with interest rate having a stronger effect than the production level in the relationship. Likewise, Zhou (1996) exhibited that interest rates have significant effects on stock returns especially in the long run and also revealed that high volatility in the stock market has a strong link with the return volatility of long term bond. Thorbecke (1997) investigated the response of stock returns to monetary policy shocks. He found that expansionary policies increase the ex-post stock returns. Dinienis and Staikouras (1998) analyzed five sectors (banks, insurance companies, investment trusts, property investment companies and finance firms) in the UK concerning stock returns and interest rates. They proved that there was a negative relationship between the changes in interest rates and stock returns, and the coefficient of the relationship of stock returns and interest rate volatilities is significantly positive.

More recently, Nissim and Penman (2003) stated that changes in interest rates are positively related to successive stock returns, though not significantly enough to cover the required rate of return, hence the net effect of interest on stock value is negative. In a different study, Wong et al. (2005) examined the relationship of SP500 and STI index returns with selected macroeconomic indicators such as money supply and interest rates through Johansen multivariate cointegration system, fractional cointegration and Granger causality methods. According to the cointegration results, while there is a long term equilibrium relationship among STI returns, and interest rates and money supply, they found no evidence for this relationship in SP500 index. Garg and Chapman (2008) conducted research on the change of federal fund rates and sectoral stock index returns and showed that some sectors are more sensitive to changes in interest rates. Furthermore, they exhibited that the relationship among these sectors has a positive coefficient. Pilinkus and Boguslauskas (2009) analyzed the effect of different macroeconomic variables on the Lithuanian stock market and proved that GDP and money supply have a positive effect whereas unemployment rate, currency rate and short term interest rates have a negative effect. Lettau and Wachter (2011) presented a dynamic risk-based model which simultaneously explains the term structure of interest rates, market return, and risk-return characteristic of stock returns.

**3. Econometric Methodology**

*3.1 Maki Cointegration Analysis with Multiple Structural Breaks*

Distinct from the studies of Gregory and Hansen (1996), and Hatemi-J (2008), Maki (2012) introduced a cointegration model which allows for up to five structural breaks. While the null hypothesis of the model claims the absence of cointegration among variables, the alternative hypothesis concerns the existence of cointegration breaks in the presence of  $i$  ( $i \leq 1$ ) breaks. Maki (2012) submitted four regression models for the cointegration analysis which allow multiple breaks:

$$y_t = \mu + \sum_{i=1}^k \mu_i D_{i,t} + \beta' x_t + u_t \quad (1)$$

$$y_t = \mu + \sum_{i=1}^k \mu_i D_{i,t} + \beta' x_t + \sum_{i=1}^k \beta'_i x_t D_{i,t} + u_t \quad (2)$$

$$y_t = \mu + \sum_{i=1}^k \mu_i D_{i,t} + \gamma t + \beta' x_t + \sum_{i=1}^k \beta'_i x_t D_{i,t} + u_t \quad (3)$$

$$y_t = \mu + \sum_{i=1}^k \mu_i D_{i,t} + \gamma t + \sum_{i=1}^k \gamma_i t D_{i,t} + \beta' x_t + \sum_{i=1}^k \beta'_i x_t D_{i,t} + u_t \quad (4)$$

where  $t = 1, 2, \dots, T$ .  $y_t$  and  $x_t = (x_{1t}, \dots, x_{mt})'$  denote the observable variables with  $I(1)$ ,  $u_t$  is the

146 equilibrium error. Given that an  $(n \times 1)$  vector  $z_t$  can be produced by  $z_t = (y_t, x_t')' = z_{t-1} + \epsilon_t$  and  $\epsilon_t$  is i.i.d with  
 147 zero mean, positive definite variance covariance matrix  $\Sigma$  and  $E|\epsilon_t|^s < \infty$  for some  $s > 4$ .  $\mu, \mu_i, \gamma, \gamma_i, \beta' =$   
 148  $(\beta_1, \dots, \beta_m)$ , and  $\beta' = (\beta_{i1}, \dots, \beta_{im})$  are the true parameters. If  $t > T_{Bi}$  ( $i = 1, \dots, k$ ),  $D_{i,t}$  will have the value 1,  
 149 otherwise it will be zero. Here  $k$  is the maximum number of breaks and  $T_{Bi}$  is the date of breaks. Equation 1 is the model  
 150 with level shifts. Equation 2 indicates the regime shifts model and allows the structural breaks for  $\beta$  in addition to  $\mu$ .  
 151 Equation 3 is a different version of the Equation 2 in conjunction with trend. As for equation 4, it is formed by structural  
 152 breaks of level, trends and regressors.

153  
154 **4. Empirical Analysis**

155  
156 In the empirical section of the study we examine the relationship between Portugal, Italian, Greek, Spanish and Turkish  
 157 stock markets and overnight LIBOR rates using two different data: first, logarithmic stock index values and second, bid-  
 158 ask spreads of index values as the indicator of liquidity of stock markets. Expanding and tightening spreads were  
 159 considered as a signal of high and low liquidity, respectively. All the data used in the study was obtained from stooq.com.  
 160 The time interval of the data sample is from 02.01.2005 to 07.08.2014. In the beginning of the econometric analysis, we  
 161 tested the stationarity of time series and then conducted the Maki (2012) test for series  $I(1)$ . Finally, depending on the  
 162 results obtained, we performed the Fully Modified OLS, Canonical Cointegrating Regression and Dynamics Least  
 163 Squares tests in order to determine the sign of the long term relationship of variables.

164  
165 **4.1 Unit Root Test Results**

166  
167 As the level of stationary is important in the cointegration test, we first conducted unit root tests for all of the index series  
 168 and LIBOR data using Augmented Dickey Fuller and Phillips Perron tests. Depending on the unit root test results, we  
 169 decided which data to use in the cointegration analysis. For dependent and independent variables we presented all unit  
 170 root test results in Table 1.

171  
172 **Table 1. Unit Root Test Results**

173

Variables	ADF Level	ADF First difference	ADF Stationary	PP Level	PP First difference	PP Stationary
P_Portugal	-0.606034	-46.53334	I(1)	-0.614964	-46.48348	I(1)
P_Italy	-0.647348	-50.79729	I(1)	-0.675475	-50.85617	I(1)
P_Greece	-1.136434	-46.62110	I(1)	-1.138154	-46.61108	I(1)
P_Spain	0.093116	-49.28259	I(1)	0.111253	-49.51129	I(1)
P_Turkey	1.215369	-49.48923	I(1)	1.177328	-49.51931	I(1)
S_Portugal	-0.482165	-24.89867	I(1)	-1.176031	-302.4289	I(1)
S_Italy	-0.217495	-26.08726	I(1)	-0.947023	-537.1421	I(1)
S_Greece	-0.906137	-29.43907	I(1)	-1.681013	-310.7036	I(0)
S_Spain	0.034671	-21.78083	I(1)	-1.223485	-461.4807	I(1)
S_Turkey	-0.116340	-22.85515	I(1)	-0.834006	-716.1724	I(1)
On	-0.989329	-11.25335	I(1)	-1.262450	-63.11396	I(1)

174  
175 Unit root tests demonstrated that all stock index series are stationary for  $I(1)$  with the exception of Greek spread series,  
 176 the preliminary requirement to proceed with the Maki (2012) cointegration test. As stated by Gujarati (2004), although  
 177 some time series are not stationary individually, a linear combination of them may be stationary. This circumstance  
 178 exhibits the long term relationship between the variables and demonstrates the long term co-movement of the series  
 179 which can be analyzed through cointegration analysis.

180  
181 **4.2 Maki (2012) Cointegration Analysis**

182  
183 As remarked by Gonzalo and Lee (1998), when breaks are present in mean or/and trend spurious cointegration may  
 184 occur. Likewise, Noh and Kim (2003) indicated that if breaks occur in the variance of innovation errors of two independent  
 185 time series, especially in early periods, spurious cointegration can appear. In addition, Noriega and Ventosa-Santaularia  
 186 (2012) found that overlooked structural breaks can cause the rejection of null hypothesis regarding non-existence of

187 structural among the time series. Given the importance of structural breaks in the cointegration analysis we conducted  
188 the Maki (2012) cointegration test to analyze the long term relationship between the index log prices and the overnight  
189 LIBOR rates, in addition to bid-ask spreads and overnight LIBOR rates allowing multiple breaks. The test results obtained  
190 under the four alternative models are presented in Table 2 below.

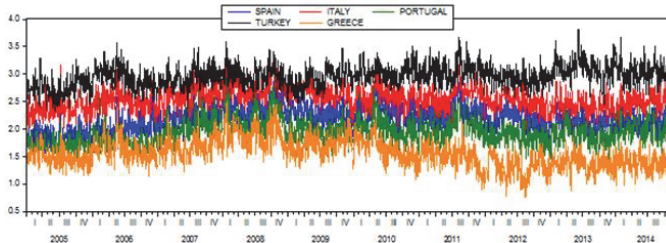
191 **Table 2.** Maki (2012) Test Results for Index Log Prices  
192  
193

	Model 0: Level Shift	Model 1: Level Shift with Trend	Model 2: Regime Shifts	Model 3: Regime Shifts and Trend	
Portugal	Test statistic	-4.0196709 (-5.426)	-3.7918174 (-5.699)	-3.5372718 (-6.357)	-5.8478044 (-7.414)
	Break Dates	2 September 2005 1 June 2006 27 June 2008 8 July 2011 4 January 2012	20 December 2005 29 September 2008 26 April 2010 8 November 2010 25 September 2012	15 September 2008 12 October 2009 7 May 2010 15 November 2012 8 April 2014	14 July 2008 30 March 2009 1 October 2009 28 June 2010 16 April 2012
	Test statistic	-5.2315989 (-5.426)	-4.997719 (-5.699)	-6.4473538** (-6.357)	-7.04696 (-7.414)
	Break Dates	29 September 2008 9 August 2011 16 April 2012 3 July 2013 15 April 2014	29 September 2008 28 June 2010 7 January 2011 31 October 2011 22 May 2012	29 September 2008 29 October 2009 28 June 2010 31 October 2011 7 May 2014	15 September 2008 20 March 2009 25 November 2009 4 January 2012 1 August 2012
	Test statistic	-4.4601694 (-5.426)	-4.8588648 (-5.699)	-4.9203059 (-6.357)	-5.6718828 (-7.414)
Greece	Break Dates	29 September 2008 20 April 2009 19 August 2010 18 February 2011 20 July 2012	29 September 2008 20 April 2009 15 October 2009 19 July 2010 22 June 2012	6 May 2010 30 December 2010 29 July 2011 21 February 2012 16 November 2012	29 September 2008 30 March 2009 10 May 2010 9 May 2012 27 December 2012
	Test statistic	-3.8901673 (-5.426)	-5.081296 (-5.699)	-4.0540386 (-6.357)	-7.5345409** (-7.414)
	Break Dates	7 May 2010 10 February 2011 9 August 2011 12 March 2012 7 May 2014	15 September 2008 13 May 2010 22 November 2010 1 August 2012 1 February 2013	30 September 2005 15 September 2008 13 May 2010 24 December 2010 25 September 2012	12 September 2008 30 March 2009 29 October 2009 4 January 2012 19 July 2012
	Test statistic	-4.4271964 (-5.426)	-5.1573768 (-5.699)	-4.5586005 (-6.357)	-5.5490698 (-7.414)
	Break Dates	11 February 2008 30 May 2011 29 November 2011 3 June 2013 2 January 2014	14 March 2008 15 September 2008 6 November 2009 7 May 2010 28 February 2011	17 October 2006 2 October 2007 11 April 2008 1 July 2010 31 January 2011	14 March 2008 29 October 2008 27 November 2012 31 May 2013 14 May 2014

194 \*\* indicates significant results at 95% confidence level  
195

196 As the table shows, there is no evidence of long term relationship for the Level Shift, Level Shift with Trend, Regime  
197 Shifts or Regime Shifts and Trend models concerning the log prices of indexes and overnight LIBOR rates. However, we  
198 obtained significant cointegration test results for Italian and Spanish stock index prices in the Regime Shifts and, Regime  
199 Shifts and Trend models, at 95% confidence level. These findings are not seen credible since they are not supported by  
200 the other three models, but still first break dates of these two significant results coincide with the collapse of the Lehman  
201 Brothers. As stated in the first section of study, the financial crisis, which was caused by mortgage credits, turned into a  
202 liquidity crisis and spread to Europe. Therefore, liquidity crunch in commercial paper market and increasing demand in  
203 LIBOR market caused the sharply raising of overnight rates. In this section of the study, we analyze the relationship of the  
204 overnight LIBOR rate movements and the liquidity of stock markets of Turkey, Portugal, Italy and Spain. In accordance  
205 with this purpose, bid-ask spreads variable were used instead of stock market log prices, to examine the liquidity issue.  
206 Bid-ask spread, which refers to difference between bid and ask prices, provides significant data concerning the liquidity of

207 financial instruments and markets. It is expected to see narrowing spreads for a high level of liquidity and widening  
 208 spreads for a low level of liquidity. When the level and changes in spreads are investigated, it is seen that the highest bid-  
 209 ask spreads belong to Turkey, Italy, Spain, Portugal and Greece, respectively. Another notable finding is the increase in  
 210 the spreads of Turkey after 2013 contrasting with a decrease of spreads in the other markets. Both general ratings and  
 211 movements in 2013 show that the Turkish stock market has the lowest liquidity of these markets.  
 212



213 **Figure 3.** Bid-Ask Spreads of PIGS Countries and Turkey  
 214

215 Table 3 presents Maki (2012) cointegration test results for the relationship of bid-ask spreads of the stock markets and  
 216 overnight LIBOR rates.  
 217

218 **Table 3.** Maki (2012) Test Results for Index Bid-Ask Spreads  
 219

	Model 0: Level Shift	Model 1: Level Shift with Trend	Model 2: Regime Shifts	Model 3: Regime Shifts with Trend		
Portugal	Test statistic	-10.846133** (-5.426)	-12.440493** (-5.699)	-11.910224** (-6.357)	-14.90969** (-7.414)	
	Break Dates	13 February 2007 15 August 2007 17 June 2008 19 May 2009 17 May 2010	23 July 2007 5 December 2008 22 July 2010 14 December 2011 7 August 2012	13 February 2007 31 December 2007 5 December 2008 20 April 2010 29 October 2012	23 July 2007 9 October 2008 31 December 2009 26 October 2010 21 January 2014	
	Italy	Test statistic	-8.8231699** (-5.426)	-9.6395999** (-5.699)	-10.027173** (-6.357)	-10.580264** (-7.414)
		Break Dates	19 February 2007 14 January 2008 3 September 2008 26 May 2009 7 August 2012	19 February 2007 14 January 2008 5 July 2011 7 August 2012 1 April 2014	19 February 2007 14 January 2008 3 September 2008 26 May 2009 7 August 2012	14 January 2008 9 December 2009 22 June 2011 21 December 2011 7 August 2012
		Spain	Test statistic	-9.6447686** (-5.426)	-9.7135731** (-5.699)	-10.135107** (-6.357)
Break Dates			26 February 2007 1 February 2008 1 October 2008 22 April 2009 9 August 2012	26 February 2007 1 February 2008 7 July 2010 21 December 2011 9 August 2012	26 February 2007 30 October 2012 22 April 2009 20 April 2010 9 August 2012	14 January 2008 22 April 2009 7 July 2010 21 December 2011 9 August 2012
Turkey	Test statistic		-9.5142356** (-5.426)	-9.8588468** (-5.699)	-11.565463** (-6.357)	-11.797519** (-7.414)
	Break Dates	18 July 2007 29 July 2009 2 February 2012 24 January 2013 2 August 2013	30 September 2005 18 July 2007 29 July 2009 24 January 2013	30 September 2005 30 June 2006 18 July 2007 29 July 2009 24 January 2013	2 January 2006 18 July 2007 29 July 2009 20 July 2011 24 January 2013	

\*\* indicates significant results at 95% confidence level

220 Unlike the outcomes of log price series, the results obtained for bid-ask spreads in Level Shift, Level Shift with Trend,  
 221 Regime Shifts, and Regime Shifts and Trend models showed that Maki (2012) test statistics for all stock markets are  
 222 statistically significant at 95% confidence level. Accordingly, bid-ask spreads of the aforementioned stock markets and  
 223  
 224

overnight LIBOR rates are cointegrated and have a significant long term relationship. However, no relationship has been identified among the log price and overnight LIBOR rates. The highest test statistics were obtained through the Model 3: Regime Shifts with Trend. Considering the findings of Model 3 we can say that the first break appeared in the Turkish stock market in January 2, 2006. This break prior to the mortgage crisis gives us clues about the fragility of the Turkish stock market and its relationship with overnight LIBOR rates. The latest break (January 21, 2014) happened in the stock market of Portugal. If this date marks the end of the mortgage crisis effects for both the USA and EU countries, we conclude the stock market of Portugal is still fragile regarding to the developments in overnight LIBOR rates.

#### 4.3 Determining the Direction of Relationship

Upon confirming long term relationship between the stock index bid-ask spreads and overnight LIBOR rates for Portugal, Italy, Spain and Turkey, we conducted Fully Modified OLS, Canonical Cointegrating Regression and Dynamics Least Squares analyses to determine the direction and strength of the relationship and to estimate the parameters of cointegration. In all of the models, we used bid-ask spread as the dependent variable, and overnight LIBOR rates as the independent variable. As stated by Montalvo (1995) Dynamics Least Squares model outperforms other two models. The results of the parameter estimations are presented in Table 4.

**Table 4.** Results of Different Cointegrating Regression Models

Variable	Fully Modified OLS	Canonical Cointegrating Regression	Dynamic Least Squares
	Coefficient	Coefficient	Coefficient
Portugal	SON (0.004989)	-0.009498 (0.004993)	-0.009243 (0.005070)
	C (0.013269)	1.963655** (0.013275)	1.964048** (0.013474)
Italy	SON (0.004419)	-0.001009 (0.004422)	-0.000776 (0.004476)
	C (0.011752)	2.548364** (0.011757)	2.548684** (0.011896)
Spain	SON (0.005083)	-0.026814** (0.005086)	-0.026542** (0.005161)
	C (0.013516)	2.227328** (0.013522)	2.227819** (0.013713)
Turkey	SON (0.003973)	-0.020830** (0.003976)	-0.020562** (0.003990)
	C (0.010567)	2.993040** (0.010572)	2.992868** (0.010603)

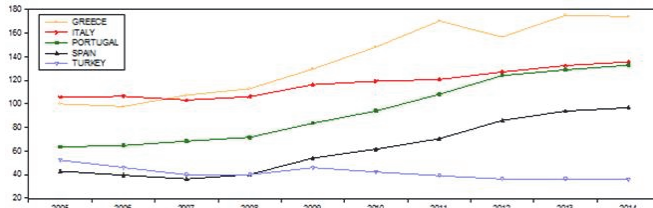
\* and \*\* indicate significant results at 95% and 99% confidence level, respectively

The findings in Table 4 demonstrate that the overnight LIBOR rate parameters for Spanish and Turkish stock markets are statistically significant at 99% percent confidence level, whereas the results for Portugal and Italy are not significant. The parameter values for both Spain and Turkey indicate that rises in overnight LIBOR rates decrease the bid-ask spread in stock index prices and therefore raise liquidity in stock markets. Consequently, decreases in overnight LIBOR rates result in low stock market liquidity in these markets. Even though this finding is inconsistent with our theoretical expectations, it is still an interesting result. A possible reason for this enigma may be explained by the decoupling process of Turkish and Spanish stock markets especially in the mortgage crisis period. The statistics related to EU-defined debt stock/GDP in Table 5 support this idea.

**Table 5.** EU Defined Debt Stock/GDP Ratios

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Portugal	63,6	64,7	68,4	71,7	83,7	94	108,2	124,1	129	132,9
Italy	105,8	106,5	103,3	106,1	116,4	119,3	120,7	127	132,6	135,6
Greece	100	97,8	107,4	112,9	129,7	148,3	170,3	156,9	175,1	174,1
Spain	43	39,6	36,3	40,2	54	61,7	70,5	86	93,9	96,8
Turkey	52,3	46,1	39,9	40	46	42,3	39,1	36,2	36,2	35,8

256 As seen in Table 5, EU defined debt stock/ GDP ratio for Spain and Turkey is notably lower than other the countries'  
257 ratios in the sample interval of our study. While Turkey has the lowest ratio, Spain showed an increasing ratio as of the  
258 year 2010. Positive decoupling of Turkey after 2009 is explicitly observed in Figure 4 below.  
259



260  
261  
262 **Figure 4.** EU Defined Debt Stock/GDP Ratios  
263

264 Despite the fact that EU-defined debt stock/GDP ratio exhibits supportive data about the decoupling of Turkish and  
265 Spanish stock markets, the nature of the relationship between bid-ask spreads and overnight LIBOR rates can be  
266 examined in a future study with additional variables. As this study analyzes the direction of the relationship, the  
267 examination of possible reasons can be the subject of further research.  
268

## 269 5. Conclusion

270  
271 This study analyzes the relationship of stock market price movements and stock market bid-ask spreads with overnight  
272 LIBOR rates. For the analyses, conducted in the period of 2005-2014, we used stock index log prices of Portugal, Italy,  
273 Greece, Spain and Turkey. Prior to the cointegration analysis, integration levels of all of the time series were determined  
274 through unit root tests and it was observed that the order of integration for all stock markets, except for Greece, are I(1)  
275 and warranted the cointegration test. According to the results of Maki (2012) cointegration analysis, there was no  
276 significant long term relationship between stock market log prices and overnight LIBOR rates except for two countries  
277 stock markets and two models. Only one model for Italy and Spain, regime shifts and regime shifts with trend, had  
278 significant statistics in the Maki (2012) test. For the analysis of long term relationship of stock index bid-ask spreads and  
279 overnight LIBOR rates, we obtained significant results for all of the countries. Subsequently, to determine the direction of  
280 the relationship, we performed three cointegrating regression models (Fully Modified OLS, Canonical Cointegrating  
281 Regression and Dynamics Least Squares) and estimated the parameters of overnight LIBOR rates for all the markets  
282 examined. The results of these tests were significant for the Turkish and Spanish stock markets with the estimated  
283 parameters of -0.021 and -0.027, respectively. The negative sign of the coefficients indicated an inverse relationship of  
284 bid-ask spreads and overnight LIBOR rates, that is, when overnight LIBOR rates increased, bid-ask spreads decreased  
285 as an indication of increasing liquidity for the Turkish and Spanish stock markets. Though this result is not consistent with  
286 our theoretical expectations, the findings were interpreted as a positive decoupling situation for the Turkish and Spanish  
287 stock markets considering the EU-defined debt stock/GDP ratio. According to the ratio Turkey and Spain have the lowest  
288 debt ratios of the countries examined.  
289

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# Problems and Prospects of Reforming the Russian Criminal Procedure Legislation

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## Abstract

The countdown of modern judicial reform in Russia has been conducted since the adoption by the Supreme Soviet of the RSFSR the Decree "On the Concept of judicial reform in the RSFSR" (The resolution of the SC of the RSFSR, 1991). However, the duration of the ongoing reforms has not led to the resolution of problems in regulation of criminal procedure. Established in the RF CCP of 2001 dualistic model of criminal procedure is constantly adjusting, while introduced in the criminal procedure law changes don't improve it, but rather mislead the law enforcer. Fundamental to the criminal procedure reform, in our opinion, is the question of the definition of the essence of criminal procedure, depending on the solution on what it is necessary to build logic of transformations. It seems that we should return to the original understanding of criminal justice as a system of guarantees of the rights and freedoms of the individual, in respect of which a criminal prosecution, and on the basis of this approach to design as a separate institutes of criminal procedure, and in General of the Russian criminal procedural form. It seems that we should return to the original understanding of criminal procedure as a system of guarantees of the rights and freedoms of the individual, in respect of which a criminal prosecution, and on the basis of this approach to design a separate institutes of criminal procedure, and in general the Russian criminal procedural form.

**Keywords:** criminal procedure, reform, legislation, human rights safeguards.

## 1. Introduction

Since the adoption in 2001 of the Criminal procedure code of the Russian Federation (Criminal procedure code of the Russian Federation, 2001) a numerous additions and changes, the contents of which are often mutually exclusive in nature, are constantly made in it. That "inflammation", in the words of M. M. Speranskiy, with which the legislator amends the criminal procedure law, indicates two things: the quality of the criminal procedure law and the lack of clarity in the question about the future direction of its reformation.

As for the quality of the criminal procedure law, this normative legal act is replete with lack of consistency to the regulation of certain institutions (for example, the language of criminal procedure), consolidation of redundant criminal procedural safeguards (in particular, the Russian formulation of the principle of presumption of innocence), the presence of gaps, reference standards, etc.

With regard to the definition of the concept of development of criminal procedure legislation, the situation is even more complex, because the supporters of the two main approaches to the understanding of the purpose of criminal procedure take an antagonistic position and are not inclined to compromise.

In the proposed publication an attempt is made to explain the author's approach to the regulation of the criminal procedure law, in the basis of which must be a liberal understanding of the purpose of the criminal procedure legislation as safeguards of the rights of criminal persecuted person.

The presented study is based on general philosophical method, the content of which includes the principles of objectivity, consistency, historical and dialectical contradictions, as well as the methods of formal logic, the legal-dogmatic method is used (interpretation and evaluation of the regulatory definitions), and also comparative legal method (in particular comparison of international legal standards and normative models of some of the Russian criminal procedure principles).

## 2. Literature Review

About inconsistency of correction of the criminal procedure law ( its private institutions) wrote many (I.A. Antonov, 2014;

57 L.A. Voskoboeva, 2014; Y.A. Lyakhova, 2010; A.Sh. Magomedov, 2013; T.K. Ryabinina and A.A. Kozyavin,  
58 <http://eizvestia.isea.ru/reader/article.aspx?id=19971>. DOI: 10.17150/2072-0904.2015.6(1).21, 2015; Karabulatova, I.S.,  
59 DOI: 10.5829/idosi.mejsr.2013.17.06.12262, 2013; and A.A. Kozyavin, 2010). This is, according to most researchers, is  
60 because the legislator has not defined the conceptual foundations of the criminal procedure reform. There are two main  
61 concepts of entity criminal justice in the literature: 1) the criminal process is a means of fighting crime and 2) the criminal  
62 process is a set of human rights guarantees, in respect to which a criminal prosecution is realized. Proponents of the first  
63 position (T.N. Ostrovskaya; A.A. Kozyavin, 2010; Y.A. Lyakhov; and T.K. Ryabinina and A.A. Kozyavin,  
64 <http://eizvestia.isea.ru/reader/article.aspx?id=19971>. DOI: 10.17150/2072-0904.2015.6(1).21, 2015) see the essence of  
65 the criminal process in the fight against crime, and, as a consequence, consider appropriate to the essence the concept  
66 of inquisitorial procedure.

67 At the same time, proponents of the second position (I.A. Antonov, 2014; L.A. Voskoboeva; and I.S. Dikarev, 2013)  
68 hold the view according to which criminal procedure legislation should evaluate toward the adversarial criminal process  
69 and along the way and the essence of the criminal process lies in ensuring procedural safeguards of the rights and  
70 freedoms of the individual, in respect of which a criminal prosecution is carried out.

71 So, I. S. Dikarev in his article, "criminal procedure: "a quiet revolution" was replaced by the reaction" in the course  
72 of reasoning about the prospects of granting the court authority to return the criminal case to the prosecutor for re-training  
73 it on the more serious offence" comes to the conclusion that "laying ... on the court the duty to monitor the object or the  
74 amount of the claims of the prosecution makes him responsible for the results of the activity which that party provides.  
75 Providing such assistance to the bodies of preliminary investigation and public prosecution, the court inevitably becomes  
76 the prosecution that destroys the competitive structure of the legislation" (I.S. Dikarev, 2013).

### 77 3. Findings and Research

80 As noted earlier, at the literature review on the topic of this publication, the main reason of problematical character,  
81 contradictions and duality of development of the criminal procedural legislation of the Russian Federation lies in the lack  
82 of consensus about the nature of the criminal-procedural activity – whether it is a way of dealing with crime (Soviet  
83 tradition) or system of human rights guarantees, in respect of which criminal prosecution is carried out (a priori  
84 assignment of the criminal process).

85 The consequence of this duality is the fact that more than 10 years of validity of the CCP of the RF of 2001 in his  
86 text 2664 amendments by adopting 148 Federal laws on amendments were made (L.A. Voskoboeva, 2014). However,  
87 changes in the CCP of the RF are inconsistent, and sometimes contradictory, simultaneously reinforce adversarial and  
88 inquisitorial components. Enforcement, in contrast, represents a purely inquisitorial results that fit into the mainstream of  
89 constitutional ideology and concepts of the criminal procedure law (Review amended of the CCP, refer to: Vereshchagina  
90 A.V., 2011) only in protecting the rights and freedoms that had been done from crime.

91 In the preparation of the current criminal procedure law a unified and clear position of the legislator on the issue of  
92 the essence of the criminal process has not been developed. This may explain the presence in the original edition of  
93 mutually exclusive provisions. For example, the duality of the legal formula for the purpose of criminal legislation, under  
94 which in criminal proceedings at the same time are protecting the rights and legitimate interests of the victim and the  
95 accused (suspect, defendant) (Art. 6 CCP of the RF). Or the preservation of a system of criminal procedural steps  
96 established in the Soviet period, which was combined with the attempt of gradual implementation of the adversarial  
97 principle. This was expressed in a clear diversification of procedural functions between subjects of enforcement; in waiver  
98 of procedural supervision of the prosecution before the court and the Institute of returning the criminal case by the court  
99 for further investigation; in changing of requirements to the content of the criminal information; in minimization of the use  
100 in the stage of the trial of derivative evidence, etc.

101 Laid dualistically purpose of criminal legislation, lobbying some of the usual provisions of the law enforcer has  
102 caused the inconsistency in introduced in the criminal procedure law changes. For example, on the one hand the Soviet  
103 Institute of returning the criminal case for additional investigation is restoring (Art. 237 CCP of the RF). On the other, the  
104 requirement of the validity of the measure of preventive detention is specifying (p.1 Art. 108 CCP of the RF).

105 The ambiguity of the purpose of criminal legislation entails the variability of the behavior of a law enforcer. In such  
106 a situation always dominates one aspect of law enforcement, in this case, inquisitorial, customary, prevailing in the Soviet  
107 time, when in the framework of criminal legislation is as thought happening the crime control and the allegedly protection  
108 of society and the victim from criminal assaults. We in the above statement used the word "allegedly" not randomly (S.I.  
109 Ozhegov, 1990), which indicates the ambiguity of such understanding of the criminal process.

110 In this regard, it should be recalled that the conceptual basis of the Criminal procedure code of 2001 is the

111 Constitution of the Russian Federation. So, part 1 of article 1 of the CCP expressly speaks about the derivativeness of  
112 the criminal procedure regulation by constitutional norms. The determinacy of the purpose of criminal legislation by  
113 ideology of this act expresses in terms of the recognition of the rights and freedoms of the individual as the highest value  
114 in the Russian Federation (Art. 2 of the Constitution of RF, Art. 6 of the CCP of the RF). In addition, the article 18 of the  
115 Constitution of the Russian Federation continues the idea of the article 2 of the Constitution, declaring the rights and  
116 liberties of man and citizen as the meaning and essence of laws, and establishes that the rights and freedoms determine  
117 the activities of legislative and executive state authorities of the Russian Federation. (The Constitution of the Russian  
118 Federation, 2008)

119 The inextricable link between the RF Constitution and the criminal procedure law was repeatedly noted many times  
120 (A.V. Vereshchagina, 2003; A.V. Vereshchagina, 2004; and A.V. Vereshchagina, 2009). It would seem that such an  
121 understanding of the role and importance of the Constitution of the Russian Federation for criminal procedure regulation  
122 should improve the quality of enforcement, the criteria to resolve complex, controversial issues of which was the priority  
123 of the rights and freedoms of personality.

124 A priori and the only essence of criminal legislation is the recognition of the criminal process, with all the  
125 guarantees of individual rights, to which the state has criminal legal claims. In the framework of criminal legislation, which  
126 is conducted on behalf and in the interests of society and the state, i.e. the public interests, the rights of a specific  
127 individual against whom the crime is committed, i.e., the victim, are protected only indirectly, because the suspect (the  
128 accused, the defendant) *may* have violated the criminal law prohibition. *The probability* of violation of criminal law ban by  
129 a specific person is most clearly manifested in the principle of presumption of innocence, i.e., the state recognizes that  
130 the fact of belonging of the person to committing crimes must be set within the framework of established by the law  
131 procedure, the violation of which is unacceptable.

132 A different understanding of the essence of the criminal legislation, i.e. as a means of crime control and protecting  
133 the rights sufferer from crimes is harmful. First, before any authority an unreachable goal is placing. Crime is inherent to  
134 any society, and therefore it is impossible to overcome.

135 Secondly, the scale of the problem (L. Kirsanova, and O. Korotina, 2014) is reducing. Fighting crime is a national  
136 problem. The higher is socio-economic relations, which provide a certain level of wealth, increased funding of state  
137 institutions involved in implementation of social programs, in fighting crime and so on, the more successful is the fighting  
138 crime.

139 Thirdly, the recognition of the criminal process as the method of protection of the victim and the associated with it  
140 understanding of the broad procedural capacities of the injured to influence the movement of criminal cases (Note 1) is  
141 contrary to the public nature of the criminal-procedural activity. This activity is carried out on behalf of the state by special  
142 authorized entities. Nasty understanding transforms the public nature of the Russian legislation to private-actional,  
143 supposing the bearing of the burden of a criminal prosecution by a private individual. In this connection the question  
144 arises: why do we need the bodies of pre-trial proceedings and prosecution, if the victim is endowed with extensive  
145 procedural opportunities to influence the process?!

146 Fourth, the understanding of the criminal process as a means of fighting crime atrophies the activities of the  
147 bodies, engaged in the operational-search activity, whose main task is the prevention of crime, detection of facts of crime,  
148 and their disclosure.

149 Fifthly, this leads to the prevalence of inquisitionist enforcement not only in pretrial proceedings, but in the trial  
150 stages. So, for the first half of 2014, by the courts of general jurisdiction was made just 2680 acquittals for a total 352700  
151 sentences (i.e., the number of acquittals was only 0.75% of total convictions), for 2013, this rate is 0.74% (5624 acquittal  
152 at made 761379 sentences) (The website of the Judicial Department under the SC of the RF, [http://www.cdep.ru/  
153 index.php?id=79](http://www.cdep.ru/index.php?id=79), 2015). Presented figures clearly indicate the absence of a court dispute about the law and the  
154 beginning of the adversarial criminal process. The role of the modern Russian court is to confirm the legality and validity  
155 of the materials of the preliminary investigation presented in court by the prosecution. It should be recalled that  
156 preliminary investigation agencies receive these materials under the inquisitorial procedure, when the implementation of  
157 the procedural rights of the defence depends on the decision of the representatives of the prosecution.

158 Sixthly, the disproportion between the declaration of adversarial system and inquisitionist of enforcement  
159 contributes to the cultivation of legal nihilism (S.F. Litvinova, 2013).

#### 161 4. Conclusion

162  
163 The situation in the criminal process involves the necessity of making decisions that would have streamlined normative  
164 regulation and enforcement. There are many propositions, which are submitted by researchers, they are from the

conceptual (the need to define the essence of criminal justice) to private (improving specific regulations) (Note 2). In General, agreeing with the fact that frequent changes should be based on the specification of the essence in criminal proceedings, we allow ourselves to express the following considerations:

1. The basis of the criminal procedure reform must be an understanding of the criminal process as a set of human rights guarantees, in respect of which a criminal prosecution is carried out.
2. The implementation of the criminal-procedural activity for each crime should be abandoned. Disclosure issues should be handled by the agencies carrying out the operative-investigative activity, and not by the bodies involved in the preparation of materials for the court.
3. To transform the system of criminal procedural stages, by abolishing the stage of excitation of criminal case and reducing pre-trial preparation materials. It is quite likely will reduce the number satisfied by the European court of human rights complaints, in connection with the violation of the right to access to justice.
4. In pretrial proceedings, the implementation of the principle of adversarial proceedings, including through the approval of the defense to participate in the investigative actions taken not only with the suspect (accused) must be extended. This minimizes doubts as submitted to the court evidentiary material and gives no consideration to the use of derivative evidence in the trial.
5. To consistently hold public beginning in the regulation of the criminal process to minimize the impact on the victim movement of the criminal case.

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# The Role of Intellectual Capital Management in Enhancing Organization' Competitiveness: An Empirical Study on Algerian Insurance Organizations

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## Abstract

The aim of this study is to empirically examine the three stages of intellectual capital management (knowledge management stage, innovation management stage and intellectual property management stage) and their relationship with business competitiveness in the Algerian insurance organizations. This study was conducted based on a psychometrically validated questionnaire designed and distributed to a random sample of 551 managers in 23 Algerian insurance organizations. The response rate was 26% as 209 managers filled the questionnaire in 16 insurance organizations. We used statistical methods to analyze the four principal hypotheses developed. In particular, we found that: (a) Intellectual capital Management (ICM) has an important existence in Algerian Insurance organizations. (b) competitiveness have an important existence in Algerian Insurance organizations. (c) Intellectual property management(IPM) is positively associated with competitiveness in Algerian Insurance organizations. (d) There is a statistically significant difference amongst Algerian insurance organizations due to privacy determinants (type, experience and turnover).

**Keywords:** Intellectual capital management, knowledge management stage, innovation management stage, intellectual property management stage, competitiveness.

## 1. Introduction

Several factors inherent in the current global situation have emphasized the importance on intellectual capital. These Contemporary forces-such as globalization, new technology, relatively free capital, increased competition, changes in customer demands, the demand for innovation, changes in economic and political structures and the role of the state in supporting knowledge economies- are constantly reshaping the way business is carried out(Guthrie and Petty,1999; Buckley and Carter2000; Thorne and Smith2000; Volberda et al 2001). Previous research has claimed that firms have begun to realize that technology-based competitiveness is transient and that sustainable advantage lies in managing intellectual capital, that is, intangible resources(Johansen et al, 1999), and in a firm's ability to create value through managing knowledge(Lev 2001; Sveiby 2001).

The term intellectual capital has existed for a long time but the concept is not in common use yet throughout the business world. Intellectual capital (IC) can be defined as all nonmonetary and nonphysical resources that are fully or partly controlled by the organization and that contribute to the organization's value creation.

Intellectual capital has been defined in several different ways. It has been defined from Larry Prusad of Ernst& Young as: Intellectual material that has been formalized, capture and leveraged to produce a higher-valued asset(Stewart, 2004), the knowledge that can be converted into value(Indra abeysekera, 2008). We all know, at least implicitly, what knowledge is. Many will think of "scientific knowledge" or even "information technology" and their outputs such as pharmaceuticals or software. Operationally, and for its strategic deployments, intellectual capital can be thought of as falling within the following specific categories:

- The Brand, being a significance and identity conveying the values and meanings of an enterprise, its products and services, and ultimately its role with the customer, consumer, and society.
- Intellectual Property, including trademarks, copyrights, patents, trade secrets, licenses, and intellectual property strategies.

- 57 - Corporate Intellect, the intelligence, energy, and creativity of the organization, including knowledge, know -
- 58 how, trade secrets, information, and data.
- 59 - Corporate Culture, the organization's way of doing business, its rituals, its practices, its history, "corporate
- 60 memory" and its social and cultural capital.
- 61 - Human Capital, the people, with their education, ethical character, abilities, talents, and relationships.
- 62 - Innovation, the work product of knowledge workers, and the ability to invent and take products and services to
- 63 market.
- 64 - Goodwill, the residual intangible, intellectual value in an enterprise that hasn't found its proper classification as
- 65 either a tangible or specific intangible asset.

66 While each of these categories enjoys high levels of strategic significance in the modern enterprise, the primary  
67 intellectual capital drivers, across all companies that can be immediately accessed and managed strategically, are the  
68 brand and intellectual property(Lindsay Moore and Lesley Craig, 2008). Although there are many different ways of  
69 subdividing IC, the one favored by the authors is to divide intellectual capital into three categories based on their  
70 economic behavior. These are:

- 71 - **Relational:** These include all relationships that the organization has, such as customers, consumers,
- 72 intermediaries, representatives, suppliers, partners, owners, lenders, and the like;
- 73 - **Organizational:** The intuitive definition was best articulated by Leif Edvinsson as "all those things that remain
- 74 in the organization when the employees have left the building but that you cannot find in the balance sheet."  
75 This includes resources such as brands, intellectual property, processes, systems, organizational structures,  
76 information (on paper or in data bases), and the like(Goran, R.& others ,2005);
- 77 - **Human:** All the attributes that relate to individuals as resources for the company and under the requirement  
78 that these attributes cannot be replaced by machines or written down on a piece of paper. This includes  
79 resources such as competence, attitude, skill, tacit knowledge, personal networks, and the like(Goran, R.&  
80 others ,2005).

81 These IC resources all form the basis for potential competitive advantage but few of them make it into any  
82 disclosure document in a verifiable form(Goran, R.& others ,2005).

## 83 84 2. Intellectual Capital Management Model

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86 To develop intellectual capital management model for organizations, it is important to illustrate the business cycle of IC  
87 and to link it to the functions of organization management. These include:

- 88 - Function of managing resources of the organization;
- 89 - Function of managing process of production;
- 90 - And the function of maximize value of the organization (value of stakeholders).

91 These functions or stages are the principal basis of organizations management. Now in economy of knowledge  
92 where 80 percent of organization value is made of intangible assets, ICM must be inheriting at each of these stages. The  
93 studies found that business cycle of IC follows the same stages as those stages above. Under this business cycle,  
94 intellectual capital develops from being a resource with a potential value to an asset with a perceived value, to becoming  
95 a product with a market value(Nermien Al-Ali, 2003, p61).

96 To incorporate the intellectual capital business cycle and stages into organizations management, this model of ICM  
97 adopts a functional classification of intellectual capital as the underlying IC model.

- 98 - Resource management offset by knowledge resources;
- 99 - Managing process of production offset by innovation resources and processes;
- 100 - Maximize value offset by intellectual property.

101 These groups are then managed, each according to its stage of development under three stages as follows. As  
102 illustrated in (Table 1), each stage is mostly focused on managing one particular form of intellectual capital(Nermien Al-  
103 Ali, 2003, p63).



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**Table (1):** The Stages of IC under the ICM Model

Intellectual Capital/ Stage of development	Human Capital	Customer Capital	Structural Capital	Purpose
Knowledge management stage	Tacit knowledge, experience, brainpower, vision	Experience, knowledge, relations, networks	IT databases,	Value creation
Innovation management stage	Ideas, product, concepts, skills.	Ideas, product, concepts, feedbacks, relationships	Work systems, business processes.	Value extraction
Intellectual property management stage	Know-how, know-why.	Brand identity, reputation, strategic alliances.	Patents, trademarks, copyrights, trade secrets.	Value maximization

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**Source:** Nermien Al-Ali, 2003, p64.2.1. The First Stage: Managing IC as Raw Knowledge Resources

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At this stage, IC—whether human, customer, or structural capital—is still in its raw form. Managing IC at this stage of its business cycle is the management of the organization’s knowledge resources in every form they come in, hence the stage of knowledge management. This stage is mostly focused on the management of human capital since employees are the main carriers and processors of knowledge(Nermien Al-Ali, 2003, p66).

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2.1 *The Second Stage: Managing IC as Innovation Resources:*

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At this stage the value of IC in the first stage is extracted at this stage when it can be materialized. The best way to describe IC at this stage is as innovation resources. This stage is mostly focused on the management of customer capital since innovation in the knowledge economy is increasingly reliant on network-based innovation(Nermien Al-Ali, 2003, p66).

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2.2 *The Third Stage: Managing IC as Intellectual Property:*

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At this stage, IC has reached its optimal level of materialized value. The best way to describe intellectual capital at this stage is intellectual property or intellectual assets. This stage is mostly focused on the management of structural capital given that IP is owned by the organization(Nermien Al-Ali, 2003, p67).

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The ICM model brings different practices, objectives, programs, and tools together in an understandable framework.

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**3. General Determinants of Competitiveness**

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- Government intervention;
- Quality of services offered;
- Price of services offered;
- Productivity and performance.
- Competitive advantage of the organization.

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**4. Research Model**

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According to the literature, intellectual capital management can affect competitiveness with three main areas: knowledge management, innovation management and intellectual property management.

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The model of research factors:

Independent Variable	Dependent Variable
Intellectual capital management	Competitiveness
- Knowledge management	
- Innovation management	
- Intellectual property management	

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152 4.1 Knowledge Management Stage

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154 Knowledge management in intellectual capital management model presents the stage at which the knowledge resources  
155 of an organization are deployed and reconfigured to create value, to form the basis for achieving the organization's goals  
156 through activities, processes of create values, innovation to extracting value, or commercialization to getting maximum  
157 profits.

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- Organizational memory loss and brain drain;

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- Tacit /Explicit Knowledge Conversions;

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- Strategizing knowledge management from applying a gap analysis, also known as a knowledge audit and  
161 adopting the knowledge strategies;

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- Operationalizing knowledge management: involves a number of steps aimed at emancipating the knowledge  
163 creation process from the rigid organizational structure, ensuring that the right culture is in place, and  
164 supporting knowledge creation processes with requisite knowledge resources (knowledge base) and IT  
165 tools(Nermien Al-Ali, 2003, p90).;

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- Storytelling or anecdote management—an ancient art revived.

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168 4.2 Innovation Management Stage

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170 Innovation management is the stage at which value created at the knowledge management (KM) stage is extracted by  
171 transforming knowledge into a product or a work process.

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- Utilization of networks in innovation management;

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- Escalation innovation management to the strategic level of the organization, where innovation strategies play  
174 two roles. First, they form part of the competitive strategy of the organization. Second, innovation strategies  
175 crystallize the mix of innovation portfolio and the way of circulate innovation management across the whole  
176 organization;

177

- Operationalizing innovation management, by adopting structural changes, spreading a culture for innovation  
178 and liberate the innovative spirit;

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- Enabling systems, practices, and tools: creating banks to gathered ideas from the human resource of the  
180 organization, adopting flexible management style of innovation management to get optimal exploitation of their  
181 customer capital, using competitive intelligence, technology management and patent intelligence to enforce  
182 the structural capital of the organization.

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184 4.3 Intellectual Property Management Stage

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- Taking intellectual property management to the strategic level in the organization: Managing IP at the strategic  
186 level based on the auditing of the primary form of IP to create an IP portfolio;

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- Operationalizing IPM—with all due respect to the legal department: Structural Changes, Cultural Changes;

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- Enabling Tools and Practices—IP Valuation.

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5. Research Problem

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Competitiveness is a topic of major interest for many organizations to monitor her success and excellence.

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Understanding the competitiveness is an important factor in determining whether it prospers, barely gets by, or  
195 fails, and "Several authors stress that competitiveness does not have a definition in economic theory"(e.g. Sharples,  
196 1990; Ahearn *et al.*, 1990).

197

Competitiveness can be defined as the ability to face competition and to be successful when facing competition.  
198 And as how effectively an organization meets the wants and needs of customers relative to others that offer similar goods  
199 or services.

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Therefore, in order for managers of Algerian insurance organizations to manage their intellectual capital to achieve  
201 high standards of excellence in meeting their costumers' wants and needs.

202

We can find many publications on competitiveness in a lot of sectors but little empirical data have been gathered  
203 on the competitiveness of Algerian insurance sector. This research will study the role of intellectual capital management  
204 in enhancing the competitiveness of Algerian insurance organizations.

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## 206 6. Research Hypotheses

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208 This research framework was developed in accordance with the literature review. From the review, it was noticed that  
209 intellectual capital management is related to business competitiveness.

210 The Intellectual Capital management Variables defined in this study is in relation to (Nermin al Ali, 2003)  
211 classification of intellectual capital management: Knowledge management, innovation management, and intellectual  
212 property management. Their interrelation and their impact on Business competitiveness will be tested. Therefore, the  
213 following four principle hypotheses are developed.

214 **H1:** There is statistically significant on the existence of "**intellectual capital management (ICM)**" in Algerian  
215 insurance companies, and this hypothesis will split into the sub-hypotheses;

216 **H2:** There is statistically significant on the existence of the "**Competitiveness**" in Algerian insurance companies;

217 **H3:** There is statistically significant relationship between "**Intellectual Capital Management**" and  
218 "**Competitiveness**" in Algerian insurance companies,

219 **H4:** there is a statistically significant difference amongst Algerian insurance organizations due to privacy  
220 determinants (type, experience and turnover).

## 221 7. Research Objectives

- 222 - To define the exploitation level of intellectual capital management in Algerian insurance organizations.
- 223 - To test the relationship between competitiveness of Algerian insurance organizations and knowledge  
224 management (Organizational memory, Tacit /Explicit Knowledge Conversions, strategizing and  
225 operationalizing knowledge management).
- 226 - To test the relationship between competitiveness of Algerian insurance organizations and innovation  
227 management (Network-based innovation, Strategizing and operationalizing innovation management, Enabling  
228 systems, practices, and tools).
- 229 - To test the relationship between competitiveness of Algerian insurance organizations and intellectual property  
230 management (Strategizing IPM, Operational zing IPM, Enabling Tools and Practices).
- 231 - To give recommendations for the management of Algerian insurance organizations regarding the intellectual  
232 capital management and his importance in enhancing their competitiveness.
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## 235 8. Literature Review

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238 Many researches proved that intellectual capital management has been a popular subject for researchers in a wide area  
239 of fields including industrial, public and private business (Nihaya El-Telbani, 2012, p128) and insurance sector. The study  
240 will compare finding of this research with modern previous studies in the insurance sector to provide some results and  
241 recommendation for Algerian Insurance Companies.

### 242 8.1 Mohammad Vafae Yeganeha, Bahman Yasbolaghi SHarahi (2014)

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245 The main purpose of this study is to investigate the intellectual capital condition and its components (human capital,  
246 customer capital and structural capital) in public and private insurance companies and the effect of the type of ownership  
247 of the insurance companies (public and private) on the degree of importance of intellectual capital and its components.  
248 The present study is a descriptive survey method in term of data collection. The findings revealed that type of ownership  
249 of the insurance companies only has significant effect on human capital variable and has not any significant effect on  
250 customer capital and structural capital variables. Also the type of ownership of the insurance companies has significant  
251 effect on intellectual capital variable and that the condition of intellectual capital in private insurance companies is more  
252 appropriate compared with public insurance companies (Mohammad Vafae Yeganeha, Bahman Yasbolaghi SHarahi,  
253 2014, p1).

### 254 8.2 Chen, Fu-Chiang, Liu, Z.-John and Kweh and Qian Long (2014)

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257 In their study, they investigate changes in productivity of general insurance firms in Malaysia for the period from 2008 to  
258 2011. Moreover, their study examines the impact of intellectual capital on changes in productivity through OLS and Tobit  
259 regressions. They provide a recommendation that general insurers in Malaysia must invest in intellectual capital,

including the improvement of their managerial skills, to gain sustainable growth in productivity (Chen, Fu-Chiang et al, 2014, p1).

### 8.3 Qian Long Kweh, Wen-Min Lu(2014)

In this study the researchers investigate the impact of intellectual capital (IC) on operating performance. They find that the overall performance of life insurance companies in China was better than that of life insurance companies in Taiwan. Their results also showed that human capital (HC) and structural capital (SC) had impacts on the operating performance of life insurance companies(Qian Long Kweh, Wen-Min Lu(2014, p1).

### 8.4 Wasim-ul-Rehman, Nabila Asghar and Hafeez ur Rehman (2013)

The main purpose of this study is to measure the intellectual capital performance of insurance sector for the period 2006-2010 using both Value Added (VA) and Value Added Intellectual Coefficient (VAICTM) model and observe intellectual capital performance's impact on financial returns of both life and non-life insurance sector. Using panel data the study analyzes the empirical relationship of Value Added (VA), VAICTM and its performance components with performance indicators of insurance sector. The results of the study reveal the existence of positive relationship between the two approaches, VA and VAICTM and financial performance indicators. As far as the existence of relationship between the performance components of VAICTM and financial performance indicators is concerned, earning per share (EPS) is positively related to human capital efficiency (HCE). There emerges a negative relationship between capital employed efficiency (CEE) and returns on investment (ROI)( Wasim-ul-Rehman et al, 2013, p1).

### 8.5 Atef Odwan, Sahar Suleiman (2012)

The aim of the study is to identify the intellectual capital and its role in Organizational Innovation, and to verify that there is a moral and an effective relation between the intellectual capital with its three elements (human, structural, customer) and the Organizational Innovation with its three levels (individual, group, and organization).The population of the study was managers from the top, executive and operational management levels from (18) Jordanian Insurance companies. The sample of the study included (80) manger in various administrative levels representing the 18 Jordanian insurance companies, an (80) questionnaire were distributed for the study, (75) were retrieved from the managers, only 50 questionnaire of the 80 was good enough to the study. The study used a set of statistical methods to analyze the data and to test the hypothesis that includes the frequencies, percentages, averages, and the standard deviations, as well as correlation coefficient level of Spearman, Simple correlation coefficient and simple regression analysis. The conclusion of the study is:There is a significant correlation between the intellectual capital and Organizational Innovation(Atef Odwan, Sahar Suleiman, 2012, p1).

## 9. Research Methodology

### 9.1 Research Instrument

The dimensions of this study and the number of the related items for each one are presented in the following table:

**Table (1):** The research' dimensions

No	Dimensions	No. of Items
1	Create value by knowledge management (KM)	20
2	Extract value by Innovation management (KM)	11
3	Maximize value by intellectual property management (IPM)	9
4	Competitiveness (C)	9
<b>Total</b>		<b>49</b>

### 9.2 Sample of the study

A simple random sample is used where 551 managers or directors of the Insurance Algerian organizations were

surveyed as recommended by (Bontis, 1998 and Bukh et al,1999).

### 9.3 Statistical Society

In this research, limited society is used because we can count and inventory of all the component units of the society studied. A limited society is used where 23 Algerian Insurance Organizations and 16 Algerian Insurance Organizations responded (response rate 70%). And the managers members responded are:

So the percentage of responded members in all the Algerian Insurance Organizations is (26%).

Category	Number of surveyed	Number of responses	Percentage
General manager	16	9	56%
Regional manager	51	19	37%
Agency manager	500	181	36%
<b>Total</b>	<b>551</b>	<b>209</b>	<b>38%</b>

### 9.4 Statistical Treatment

This research will use ordinal scales. Where the number assigned to the important (1, 2, 3, 4, 5) do not indicate that the interval between scales are equal, nor do they indicate absolute quantities. They are merely numerical labels(Nihaya El-Telbani, 2012,p129). Based on Likert scale we have the following table:

Item	Always	often	Occasionally	Rarely	Never
scale	5	4	3	2	1

Table (3) shows the results for Kolmogorov-Smirnov and Shapiro Wilks test of normality. From table (3), the (p - value=0.000) for each field is smaller than 0.05level of significance, then the distribution for each field is not normally distributed.

**Table (3):** Kolmogorov-Smirnov and Shapiro Wilks test of normality

	Kolmogorov-Smirnov <sup>a</sup>			Shapiro-Wilk		
	Statistique	ddl	Signification	Statistique	ddl	Signification
KMS	,330	209	,000	,801	209	,000
INS	,250	209	,000	,819	209	,000
IPMS	,185	209	,000	,912	209	,000
COMP	,237	209	,000	,812	209	,000

a. Correction de signification de Lilliefors

Consequently, this study will use non-parametric tests to perform the statistical data analysis. The data will therefore be analyzed using (SPSS). The research would utilize the following statistical tests:

- 1- Spearman Rank correlation for Validity.
- 2- Cronbach's Alpha for Reliability Statistics.
- 3- Kruskal-Wallis test.

## 10. Questionnaire

10.1 Questionnaires validity: Statistical validity is used to evaluate instrument validity, by using the structure validity.

### 10.1.1 Structure Validity of the Questionnaire

Structure validity is for testing the validity of each field and the validity of the whole questionnaire. It measures the correlation coefficient between one field and all the fields of the questionnaire that have the same level of liker scale.

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**Table (8):** Correlation coefficient of each field and the whole of questionnaire

N°	Paragraph	Spearman Correlation Coefficient	P-value (sig)
1	Creating value by knowledge management stage	0.879	0.000**
2	Extracting value by innovation management stage	0.965	0.000**
3	Maximizing value by intellectual property management stage	0.921	0.000**
4	Competitiveness	0.749	0.000**

\*\*correlation is significant at the 0.01 level.

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Table (8) presents the correlation coefficient between each filed and the whole questionnaire. Noticeable that the p - values (sig.) are less than 0.01, so the coefficient of correlation in all the fields is significant at  $\alpha=0.01$ , so that the fields are valid to measure what it was set for and to achieve the purpose of the study.

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### 10.2 Questionnaires reliability

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The studies used the reliability of an instrument to measure the degree of consistency which measures the attribute. Reliability can be replaced by the stability, consistency, or dependability of a measuring tool(Nihaya El-Telbani, 2012,p130).

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#### 10.2.1 Cronbach's Coefficient Alpha

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In this study we use this coefficient to measure the reliability of the questionnaire between each field and the mean of the whole fields of the questionnaire. When it supposed that the normal range of Cronbach's coefficient alpha value is between 0.0 and (+1.0), and the higher values reflects a higher degree of internal consistency(Zikmund, W. G. (2003). Table (9) shows the values of Cronbach's alpha for each filed and the entire questionnaire. The results of fields show that values of Cronbach's alpha were in the range from 0.677 and 0.944. This range is considered high; the result ensures the reliability of each field of the questionnaire. Cronbach's alpha equals 0.944 for the entire questionnaire which indicates an excellent reliability of the entire questionnaire.

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**Table (9):** Cronbach's Alpha for each filed and the entire questionnaire

N°	Field	Cronbach's alpha
1	Creating value by knowledge management stage	0.881
2	Extracting value by innovation management stage	0.772
3	Maximizing value by intellectual property management stage	0.905
4	Competitiveness	0.677
	All paragraphs of the questionnaire	0.944

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## 11. The Study Sample' Profile

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The study sample' profile is presented in table (10):

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**Table (10):** The of study sample' profile

		Percent
Type	Public	64.11
	Private	15.31
	International	20.58
	<b>Total</b>	<b>100%</b>
Years of experience	Less than 10 years	4.79
	10-less than 20	40.67
	20 and above	54.54
	<b>Total</b>	<b>100%</b>
The turnover	Less than 5Billion DA	41.67
	5-less than 10	12.94
	10-less than15	10.54
	15-less than20	04.79
	20 and above	30.06
	<b>Total</b>	<b>100%</b>

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**12. Empirical Analysis and Hypothesis Testing**

H1: There is statistically significant on the existence of intellectual capital management (ICM) in Algerian insurance companies, this hypothesis can split into the following sub-hypotheses:

H1 (a): There is a statistically significant on the existence of “Creating value from Knowledge Management Stage” in Algerian insurance companies:

**Table (11): Means and standard deviation for “«Creating value from knowledge management stage”.**

	Creating value from knowledge management stage	Mean	S.D	Test value	p-value
1	You have a strategic shift of vision where recognize yourself as a knowledge organization.	3.97	1.004	3.727	0.000
2	You are adapting knowledge strategy.	4.11	0.994	3.771	0.000
3	You have policies or programs intended to improve worker retention.	4.80	0.514	7.302	0.000
4	You use partnership or strategic alliance to acquire knowledge	4.35	1.073	5.473	0.000
5	You change the organizational culture to be knowledge organization.	3.71	1.105	3.020	0.000
6	You change the organizational structure to be knowledge organization.	3.75	0.939	3.925	0.000
7	You try to eliminate the level of departmental and divisional isolationism.	4.07	1.284	4.645	0.000
8	You encourage the collaboration among people in the organization.	4.66	0.689	6.846	0.000
9	Your organization knows what it knows.	3.87	0.457	6.277	0.000
10	You give a Monetary incentive to your employees.	2.92	1.512	2.504	0.000
11	you give a Nonmonetary incentive to your employees	3.77	0.953	3.832	0.000
12	Usage IT tools and systems to performing the knowledge management stage.	4.39	0.819	5.429	0.000
13	Usage of IT tools for the interaction between individual and organizational knowledge	4.35	0.807	5.056	0.000
14	Usage of IT tools and systems for the Tacit/ Explicit knowledge conversions.	3.54	1.109	2.669	0.000
15	Regularly up dating databases of good work practices, lessons learned or listing of experts.	4.26	1.209	5.161	0.000
16	Provide formal training related to knowledge management practices.	2.10	1.630	6.210	0.000
17	Provide informal training related to knowledge management.	3.22	1.252	3.868	0.000
18	Encourage experienced worker to transfer their knowledge to new and less experienced workers.	2.17	1.211	3.388	0.000
19	Encourage workers to continue their education for successfully completed work-related courses.	4.70	0.945	7.558	0.000
20	Facilitating virtual teams.	3.72	1.494	5.199	0.000
	<b>All paragraphs of the field</b>	<b>3.87</b>	<b>0.767</b>	<b>4.427</b>	<b>0.000</b>

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The table (11) presented above presents the following results:

The mean, Standard deviation equals, Test-value of all paragraphs of the field “Creating value from knowledge management stage” are respectively equal to (3.87 (77.4%), (0.767), 4.427) and the value of significance equal to 0.000 which is smaller than the level of significance ( $\alpha = 0.01$ ), so the mean is greater than the hypothesized value 3. We can conclude that the respondents are agreeing on the content of this dimension “Creating value from knowledge management stage” in Algerian insurance companies.

H1(b): There is a statistically significant on the existence of «Extracting value from innovation management stage” in Algerian insurance companies:

**Table (12): Means and standard deviation for «Extracting value from innovation management stage”**

	«Extracting value from innovation management stage”	Mean	S.D	Test value	p-value
1	You are adapting an innovation strategy.	3.41	1.057	3.801	0.000
2	You have values system or culture intended to promote (IM).	3.12	1.256	3.739	0.000
3	You change the organizational culture and structure to be more flexible.	3.84	1.019	3.484	0.000
4	Facilitate the forming of cross-functional innovation teams.	3.87	1.266	4.150	0.000
5	The use of carefully designed reward to encourage innovation	1.86	1.273	5.042	0.000
6	You Have a bank idea	4.24	1.178	4.466	0.000
7	You seek and gather idea and knowledge, from customers, suppliers, employees, other industries and competitors	2.78	1.581	2.753	0.000
8	Capturing and using knowledge obtained from public research institutions including universities, technical colleges	4.37	1.044	5.259	0.000
9	Encouragement the diversity of viewpoint, talent and expertise.	3.50	1.286	3.778	0.000
10	The involvement of customers at innovation management to help the new product development team.	2.95	1.444	3.165	0.000
11	The incorporating of a competitive intelligence system in the organization’s work systems (i.e., be cultivated as part of the structural capital).	2.36	1.532	4.621	0.000
	<b>All paragraphs of the field</b>	<b>3.27</b>	<b>0.744</b>	<b>4.085</b>	<b>0.000</b>

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The table (12) presented above presents the following results:

The mean, Standard deviation equals, Test-value of all paragraphs of the field «Extracting value from innovation management stage” are respectively equal to (3.27 65.4%, 0.744, 4.085), and the value of significance equal to 0.000 which is smaller than the level of significance ( $\alpha = 0.01$ ), so the mean is greater than the hypothesized value 3. We can conclude that the respondents are agreeing on the content of this dimension «Extracting value from innovation management stage” in Algerian insurance companies.

H1(c): There is a statistically significant on the existence of «Maximizing value from intellectual property management stage” in Algerian insurance companies;

**Table(13):** Means and standard deviation for «Maximizing value from intellectual property management stage”.

	«Maximizing value from IPM stage”	Mean	S.D	Test value	p-value
1	Your organization put the intellectual property strategies as a part of the competitive strategies.	3.45	1.263	2.978	0.000
2	IN your organization, at strategic level, the intellectual property they have across the whole organization is clear.	3.91	1.157	3.988	.000
3	Your organization incorporating the knowledge of patents, trademarks (brands), copyrights, and trade secrets to create synergy between the management of the various forms of intellectual property.	2.66	1.183	2.667	.000
4	Management of intellectual property as a business asset throughout the whole organization.	3.78	1.060	2.676	.000
5	IPM has to shift from a defensive and legal-oriented to an integrative approach wherein it is engrained in the management of business as a whole.	3.06	1.389	2.907	.000
6	You change culture to create an intellectual property aware culture.	3.99	1.076	3.310	.000
7	The responsibility of capitalizing on IP is handed down to the various business units, to operationalize the IP strategies forged by top management.	3.11	1.210	3.038	.000
8	Your organization provided with IT tools that aid decision making in the intellectual property management processes.	3.22	1.461	2.400	.000
9	Your organization provided with methods that aid decision making in the intellectual property management processes.	2.83	1.476	3.677	.000
	<b>All paragraphs of the field</b>	<b>3.27</b>	<b>1.064</b>	<b>3.572</b>	<b>.000</b>

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The table (13) presented above presents the following results:

The mean, Standard deviation equals, Test-value of all paragraphs of the field «Maximizing value from intellectual property management stage” are respectively equal to (3.27 (65.4%), 1.064, 3.572), and the value of significance equal to 0.000 which is smaller than the level of significance ( $\alpha = 0.01$ ), so the mean is greater than the hypothesized value 3. We can conclude that the respondents are agreeing on the content of this dimension «Maximizing value from intellectual property management stage” in Algerian insurance companies.

H2: There is statistically significant on the existence of the “Competitiveness” in Algerian insurance companies;

**Table(14):** Means and standard deviation for « Competitiveness”.

	Competitiveness	Mean	S.D	T-value	p-value
1	The government intervened in your business.	3.27	0.639	4.182	.000
2	Adaptation of a strategy to deal with the new competition.	4.49	0.659	5.249	.000
3	You move faster than your competitors in the market.	3.99	0.874	3.727	.000
4	You have an increasingly rise of market share.	4.26	0.614	4.506	.000
5	Implementation of quality improvement in your business, to increase productivity and performance.	4.00	0.616	4.506	.000
6	Improvements in design of new product to increase your share market and strong your competitive position.	4.08	1.067	3.914	.000
7	Improvement of customer satisfaction through customization.	3.02	1.297	4.763	.000
8	Investments in image, brand and communication.	3.65	1.248	4.148	.000
9	Investments in patents to protect your competitive advantage.	2.39	1.232	2.601	.000
	<b>All paragraphs of the field</b>	<b>4.00</b>	<b>0.772</b>	<b>2.940</b>	<b>.000</b>

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The table (14) presented above presents the following results:

The mean, Standard deviation equals, Test-value of all paragraphs of the field «Competitiveness” are respectively equal to (4.00 (80%), 0.772, 2.940), and the value of significance equal to 0.000 which is smaller than the level of significance ( $\alpha = 0.01$ ), so the mean is greater than the hypothesized value 3. We can conclude that the respondents are agreeing on the content of this dimension « Competitiveness in Algerian insurance companies.

H3- There is statistically significant relationship between “Intellectual Capital Management” and “Competitiveness”



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in Algerian insurance companies, this hypothesis can be divided into the following sub-hypotheses:

**Table(15):** Spearman coefficient correlation of each field and competitiveness

		KMS	IMS	IPMS	competitiveness	ICM
KMS	Coefficient de corrélation	1,000	,561**	,680**	,508**	,806**
	Sig. (bilatérale)	.	,000	,000	,000	,000
	N	209	209	209	209	209
IMS	Coefficient de corrélation	,561**	1,000	,349**	,316**	,622**
	Sig. (bilatérale)	,000	.	,000	,000	,000
	N	209	209	209	209	209
Rho de Spearman IPMS	Coefficient de corrélation	,680**	,349**	1,000	,298**	,672**
	Sig. (bilatérale)	,000	,000	.	,000	,000
	N	209	209	209	209	209
competitiveness	Coefficient de corrélation	,508**	,316**	,298**	1,000	,827**
	Sig. (bilatérale)	,000	,000	,000	.	,000
	N	209	209	209	209	209
ICM	Coefficient de corrélation	,806**	,622**	,672**	,827**	1,000
	Sig. (bilatérale)	,000	,000	,000	,000	.
	N	209	209	209	209	209

\*\* La corrélation est significative au niveau 0,01 (bilatéral).

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H3(a): tested the association connecting knowledge management stage and innovation management stage. The end results show a positive and significant relationship, +0.561(at  $p < 0.001$ ) for the Algerians insurances organizations sample (see Table 14).

Furthermore, H3(b) tested the association between knowledge management stage and intellectual property management stage. Finally, the conclusions also illustrate a positive and significant coefficient +0.680 (at  $p < 0.01$ ).

Moving on, a positive significant coefficient for the sample (+0.349) (at  $p < 0.001$ ) confirmed the H3(c) (intellectual property management is positively associated with innovation management in Algerian Insurance organizations).

H3(d) tested the relationship between knowledge management stage and competitiveness, and according to the result in the sample there is a positive coefficient (+0.508), (at  $p < 0.001$ ).

H3(e) tested the relationship between innovation management stage and competitiveness, and according to the result in the sample there is a positive coefficient (+0.316), (at  $p < 0.001$ ), H3(f) tested the association between intellectual property management stage and the competitiveness. The results show a positive coefficient (+0.298 at  $p < 0.001$ ).

Finely, H3: tested the association between intellectual capital management and the competitiveness. The results show a positive coefficient (+0.827 at  $p < 0.001$ ), (see Table14).

H4: there is a statistically significant difference amongst Algerian insurance organizations due to privacy determinants (type, experience and turnover), this hypothesis can be divided into the following sub-hypotheses:

H4(a): there is a statistically significant difference amongst Algerian insurance organizations due to type (public, private and international);

**Table(16):** Kruskal-Wallis test of the fields and their P-values for type (Public, private and international)

	K-M-S	I-M-S	IP-M-S	competitiveness	ICM
Khi-deux	115.376	61.988	40.819	126.564	123.322
N	2	2	2	2	2
Significant	0.000	0.000	0.000	0.000	0.000

\*\*The mean difference is significant a 0.01 level

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Table (15) shows that (P-value=0.000) of each field is smaller than the level of significance (0.01). There is a statistically significant relationship difference amongst Algerian insurance companies toward "The role of intellectual capital management in enhancing organization' competitiveness" due to type of company (public, private or international).

H4(b): there is a statistically significant difference amongst Algerian insurance organizations due to experience;

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**Table(17):** Kruskal-Wallis test of the fields and their P-values for experience

	K-M-S	I-M-S	IP-M-S	competitiveness	ICM
Khi-deux	98.419	25.757	24.142	17.986	29.259
N	2	2	2	2	2
Significant	0.000	0.000	0.000	0.000	0.000

\*\*The mean difference is significant a 0.01 level

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Table (16) shows that (P-value=0.000) of each field is smaller than the level of significance (0.01). There is a statistically significant relationship difference amongst Algerian insurance companies toward "The role of intellectual capital management in enhancing organization' competitiveness" due to experience of Algerian insurance organizations.

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H4(c): there is a statistically significant difference amongst Algerian insurance organizations due to turnover;

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**Table(18):** Kruskal-Wallis test of the fields and their P-values for Turnover

	K-M-S	I-M-S	IP-M-S	competitiveness	ICM
Khi-deux	111.655	140.308	53.461	10.242	30.240
N	4	4	4	4	4
Significant	0.000	0.000	0.000	0.000	0.000

\*\*The mean difference is significant a 0.01 level

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Table (17) shows that (P-value=0.000) of each field is smaller than the level of significance (0.01). There is a statistically significant relationship difference amongst Algerian insurance companies toward "The role of intellectual capital management in enhancing organization' competitiveness" due to turnover of Algerian insurance organizations.

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### 13. Conclusion

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The results from this study are as expected and significantly supportive to the hypotheses developed.

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- The first hypothesis proved that the Algerian Insurance organizations manage their intellectual capital, by managing knowledge management to create value (mean=3.87), manage innovation to extract value (mean=3.27) and manage the intellectual property to maximize value in the market (mean=3.27);

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- The second hypothesis proved that the Algerian Insurance organizations have a competitiveness in their market (mean= 4);

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- The third hypothesis proved that the relationship between ICM and competitiveness is positive. This relationship is by value close to 0.827 in this sample of Algerian insurance organizations.

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- The fourth hypothesis proved that there is a statistical significant difference amongst Algerian insurance organizations due to privacy determinants like their type, years of experience in the market of insurance and their turnover.

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### 14. Recommendations

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It is essential before embarking on implementing any ICM stage or program to ensure that the organization has the appropriate business model, vision, and culture in place—in short, to ensure that it has its act together.

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There is a need in Algerian Insurance Organizations to recognize knowledge management as the first stage of a total model of intellectual capital management where the organization deploys its resources to enhance their competitiveness, especially in the economy of knowledge;

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There is a need in Algerian Insurance Organizations to adopt flexible innovation management, and utilize networks based innovation to spread the culture and possess of innovation across the whole organization;

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There is a need in Algerian Insurance Organizations to creating an innovation portfolio of projects to translate competitive strategies and to manage risk across the whole organization.

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There is a need in Algerian Insurance Organizations to effecting the necessary structural changes (culture, structure, information technology tools) to arrange skills throughout the organization in competence centers, and enable the formation of the right team for the purposes of the innovation project.

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There is a need in Algerian Insurance Organizations to adopt and mainstream an organizational culture that

504 promotes innovation by allowing employees time to innovate for improving job performance.

505 There is a need in Algerian Insurance Organizations to know and assess the intellectual property wealth of the  
506 organization and assess its current and potential uses, particularly in relation to the primary form of intellectual property.

507 There is a need in Algerian Insurance Organizations to build a strong IP portfolio by combining weak with strong  
508 IP, reinforcing strong IP through acquiring additional supporting same or different forms of IP, and abandoning low-  
509 performing IPs.

510 There is a need in Algerian Insurance Organizations to adopt IP strategies that enable the use of IP as a  
511 competitive weapon (lawfully) to hamper competition's efforts in securing a strong competitive position for short- and  
512 medium-term purposes.

513 There is a need in Algerian Insurance Organizations to adopt IP strategies to sustain and create new competitive  
514 advantage in the long term.

515 There is a need in Algerian Insurance Organizations to adopt intellectual property strategies for commercialize it as  
516 a business asset to expand geographically and be able to take more market shares and destroy their competitors;

517 There is a need in Algerian Insurance Organizations to take intellectual property management to the operational  
518 level by effecting the necessary changes to the structure of the organization, and allocating responsibility to intellectual  
519 property teams and units;

520 There is a need in Algerian Insurance Organizations to instill in the culture of the organization awareness of the  
521 proper use of IP by establishing sound management practices, both to preserve the value of IP and to guard against  
522 infringing the IP of others.

523 There is a need in Algerian Insurance Organizations to provide tools and systems to help the employers at the  
524 operational levels to managing intellectual property. In particular, using tools for the valuation of intellectual property.

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## Italian Attitude Towards the Albanian Issue: Albania's Southern Border at the Conference of Ambassadors in London 1912-1913

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### Abstract

*This paper aims to analyze the overall attitude of Italy on Albanian issue and in particular the determination of the southern border with Greece in the Conference of Ambassadors in London 1912-1913. The problem of the South Albania and setting of the borders with Greece have implicated as the Balkan states, but also the great powers, like Italy. Italy had politico-strategic interests on Albania, which cross the boundaries of this area. They could not allow the establishment of Greeks on the coast in front of Corfu being a threat to the safety of the Italian state. The issue of Southern Albania connected to solving the Aegean problem or the islands of Dodekanesz; unraveling the great Italian interest on Southern Albania. Italian attitude in determining the Greek-Albanian border was in line with the attitude of Austria-Hungary, by creating a common front against the unfair expansionist aims of Greek to Southern Albania (Northern Epirus).*

**Keywords:** Conference of Ambassadors; "Northern Epirus"; southern boundary; Italy.

### 1. Introduction

Albania today represents within its borders a glorious as well as fragmented history. It is the home of Skanderbeg, the national hero of the Albanians, wellknown as Prince of Albania and Epirus. But pride of Skanderbeg, ancient Epirus of Pirro, Epirus of Ali Pasha Tepelena, suffers from painful separation of the London Conference, from the ilyrian age-longing body that has permanently fed. Leaving across the borders of Cameria (South Epirus), 1913, constitutes a major disaster for the Albanian nation but also for Europe with its culture and history. Why did not new Rome (Italy), want new Epirus (Albania) to stand alongside of the golden pantheon of European history and culture, like Athens (Greece) did? With its division Epirus was overshadowed in this pantheon. Namely, starting from this perspective, in this paper we aim to shed light on this historical fact, setting the southern border of Albania, a border that separated Epirus (London Conference of 1913) and the role of Italy in it. Did the Italian state have any opportunity to influence the right solution for this problem?

Italy as one of the countries with geographical but also historical proximity to Balkans had a very important role in setting the southern border of Albania, a role this which in the future would have continuous implications until nowadays. The importance of this border was not merely territorial but also historic, cultural, religious, it assigned the future of ancient Epirus.

This topic is treated in its entirety in the historical literature. While for northern and northeastern border this problem appeared simpler because Serbia-Montenegro claims could not be other than territorial ones; the southern border provinces since the Cameria consisted in a small percentage of the Greek population, and given the old history of Epirus, Greece claims were as historical and territorial, political and religious ones. Given this context, this article aims to shed light specifically on the issue of the southern border in which obviously Italy as a neighbor of Albania and Greece and as one of the participating powers of the London Conference, would play its role.

Domestic and foreign historiography have made valuable contributions on the treatment of this topic, but these publications have not had a particular item to study. The novelty of this paper, stands to the bleaching of Italian politics, Italian residence investigation in relation to the Great Powers, especially with Austria-Hungary against Albania. This new approach represents a challenge that aims to bring to light and to treat with scientific objectivity the truth of Italian politics, especially Italy's diplomatic activity, to explain why Italy pursued a particular policy towards this Albanian issue and which were the reasons for this attitude.

For the realization of this paper it is used the literature selected by major institutions on historical sources as the National Library of Albania, Albanian Central State Archive, the Library of the Academy of Sciences of Albania, the

56 Library of the Institute of History of Albania. The literature consists of primary historical sources, such as manuscripts and  
57 the dailies of that period, memories of historical persons of the respective period, as well as secondary sources: historical  
58 publications and the most significant scientific articles about this issue.  
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## 60 **2. Albanian Issue and the Interests of the Great Powers**

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62 The Albanian issue was placed in the center of the diplomatic war between the Great Powers with the beginning of the  
63 First Balkan War, due to their interests in the Balkans.

64 The victory of the Balkan allies against the Ottoman army forced European countries to abandon the preservation  
65 of the status quo on the peninsula. Antanta's countries supported the plans of the allies for the territorial changes at the  
66 expense of Albanian lands; actually that was opposed by the powers Tripartite Bond, particularly from Italy and Austria-  
67 Hungary. They considered Albania as a fence that will prevent the spread of pan-Slavism and Greek influenza and a  
68 basis for extending their political and economic influence in Balkans (Albania Academy of Sciences, 2002, pp. 514-515).  
69 Italy saw Albania in perspective as "the fifth coast" ("quinta sponda"), as a headbridge for late infiltration of Italian  
70 imperialism in the East (Puto, 2009, p.53), as the best means to ensure free sailing across the Adriatic Sea (Zavalani,  
71 1998, p.226).

72 Disagreements between the Great Powers and the fight of the Albanian people against the foreign yoke dictated  
73 the Declaration of Independence of Albania, on 28 November 1912 in Vlorë, by the famous patriot and diplomat Ismail  
74 Qemali (Academy of Sciences of Albania, 2002, p.515).

75 On the international plan, independent Albanian state "seen in horror as the illegitimate child of Austrian diplomacy,  
76 with Italy that figured as the mom" (Swire, 2005, p.130). Balkan states had no interest and the existence of the Albanian  
77 nation didn't suit to them, because they saw it as an obstacle to the realization of their expansionist goals.

78 One of the contenders of the Albanian land was Greece, which aimed to expand its occupation in Vlorë,  
79 considering South Albania as the "Northern Epirus", as an integral part of Hellenic heritage (Krisafi, 2007, p.124). Greek  
80 media expressed this view in the most brutal way by writing: "It is an impossible thing to let the barbarians Albanians live  
81 in the cradle of Greek civilization" (Zavalani, 1998, p.225). But precisely for these "barbarians", the ancient Greek  
82 historians themselves had written that they stretched to the bay of Arta, so exactly to the settlements of this period with  
83 Albanians.  
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## 85 **3. Italy, Albanian Issue and Southern Border of Albania**

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87 Conference of Ambassadors in London was gathered to mediate the Turkish-Balkan conflict of 1912-1913 and to decide  
88 about the political future of the Balkan territories of the Ottoman Empire. It was held (December 1912-August 1913) under  
89 the chairmanship of British Foreign Minister Edward Grey. Position and geopolitical and geostrategic importance,  
90 the goals of the Balkan countries to the end the conflict with Turkey and intertwining interests of the Great Powers put the  
91 Albanian issue at the center of the agenda of the Conference. (Krisafi, 2007, pp.119-120).

92 During the conference they discussed two aspects of the Albanian issue: the future political status and the setting  
93 of boundaries of Albania. Ambassadors decided the creation of autonomous Albania under the "sovereignty or the  
94 "suzerainty" of the sultan, assuming "the guarantee of exclusive control of the six powers" and "proclamation of  
95 neutrality". This decision of the international factor marked a step back of the Albanian problem undermining the  
96 achievement of the Assembly of Vlorë which proclaimed secession from Turkey and the country's full independence.  
97 Representatives of Austria-Hungary and Italy were charged with drafting and presentation of a project for organizing the  
98 autonomous Albanian state (Academy of Sciences of Albania, 2007, p. 20). Albania, according to this decision, would be  
99 still under the framework of the Empire, knowing just the right of internal autonomy. In Conference didn't participate  
100 neither the Balkan allies nor Albania, whose voice was not heard because the formula of independence was disregarded.

101 Italy and Austria-Hungary were for an autonomous or independent Albania with wider borders. Their action in  
102 positive complexity, was nevertheless confused with suspicious purposes, each of the two powers, require the new state  
103 to enter its sphere of influence (I. Qemali, 2007, pp.367-368). Italy considered Austria-Hungary as a strong competitor,  
104 after it became dominant throughout the east coast, owning Vlorë, Otranto channel, with an aim to turning the Adriatic  
105 sea in an Austrian one. Italy could not be limited to a passive vigilance attitude. Italy had to oppose Austrian influence, at  
106 least in the most risked area to it such was southern Albania. At the conference, even if the two countries did not have the  
107 same goals, they had a common line of conduct: Albania of Albanians (Giannini, 1940, pp.11-12). At first glance it is a  
108 right principle, but it was not clear what each party meant by "Albanian" as a territory.

109 In its first session, the Conference took overall decisions placing in principle that autonomous Albania bordered in

110 the north by Montenegro and south by Greece. Delineation of boundaries was a very sensitive issue that affected many  
111 interests as Balkan states but also the powers that were behind them. As at the time of the Berlin Congress, but on a  
112 more extensive scale, Albania became the apple of discord between European powers and their satellites in the Balkans.  
113 The point was how land of the Ottoman Empire should be divided. (Zavalani, 1998, p.225).

114 The issue of defining the boundaries fragmented the attitude of the Great Powers, which leded not by the ethnic  
115 principle, but by the fulfillment of strategic interests in the region. Austria-Hungary and Italy favored the inclusion of as  
116 many territories within the political borders of Albania, necessary for the stability and progress of the country (Swire,  
117 2005, p.133). This is a basically positive attitude but not enough to Albanian concerns that was threatend by numerous  
118 enemies, or behind of which stayed significant forces.

119 In late December and early January 1913 the governments of the allied countries of the Balkans presented in the  
120 Conference their views on territorial changes that should be made in the peninsula after the war. However, despite these  
121 legitimate demands, based on the principle of nationality, the Balkan allies appeared quite exaggerated claims, driven by  
122 chauvinist greeds. These claims touched, firstly, inhabited lands by Albanians. Greece claimed, besides the Greek  
123 provinces of Thessaly and parts of southern Albania (which included the Vilayet of Ioannina), inhabited by  
124 overwhelmingly Albanian population (Albanian Academy of Sciences, 2007, p.21). While the organization of the new state  
125 resulted in serious disagreement, discussion of borders lasted eight months. Italy and Austria would insist in providing  
126 boundaries to ensure not only the vitality of Albania (of what would remain), but also contribute to the safety of the  
127 Adriatic, preventing Greece from threatening Vlorë and strengthen the Corfu Channel (Torre, 1960, pp.421-422).

128 London Conference began to deal specifically with the setting of the boundaries between Albania and Greece only  
129 during the second half of March 1913, after an agreement was reached in general for northern and northeastern borders.  
130 By that time the issue was discussed outside the conference especially in bilateral negotiations between Austria-Hungary  
131 and Italy, which had previously determined the common position that would keep in the conference. Italy took the leading  
132 role in discussing southern border (Academy of Sciences of Albania, 2007, p.25). On 19 March 1913, the Italian  
133 ambassador Imperial presented to the Conference of Ambassadors the Austro-Hungarian and Italian joint project for the  
134 south borders. According to the project, Janina and a considerable area of southern Albania jointed Greece, while Korca  
135 and Gjirokastra remained to Albania (Duka, 2007, p. 34).

136 This project from one hand, reflected the concern of Vienna not excessively curtailing Albanian territory and  
137 especially leaving Korca to Albania. On the other hand, it was Italy's opposition for not leaving the entire coast in front of  
138 Corfu to Greece. According to Rome, a Corfu channel all at Greece could constitute a potential danger to the southern  
139 coast of Italy (Puto, 2009, p.80). Italy to facilitate reaching an agreement, proposed a boundary on the coast not the  
140 discharge of the river Kalamas, but Stillo Cape in front of Corfu (Academy of Sciences of Albania, 2007, pp.25-26).  
141 Austro-Hungarian and Italian diplomacy motivated by politics of balance not by the principle of rights for the delineation of  
142 the borders of Albania (Bumci, 1920, p.3).

143 The situation in southern Albania, keeping Greek military forces on the island of Sazan and the threat to blockade  
144 from the Greek fleet of the port of Durres, quickly put on alert two powers interested in the Adriatic, which signed on May  
145 8, 1913 in Rome a secret agreement, according to which both powers engaged to conquer and share Albania.  
146 Specifically Italy wanted Greece to leave as soon as possible from the occupied territories in the east coast of the Adriatic  
147 and especially from Saranda and Gjirokastra. Italian government informed the Greek government that the occupation of  
148 both coasts of the Strait of Corfu jeopardized the communication in a channel that was considered vital for Italy.  
149 Therefore, this place was even prepared to go to war to prevent such a development. Even Italy began to mobilize the  
150 troops to deploy in Vlorë (Pearson, 2004, p.42). The agreement provided the possibility of invasion of Albania by their  
151 armed forces dividing its territory into two equal parts: Austro-Hungarian would have the provinces over Shkumbin, Italy  
152 those south of the river. So Italy in coordination with Austria-Hungary also held positions that highlighted their maximum  
153 interest for territorial gains against Albania clearly evidenced in this agreement (Mousset, 2004, p.14). Italian troops  
154 began to concentrate in Brindisi. Italian military expedition objectives were Vlorë, Saranda and southern Albania up to  
155 Shkumbini River. Objectives of Austria-Hungary were Shkodra, Shengjin and North Albania. The official objective of the  
156 two powers of the Adriatic, with this project would venture, to impose respect for the decisions of the Great Powers and  
157 the establishment of a minimum of public order in the troubled Albania by Turkish militiamen, by interim rival  
158 governments, the provincial authorities that were created and arised everywhere in this country, by the Greek troops  
159 which threatened Vlorë and the Serbian ones who had not yet left the country (Pernice, 191, p.498).

160 A letter sent from Luigj Gurakuqi to Lef Nosi on May 18, 1913, from Rome, where among other things writes "for  
161 the lower boundary of Albania we are trying in London and here, with all the powers: they are ensuring us that Korca and  
162 Konica will be ours and by the sea side will not give Greece more than up to the gulf of Ftelias "(the Central State Archive  
163 of Albania (AQSH), P. 32, D.55 / 1, p.103). From these words of L. Gurakuqi, we understand that Albanian's hopes to

164 preserve their ethnic territories were few. This shows that international opinion had not yet properly assessed Albanian  
165 national factor and saw Albania as a territorial expression without significance, except for their interests. While in another  
166 state it was justifiable, for Italy, next door to Albanians, Skanderbeg ally, this was unacceptable. Italy as a civilized  
167 country, power of the London Conference should have supported the principle of self-determination for the Albanians, the  
168 right to live in their lands.

169 Following the works of the Conference became apparent that the spotlight was the contradiction between Greece  
170 and Italy. Italians have been against allowing the Greeks to decide their border in the north of Corfu, having feared that  
171 the control of both sides of the canal from a single power would constitute a threat to the security of Italy in the Adriatic  
172 (Gurakuqi, 2011, p.43). Albanian southern border issue was complicated with that of Dodecanese. This archipelago was  
173 desired by Greece. (Torre, 1960, p. 422).

174 Why was the issue of South Albania connected with the problem solving of Aegean?

175 During the Balkan wars the Greek military navy had conquered all previously owned islands of Greece. Italy since  
176 the Italian-Turkish war in 1911, carrying the Dodecanese islands occupied. Aegean islands were a tremendous strategic  
177 importance after controlling entries and exits from the Dardanelles. Therefore, their future was of vital importance to all  
178 the particular powers especially for the powers claiming for dominance in the Mediterranean. Solving the southern border  
179 of the Albanian state was linked in this way with the issue of the Aegean islands, because the Italians thought to use the  
180 islands held by them as a counterweight to limit the greek claims in the case of and southern borders and in case of  
181 issuance of Crete to Greece (Gurakuqi, 2011, p.38). During the Conference of Ambassadors Italy agreed with the  
182 proposal made by E. Grey Greece to get Aegean islands occupied by Greek troops, including the Dodecanese held by  
183 Italians. Italy agreed with this proposal because it intended to prevent Greek invasion of Epirus. This statement of the  
184 Italian government in the last minutes of the London Conference of Ambassadors dated May 30, 1913 and under these  
185 circumstances they find out that the Greek government admitted (not saying that was forced to accept) to sign the Treaty  
186 of London of May 30, 1913, recognizing that the appointment of the border with Albania to be made by Great Powers  
187 (Gurakuqi, 2011, p.37). Italy, in agreement with Austria-Hungary, on May 21 presented a second draft containing a  
188 concrete description of the borderline. Gjirokastra and Korca remaining within the borders of Albania and the border  
189 resulted in Ftelias Bay to Cape of Stillo. In exchange for consent Rome appeared ready to pass Aegean islands to  
190 Greece (Puto, 2009, p.80). Italy proposes, contrary to Greece, supported by France, to reach the Albanian border to  
191 Cape of Stillo not to relinquish control of the Straits of Corfu, therefore the Strait of Otranto entirely up to Greece, and to  
192 include Korca, a major center, a big area inhabited mainly by Albanians, a basic for the future economic prosperity of the  
193 new state. (Biagini, 2000, p. 114).

194 The government of Rome ordered its ambassador in London to insist that the expansion of Greece limited with  
195 Kalamas river and city of Preveza in Cameri, taking as his basic requirements that Athens government had submitted to  
196 the Congress of Berlin. Fortunately, the British government was convinced that Greece had excessive oppression and Sir  
197 Edward Grey, by leaving indifferent position of impartiality, took the side of Albania (Zavalani, 1998, p. 229).

198 Treaty of 30 May, 1913 was the first international act to express the idea of an Albanian state on its own, but it is  
199 not a final act, while the Conference of Ambassadors had still in its agenda the status of Albania (Puto, 2009, pp.61-62).  
200 The Greek government is making another attempt to avoid enforcement of the decision of the Great Powers.

201 In mid-June 1913 Greek Foreign Minister in a meeting with the British ambassador in Athens expressed the greek  
202 view. According to him the boundary could begin from the Stillo's bay or Ftelia to continue northwards leaving only a  
203 coastal strip to Albania, and Greece would take Gjirokastra and the valley of Drinos, Përmet, Këlcyrë and Korca. It was a  
204 sacrifice that Himara and Saranda were left (Kontis, 1976, pp. 107-108). So Greece aspired to take all the province of  
205 Epirus (Southern Epirus or Cameria) as well as the North-of the southern Albania to the Seman river. This was a totally  
206 unfair request and of chauvinistic character. The government of Vlora and the Albanian patriotic forces were against  
207 these claims, seeking diplomatic plan that territory from Korca to Ftelias Bay to remain to Albania.

208 To support its efforts for a more favorable solution to setting boundaries, by the end of June 1913, the Provisional  
209 Government decided to send a special delegation to Rome and Vienna to present requests of Albania to one of the  
210 Albanian provinces that threatened more of the greek claims. This was all about Cameria (South Epirus). The delegation  
211 presented a memorandum. It was well received in Rome and in Vienna even better. Here it held meetings at various  
212 levels, state and private, but heard good words for their predisposition for a fair resolution of the issue of boundaries  
213 (Vlora, 2001, pp. 26-27). Now this newly formed state needed secure and internationally recognized borders. The interim  
214 government of Vlora, required all territories inhabited by Albanians (Salleo, p. 45).

215 The agreement about the the coastal border was reached in June according to the proposal of Italy. But it took two  
216 months of discussions outside the Conference to resolve the full agreement for all the border between Albania and  
217 Greece. Rome and Vienna decided not to make any concessions and announced that they called Korca at east and Cape



218 Stillo southwest like "pillars of Hercules" to Albania (Albanian Academy of Sciences, 2007, p. 26).

219 The final decision of the Conference of Ambassadors is the act of 29 July 1913, the most important in terms of  
220 recognizing the independence of Albania. Powers decided the formation of "a sovereign principality hereditary and  
221 neutral, under the guarantee of Powers". In this way, after the difficult birth of Vlora on 28 November 1912, it was  
222 internationally official recognized baptism of the albanian state (Castellan, 1996, p.397) or act of collective recognition of  
223 the independence of Albania by the Great Powers, without which, the act of the Assembly of Vlora would remain simply  
224 an expression of aspiration (Puto, 2009, p.63).

225 Six major powers decided unanimously about the last fate of Dodekanez islands. The proposal made by Grey of 1  
226 August was accepted (Torre, 1960, p. 423).

227 The draft of the southern border of Albania eventually determined two main points: 1. Boundary line would go from  
228 Korca in Cape of Stillos, leaving both of these points and Sazan Island, to Albania; 2. Definitely agreed to a technical  
229 committee that would put points on the ground for all domestic provinces, provided that all the islands of the Aegean  
230 (which until now Italy had kept as a counterweight to Greece for southern Albanian border), passed to Greece (Puto,  
231 1978, p.251).

232 If the news of the remnant of Korca and Gjirokastra in Albania enjoyed immensely Albanian patriots across the  
233 ethnic regions, the decision to a committee that would set in place the border points "strongly saddened all Albanians  
234 who knew intrigues that would Greece use to win our country ". For this reason in Vlora it was organized a meeting which  
235 elected a committee, which will be heading to Rome and Vienna to protect "national rights where it was needed."  
236 Albanian delegation in Rome failed to meet San Giuliano, but met with his deputy, who promised that Italy would try as it  
237 could to protect certain territories of Albania (The Central State Archive of Albania (AQSH), F . 22, D.7 / 1, p.197).  
238 Orthodox population of Korca accepted with great joy the news of the remnant of their city in Albania. Alexander Staver  
239 Drenova wrote from Bucharest that "these days we received the good news that Korca remained in Albania after the  
240 decision of the Ambassadors Conference in London" (The Central State Archive of Albania (AQSH), F 2, D.75, p.76) .

241 On August 11, 1913, it was determined the southern border of Albania, with the relocation of the southern edge of  
242 the river Kalamas at Cape of Stylo; Korca was left to Albania, and Gjirokastra remained with undetermined status. Sazan  
243 was left to Albania (Duka, 2007, pp.34-36).

244 All of these were left to be worked out eventually after the Conference, during the assignment phase of the borders  
245 of Albania. For this reason the Conference of Ambassadors created two International commissions, one for the borders  
246 with Montenegro and Serbia, and the other for the border with Greece. The conference set as a criterion to the  
247 commission border in the south to comply with the combined ethnogeographic principle. With the establishment of these  
248 committees, the Conference of Ambassadors ended on August 12, 1913.

249 But diplomatic war on the borders of Albania did not end with the closing of the conference, only its center moved  
250 from the English capital's palaces in the mountains of Albania (Albanian Academy of Sciences, 2007, p. 26). The new  
251 boundaries of the new Albanian state did not make happy none parties, neither the Balkan States which then in turn were  
252 disappointed in their ambitions, nor Albania from which were taken the most fertile provinces. Thus the rights of the  
253 Albanian nation were sacrificed on the "altar of peace in Europe" (Mousset, 2004, p.13). Delimitation of the boundaries of  
254 the new state was in reality a second split, which was more revolting to Albanians. Two-thirds of the Albanian national  
255 territory with more than 1.5 million Albanians were separated and distributed to neighboring countries; Greece stretched  
256 its boundaries beyond Kallams River, annexing the province of Cameria with its coast from Preveza in the Corfu Channel  
257 (The Adriatic Review, 1919, p. 99)

258 Edward Grey, the British chairman of the London Conference, speaking on August 12, 1913 in the House of  
259 Commons concerning the delimitation of the Albanian borders from the London conference, said: "I know very well that  
260 when everything will become known, this solution will give rise to major criticism from anyone who knows the place ... the  
261 main goal was to preserve the agreement between the Great Powers ... for the good of peace in Europe ". ( Krisafi, 2007,  
262 p.136)

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#### 264 4. Conclusions

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266 Albanian state dedicates more being but also his not fully being to the Conference of Ambassadors in London in 1913.  
267 Shaken protection of the interests of the Albanian issue and Albanian southern border from the Italian state led to the  
268 growth of greeds of the Greek state on the southern Albanian lands. If Italy would have kept a principled and steadfast  
269 stand about the issue of the Albanian state and its borders then it would be a major obstacle on the Greek aims.

270 Also dualism of the attitudes of Italy and Austria-Hungary, having as their main point their interests makes a weak  
271 link in the chain of problems in the delimitation of the borders of the Albanian state.

272 Decisions of the Conference of Ambassadors in London gave a partial, unstable, unfair solution which carried itself  
273 more open problems to the Albanians and potential crises and conflicts throughout the Balkans. Decisions of 1913 were a  
274 major blow to the cause of Albanians, were a profound reduction of their aspirations, an unfair fragmentation and very  
275 painful to the territories and the Albanian population. Political boundaries, designed in London were a denial painful  
276 operation of territory and the Albanian people, operation that Italy should have eased with its role.

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## The Effectiveness of Tax Incentives for Business R&D in Russia and Abroad

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### Abstract

*Aim. The article presents the international experience of introducing tax incentives for research and development in the business sector, the investigation of the possibility of assessing the effectiveness of tax incentives and their impact on the share of expenditure on research and development in the country's GDP. Some recommendations for the improvement of tax support for enterprises conducting research and development are done on the example of Russia. Method. In the article the analysis of existing tax measures to support enterprises is presented. Evaluation of the influence of the introduction of indirect tax incentives for the increase in the share of expenditure on research and development in the country's GDP was performed by the method of correlation-regression analysis. Results. The study showed that not all cases of indirect tax incentives lead to an increase in the share of research and development in the cost structure of enterprises. Tax incentives should be reviewed regularly in accordance with the analysis of changes in key macroeconomic indicators showing the level of innovativeness of the economy. The introduction of tax incentives for R&D expenditure of business may give a positive socio-economic impact. Conclusion. Tax incentives are one of the instruments to encourage the market development of the RIA, which can have a positive impact on the supply of new products and technologies, as well as on their demand.*

**Keywords:** research and development, tax incentives, results of intellectual activities

### 1. Literature Review

Tax incentives are one of the most effective indirect tools for stimulating business enterprises to conduct research and development (R&D) and use the results of their intellectual activities (RIA), which are widely used in the world today. Enterprises of the commercial sector of economy make their investment decisions primarily based on the goal of obtaining the maximum profit, including through minimization of costs of goods and services production. The combination of product quality growth and reduction of its production cost and as a result the reduction of its market price increases the competitiveness of an enterprise. R&D are the instrument for improving the quality of the product and reducing of its cost production. On the other hand conducting R&D always involves considerable financial costs for an enterprise. Tax incentives for the enterprises conducting R&D can be an effective form of indirect government support for these enterprises which reduces the cost of the production of high-tech products, and hence brings more profit to commercial enterprise.

Tax incentives become more and more popular in Russia and other countries all over the world. This form of indirect government support is used in USA, France, Canada, the Netherlands, Spain, Great Britain, Belgium, China, Brazil, India, South Africa and many others. This form of indirect government support of business R&D and market development of RIA in Russia and other countries become increasingly important in the whole complex of measures aimed at stimulating R&D in the business sector (Gokhberg, Kitova, Rud', 2014).

It should be noted that in recent years the role of tax incentives for R&D in the business-sector of economy is increasing in the countries with a high portion of direct government participation in the financing of scientific and technical sphere. These countries include, for example, Norway, where in recent years attempts have been made to increase the share of private business in R&D (Klavdienko, 2014). Russia also holds one of the first places in terms of direct government funding for R&D, including those carried out in the business sector. During the period 2001-2011 the amount of direct government funding for R&D increased by 9.63% to 58.67% of all R&D undertaken in the business sector. In

57 recent years along with the high level of direct public funding of R&D in Russia it was introduced a whole range of  
58 additional fiscal measures aimed at stimulating R&D (Feoktistova, 2014).

59 With the increasing of popularity of tax incentives worldwide, evaluating of their effectiveness and their impact on  
60 the growth of business enterprise expenditure on R&D becomes of the particular importance for management decisions  
61 at the state level to improve and adjust them.

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63 **2. Research Methods**

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65 Based on OECD statistics the existing measures of tax incentives for business R&D were analyzed. The existing  
66 measures of tax incentives, their description and the list of countries in which they are used are represented in the Table  
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69 **Table 1.** Measures of tax incentives, their description and the list of countries in which they are used  
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Measures of tax incentives	The description of tax incentives	Countries where tax incentives are used
The income tax rate reduction ("Patent Box")	The income tax rate depends upon the use of qualified intellectual property objects. The effective tax rate is determined by the share of income that is not taxable according to the country tax legislation.	Belgium, France, Hungary, Luxembourg, the Netherlands, Spain, Great Britain
The reduction or annulment of the income tax rate on profits from the sale of stocks of innovative companies	The reduction or annulment of the income tax rate on profits from the sale of stocks of innovative companies takes place if the investor was in possession of stocks of an innovative company for several years	Belgium, USA
Allowance for value-added tax	Reduced tax rates, or the application of differential rates for high-tech products	Great Britain, Germany, Spain, Sweden
Write-off the R&D costs with an increasing coefficient	The tax credit is calculated either on the volume of R&D expenditures or on gains R & D expenditure.	Australia, Austria, Belgium, Great Britain, Denmark, Hungary, Czech Republic
Investment tax credit	The compensation of the part of tax charged on the profits of companies engaged in R&D. Amount of tax refund is calculated as the share of R & d expenditures.	Australia, Austria, Belgium, Great Britain, Hungary, Denmark, Canada, USA, Czech Republic
The granting of tax holidays on payment of tax on income from ongoing investment projects	Postponing the payment of tax on profits of companies engaged in R&D	China, India
Accelerated depreciation for R&D capital	Accelerated depreciation of fixed assets used in R&D	Belgium, Brazil, Britain, Denmark, Canada, China, Mexico, France, Poland, Chile
Income tax incentives for research staff salaries and social contributions	Exemption of income tax on salaries of researchers with Ph.D. degree or masters, as well as to the salaries of engineers, and employees of companies having the status of "young innovative company"	Hungary, the Netherlands, Turkey, France

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72 In addition, correlation and regression analysis was used as the basic method of statistical data analysis. On the basis of  
73 statistical data of the OECD (Table 2) correlation and regression analysis of the dependence of the rate of business R&D  
74 as a percentage of GDP (dependent variable y) of the volume of indirect government support through tax incentives of  
75 firms conducting R&D as share of GDP (explanatory variable x) was conducted to identify the degree of dependence  
76 between these variables. The sample included countries for which there were numeric data, and countries with a non-  
77 zero indices of indirect state support for R&D through tax incentives.  
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**Table 2.** Data on indirect government support measures of R&D through tax incentives as a share of GDP (%) and share of business expenses on R&D as a share of GDP (%)

№	Country	Indirect government support through R&D tax incentives (x) <sup>1</sup>	Business enterprise expenditure on R&D (y) <sup>2</sup>
1	France	0,2600	1,42
2	Canada	0,2100	0,89
3	Korea	0,2000	3,09
4	Belgium (2010)	0,1800	1,37
5	Netherlands	0,1500	0,89
6	Ireland (2010)	0,1400	1,17
7	Australia (2010)	0,1000	1,27
8	Austria	0,1000	1,87
9	Portugal	0,0900	0,69
10	United Kingdom	0,0800	1,09
11	Hungary	0,0800	0,75
12	Japan	0,0700	2,61
13	United States	0,0600	1,89
14	Slovenia	0,0600	1,83
15	China (2009)	0,0500	1,4
16	Denmark	0,0500	2,09
17	Norway	0,0500	0,86
18	Czech Republic	0,0500	1,12
19	Turkey	0,0400	0,37
20	Spain (2010)	0,0300	0,7
21	South Africa (2009)	0,0200	0,46
22	Russian Federation	0,0200	0,67
23	Chile (2010)	0,0030	0,16
24	Italy	0,0030	0,68
25	Slovak Republic	0,0002	0,25

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On the bases of the data of Table 2 the correlation analysis between dependent and explanatory variables was conducted. The result is presented in Table 3.

**Table 3.** Construction and analysis of field correlation

The value of the coefficient b	4,287645
Standard deviation b	1,973139
The coefficient of determination R <sup>2</sup>	0,170333
F- statistics	4,72196
The regression sum of squares	2,146428
The value of the coefficient a	0,82409
Standard deviation a	0,213434
Standard deviation y	0,674213
The number of degrees of freedom	23
The residual sum of squares	10,45495

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Analysis of the sample showed that only 17% of the variation in the share of business expenses on R&D in GDP is explained by the factor x – the share of indirect state support for R&D through tax incentives, and 83% is explained by the influence of other factors not included in the model. The relationship between the explanatory and dependent variable can be assessed as weak. Thus, we can conclude that the increase in the share of business R&D expenditure affects a number of other factors, and it is difficult to evaluate the strength of the impact of tax incentives for business R&D.

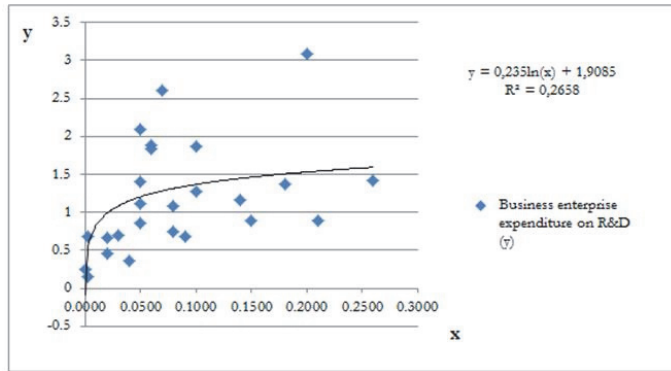
<sup>1</sup> OECD (2013), "R and D tax incentives", in OECD Science, Technology and Industry Scoreboard 2013: Innovation for Growth, OECD Publishing. [http://dx.doi.org/10.1787/sti\\_scoreboard-2013-16-en](http://dx.doi.org/10.1787/sti_scoreboard-2013-16-en).

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The relationship between the considered variables can be described by a logarithmic function (Figure 1).

**Figure 1.** the Relationship of the share of indirect state support for R&D through tax incentives and the share of business expenses on R & d in GDP



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Figure 1 shows the smoothing of the trend line, based on a logarithmic function. The value of coefficient of determination R2 increases to 0,2658, but it is not enough to draw a conclusion about the relation of explanatory and dependent variable.

### 3. Analysis Result

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Analysis of the innovation activity dynamics of countries using tax incentive measures, shows that not in all cases, they lead to an increase in the share of research and development in the cost structure of enterprises. For example, a retrospective analysis of OECD data showed that in 2010 and 2011, countries such as Spain and Canada has provided significant support to the business sector by indirect methods of stimulating R&D and use of RIA. However, as far as the activity of the business sector to conduct their own R&D these countries are far from leading positions (27 and 22, respectively, of the 36 countries included in the OECD sample). Moreover, in Canada there is a decrease of activity of the business sector in the financing of its own R&D compared with the data in 2001. In Finland, on the other hand, the amount of fiscal stimulus is small, however, according to the 2011 it was the 3rd country out of 36 in terms of Business enterprise expenditure on R&D. In Norway, despite the attempts to increase the share of the private sector in R&D expenditure for the period 2005 - 2012 years, the proportion of business expenditure declined from 47 to 44% (Klavdienko, 2014). Thus, a retrospective analysis of statistical data shows that it is not always the use of indirect incentives gives the desired effect.

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Periodically countries using tax incentives for R&D have to adjust instruments of indirect support by introducing additional benefits, or cancel the earlier ones. For example, tax deductions for R&D were abolished in 2013 in such countries as Mexico, New Zealand, Chile. In Austria tax incentives for R&D, that had been in force earlier, also have been cancelled. In Slovenia in 2012 regional tax incentives for enterprises engaged in R&D spending were abolished, but because of the introduction of the tax credit for all high-tech enterprises of the country without reference to the region. In Canada, even in 2013, the scheme of accelerated depreciation was operating in which the fixed assets, which are at least 90%, were used in research and development and could be written off fully expensed in the year of acquisition. Since 2014 Canada decided to abandon accelerated depreciation for R&D expenses which had been in force before.

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The study of international experience has shown that an effective state policy in the sphere of R&D stimulating is a combination of direct and indirect instruments and it should be subjected to periodic review in accordance with the analysis of changes in the main macroeconomic indicators showing the level of "innovation" of analysed economy.

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The Russian economy is facing the same problems as other countries that make extensive use of tax incentives for business R&D expenditure. The whole wide range of tax incentives does not have undue influence on the growth of the share of business R&D expenditure. One of the problems existing in Russia is a lack of interest from the business sector enterprises in putting on the balance the RIA obtained free of charge from third parties or created in the course of its activities. The companies' reluctance to put the RIA on the balance is caused by the obligatoriness to pay the income tax

140 from non-operating income. However, a large number of RIA has been accumulated on the state balance that was  
141 created in the state budget and has not been yet practically applied. As a result, the RIA become obsolete, losing their  
142 relevance and practical utility.

143 The solution to this problem is seen in the introduction of the comprehensive tax measures, for example an  
144 exemption from income tax revenue resulting from the statement the on the balance RIA which is received free of charge  
145 or previously created by the enterprise itself with simultaneous cancellation of the accelerated depreciation for such RIA  
146 to avoid significant losses to the state budget. This will increase the demand from the business sector for intellectual  
147 property created by the state and granted to companies free of charge, as well as encourage businesses to put on the  
148 balance RIA, previously developed and identified in the inventory.

149 It should be noted that in many areas of science and technology RIA are complex objects that can include multiple  
150 parts or components, platforms, add-ons and modifications. This may relate, for example, to RIA created in information  
151 technology, electronics and informatics. Such RIA can be called complex objects of intellectual property, which includes  
152 such a component as a basic RIA. Each time, implementing new and improved modification RIA entrepreneur pays  
153 income tax on their sales, including sales to the basic component of RIA in the new version. One of the options of tax  
154 benefit may be the exemption from income tax of income from the sale of the basic component of RIA.

155 The analysis showed that assessing the positive impact of the introduction of indirect measures to encourage  
156 businesses to increase spending on R&D through the tax incentives is a difficult task. Nevertheless, it can be argued that  
157 the introduction of tax incentives for R&D expenditure of business may give a positive socio-economic impact. As a result  
158 of the introduction of tax incentives business enterprises obtain additional monetary funds which can be used to create  
159 new jobs, provide further increase in R&D spending, stimulate enterprises to use RIA in their production of goods and  
160 services. It also stimulates the growth in the number of transactions with RIA and the development of RIA market. All  
161 these socio-economic effects lead to additional budget revenues and enhance the level of "innovation" of the economy.

#### 163 4. Conclusions

165 Tax incentives are one of the instruments to encourage the market development of the RIA, which can have a positive  
166 impact on the supply of new products and technologies, as well as on their demand. It can be considered as an incentive  
167 for business sector to use RIA for the production (new equipment, materials, technology, formula and so on), to  
168 implement their own R&D to create new products and technologies and to attract research organizations to conduct joint  
169 R&D, i.e. the cooperation of business and science. These measures are aimed at improving the instruments to stimulate  
170 spending on R&D both in traditional and innovative sectors of the economy. The latest contribute to the creation of the  
171 breakthrough R&D and the high-tech production development, re-industrialization, as well as RIA commercialization,  
172 which in turn leads to an increased technological competitiveness of the country.

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## Forming a Sense of Civic Responsibility in Youth Students

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### Abstract

*This article examines the priority areas of the activity of colleges in terms of the civic-patriotic education of students and factors impacting on the development of a sense of civics in youth students. The authors propound a model for the development of a sense of civic responsibility in college students, propose pedagogical conditions that would ensure the effectiveness of formation of a sense of civic responsibility in students, and bring to light the major forms, methods, and means of the civil making of the student's personality.*

**Keywords:** *civics, patriotism, education/bringing-up, college, educational space, students, pedagogical model, pedagogical conditions*

### 1. Introduction

Despite the fact that at present there are numerous studies dedicated to the issue of civic education (mainly in the area of school education), there has been a lack of research concerning issues related to the formation of a sense of civic responsibility in youth students. What makes the issue of the civic education of students more topical is that we are currently observing:

- the orientation of the content of civic education towards legal education with the personality-oriented aspects of civil behavior being ignored – the ideals and principles of civics, the spiritual-moral criteria of social life, a humane attitude towards cultural differences between and the traditions of various peoples, and the ability to perceive a specific life situation and act accordingly, etc.;
- the lack of a clear-cut methodology for educating youth students, which would meet the challenges of changed social conditions, and the lack of a proper system of the moral and material encouragement of college instructors for carrying out educative work among students.

This is attested to by a whole range of contradictions: between society's imperious need in youth with a developed civil culture and the insufficient degree to which mechanisms that would help to successfully resolve this issue in the setting of college education have been worked out; between the orientation of the very system of higher education towards resolving issues in the formation of professional competencies and the need to concurrently resolve the objectives of fostering a civic culture in youth students (in scientifically organized educative work), etc.

The article "The Importance of Civic Education", published in the magazine "Democracy and Society", stresses that "in many ways this focus on civil society is well deserved, since public awareness and activity play a critical role in any functioning democracy" [1]. Furthermore, "civic education in a democratic society most assuredly needs to be concerned with promoting understanding of the ideals of democracy and a reasoned commitment to the values and principles of democracy" [2]. The same thought has been accentuated in Russian encyclopedic dictionaries: "the primary aim of civic education is to nurture in people the moral ideals of society, a sense of love for one's homeland, the need to act for the benefit of society, etc." [3].

This article aims to: bring to light the essence of the term "students' civic responsibility", identify factors in, particular forms of, and methods for, and work out a model and propose pedagogical conditions for the formation of a sense of civic responsibility in present-day youth students.



## 2. Methods

This study's methodological basis is grounded in: the theory of human development and its dependence on natural and social factors, the axiological and personal-activity approaches, and the principle of the unity of consciousness and activity.

To resolve the objectives set, the authors have employed the following methods: comparative and logical analysis, synthesis, generalization, modeling, study and generalization of the innovation experience of colleges in terms of fostering civic responsibility in students, conversation, questionnaires, goal-oriented observations of the activity of youth students, mathematical statistics methods, and conducting a pedagogical experiment on fostering civic responsibility in the setting of specific colleges. In the summative stage of the experiment, the authors determined the degree of development of civic responsibility in students, based on which there were formed an experimental (61 students) and a control (66 students) groups. The overall number of trial subjects was 127 individuals. The experiment's formative stage involved work on implementing in the education/bringing-up process the pedagogical conditions for the formation of a sense of civic responsibility in students, which were identified as a result of the study. In the experiment's control stage, the authors performed final work on comparing initial data obtained, determined the development level of civic responsibility attained by the students over the course of the experiment, and conducted a comparative analysis of data obtained at various diagnostic stages.

The results of sections on the study of the degrees to which a sense of civic responsibility was formed in students substantiated the correctness of the hypothesis put forward: the indicators of the development of civic responsibility in students within the control group remained almost unchanged, whereas they increased in the experimental group.

The assessment of the pedagogical process on the development and formation of a sense of civic responsibility also included the analysis of information on the state of educative work, which was provided by the Dean's office, the student body of the academic group, the curator, the heads of various scientific-creative collectives, study groups, and sports groups. The collection of information was conducted by the group's curator.

## 3. Main Part

As we know, the period of attending college is the most important in the process of formation of personality. Along with the acquisition of general and special knowledge, students develop not only their first professional competencies and skills but a corresponding system of values. As a social-demographic group, the youth of today possess high social mobility, are a source of innovations, and are most susceptible to them. Yet, the lack of life experience is reflected in that the culture of responsible civic behavior is poorly developed within the youth environment of today [4].

In this regard, we ought to pay the most meticulous attention to issues related to the development of civics in students in the process of their professional preparation in college.

The terms "citizen", "civil society", "civic education/bringing-up", and "civic responsibility" were basic in identifying factors and conditions for the formation of a sense of civic responsibility in students. According to "A Dictionary of Law", "a citizen is a person that belongs to a particular state on a legal basis. He/she possesses political rights and liberties. It is apparent that civic responsibility can exist within a civil society. A civil society is an aggregate of relations in the sphere of economics, culture, etc., which develop within a democratic society independent and autonomous of the state" [5].

Margaret Stimmann Branson, Associate Director of the Center for Civic Education in Calabasas, CA, writes in her article "The Role of Civic Education": "Civic education, therefore, is – or be should be – a prime concern.... It is imperative, therefore, that educators, policymakers, and members of civil society make the case and ask for the support of civic education from all segments of society and from the widest range of institutions and governments" [6]. For "good civic education develops skills, such as deliberation, collaboration, and public-speaking, however, achieving those outcomes requires more challenging standards for civics and better integration with other disciplines" [7].

In foreign literature, we also find the following definition of a key term: "In its broadest definition, "civic education" means all the processes that affect people's beliefs, commitments, capabilities, and actions as members or prospective members of communities. Civic education need not be intentional or deliberate; institutions and communities transmit values and norms without meaning to" [8].

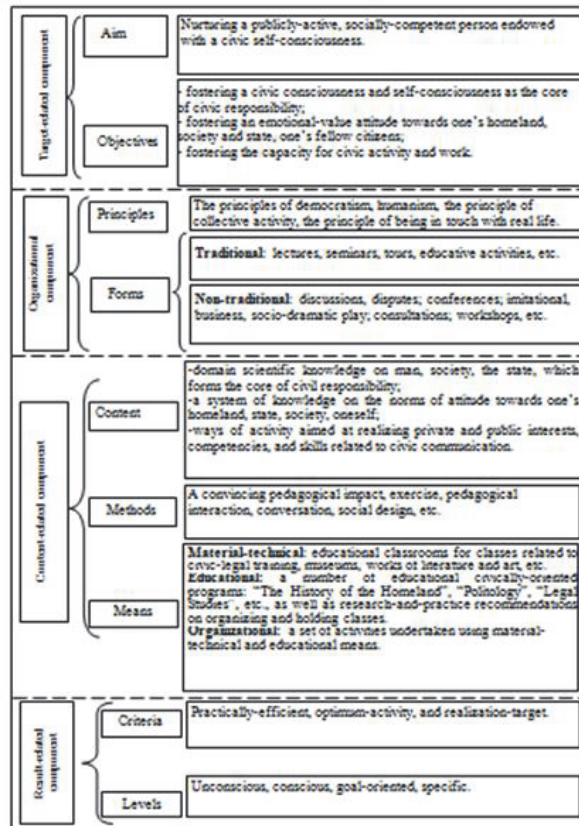
In her article "Civic Education. What is It?", Jennifer Rietbergen-McCracken writes: "The overall goal of civic education is to promote civic engagement and support democratic and participatory governance" [9].

Civics is "an essential characteristic of a person and his/her activity as a human being with a civic mindset, an active civic attitude, patriotic feelings, and experience of publicly beneficial activity" [10]. Civic responsibility is a personal quality that includes moral-value, intellectual, emotional-volitional, operational, and reflexive components and reflects the

110 student's readiness to display a responsible civic attitude in the form of deeds, behavior, lifestyle, and way of living in  
111 present-day society.

112 During the course of the study, the authors worked out a model for the formation of a sense of civic responsibility,  
113 which is construed as an algorithm for constructing and organizing the effective ensuring of the educational process in  
114 terms of fostering civic responsibility in students, which could be realized at institutions of higher professional learning.

115 For the description of the model for fostering civic responsibility in students, the systemic approach was employed.  
116 Viewing the process of formation of a sense of civic responsibility in students as a complex multi-tiered system whose  
117 component parts are the elements of the educational process of an institution of higher professional learning, the authors  
118 marked out the following major components in it: target-related, organizational, content-related, and result-related. All the  
119 components of the model for the formation of a sense of civic responsibility in pedagogical college students are  
120 interrelated and form a unity (Figure 1).  
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124 **Figure 1.** A model for the formation of a sense of civic responsibility in college students

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127 In addition, the authors have determined pedagogical conditions that ensure the effectiveness of formation of a sense of  
128 civic responsibility in students: providing pedagogical support for students developing civic qualities during the course of  
129 educational and bringing-up work; realizing the technology of social design of classes aimed at fostering civic  
130 responsibility in students; conducting a cycle of scientific-methodological seminars for college instructors on issues in  
131 fostering civic responsibility in students; creating a special educational environment. "In any event, the environment has a  
132 major impact on bringing up a citizen. The environment approach towards fostering one's civics characterizes the  
133 peculiarity of this process ", but "the main condition for the success of civic education is the proper organization of the  
learning process and creation of conditions for fostering one's moral making, proper development, and sense of being

134 successful" [11]. In that study, the authors mainly relied on the subject-oriented approach, since "it ensures freedom of  
135 choice of the content of education with a view to meeting not just the educational but spiritual, cultural, and life needs of a  
136 person" [12], which is crucial to the formation of a sense of civic responsibility in students.

137 The authors have worked out and tested the diagnostics of the degree to which a sense of civic responsibility has  
138 been developed in students, which includes the practical-efficient, optimum-activity, and realization-target criteria and the  
139 unconscious, conscious, goal-oriented, and specific levels, which are provided in the integral model (Figure 1).

#### 140 141 **4. Conclusion**

142  
143 Civic education is a goal-oriented, specially organized process of formation of sustainable civic qualities in youth. Based  
144 on the results of their study, the authors have arrived at the following conclusion.

145 During the course of the study, it was established that the aim and result of the civic education of students within  
146 the system of their professional preparation is a civic culture, which is construed by the authors as an integrative quality  
147 of a person, which is characterized by students possessing in-depth and sound knowledge in the area of the civil  
148 education of students; a value attitude towards one's homeland, one's people and its culture, representatives of other  
149 ethnicities and their culture, the state's political-legal sphere, society and common human issues; a positive mindset  
150 towards professional activity in the area of civic education.

151 The authors have revealed the characteristics of organizing the civic education of students in the system of  
152 professional preparation, which are associated with the unity of the person-oriented and professional components of  
153 professional preparation; the integration of its theoretical, methodological, practical, and scientific-research spheres; the  
154 special significance of the patriotic, political-legal, national, international, and common human aspects of civil education  
155 for young people; the complex nature of the aim of civic education, which is manifested in the unity of scientific  
156 knowledge, value relations, and practical activity.

157 The effectiveness of formation of a sense of civic responsibility in the personality of students, which is manifested  
158 in one's readiness to take part in enhancing modern society and make an impact on the country's social-political life, can  
159 be attained in the educational environment of colleges in meeting the following conditions:

- 160 - including issues related to civic-patriotic education among the top-priority objectives of education and bringing-  
161 up in college;
- 162 - fostering in students a motivational-value attitude towards the process of formation of a sense of civics as a  
163 person's integrative quality oriented towards the real conditions of present-day life;
- 164 - enriching the content of education through introducing in the educational process moral-creative and cultural-  
165 creative functions and using the potential of social-humanities and psychological-pedagogical disciplines;
- 166 - boosting the role of the college instructor's personality, his/her apprehension of pedagogical targets, values,  
167 and principles;
- 168 - humanizing and humanitarizing education, which is based on that the college student is a conscious,  
169 independent person with self-esteem and a sense of responsibility;
- 170 - fostering a culture of international communication, the ability to resolve possible interethnic conflicts through  
171 soft, rather than hard, power.

172 The effectiveness of the process of civic education in the system of professional preparation of students is ensured  
173 through the consistent realization of the set of interrelated components in the model for civic education.

#### 174 175 **5. Inferences**

- 176  
177 1. The authors construe the civic responsibility of college students as one's ability to conduct one's activity  
178 relying on a sense of civic duty, as well as in correspondence with the norms of civil behavior accepted in  
179 society.
- 180 2. The pedagogical conditions for the formation of a sense of civic responsibility are: providing pedagogical  
181 support for students developing civic qualities during the process of educational and bringing-up work;  
182 realizing the technology of social design of classes aimed at the formation of a sense of civic responsibility in  
183 students; conducting a cycle of scientific-methodological seminars for college instructors on issues in the  
184 formation of a sense of civic responsibility in students.
- 185 3. As means of pedagogical control and self-control over the degree to which a sense of civic responsibility has  
186 been developed in students, the authors have worked out and tested various questionnaires, tests, and a map  
187 for the study of civic responsibility in students.

188 The authors feel that further research into issues related to the specificity of civic responsibility in pedagogical  
189 science, as well as the development of methodologies and technology for fostering it, is an objective to be pursued in the  
190 observable future. The subject of our next research can be the study, development, and testing of innovative forms and  
191 methods of pedagogical activity aimed at the formation of a sense of civic responsibility in students.

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# The Prospects for Legislative Modeling “Smart Government” in Political and Legal Realities of Russia

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## Abstract

The article is devoted to the problem of the current establishment and further development of democratic, legal, progressive model of government, based on a fundamentally new approaches to the modelling of the state administration of Russia, the Russian bureaucracy and building of powerful communications through the application of information and communication technologies. Thus, the subject of the research is a new global trend of “smart government”, including the latest global trends in the development of E-Government and the formation of a fundamentally new form of bureaucracy. The author gives a critical evaluation model of E-Government, played by Russian legislation and the system of official electronic resources of Russia, reveals the national peculiarities of the state traditions of public administration, the archetypal features of the Russian bureaucracy, indicating the level of viability of the project “E-Government” in the context of clashes with the real political and legal practices, analyze the latter, highlighting key legislative and infrastructural achievements and problems of the system organization of electronic forms of government communications with which the current IT reform by the Russian government is dealing. In concluding the article, the authors formulate the key findings of the study, the prospects for legislative modeling and development of “smart government” in the world and the Russian Federation.

**Keywords:** E-Government, information and communication technologies, bureaucracy, state archetypes, smart government.

## 1. Introduction

Today one of the global problems of mankind is the question of finding the optimal model of state administration, which could provide the most rationally constructed processes of public management in the economic, political, legal, cultural, social and other spheres of society life. Regardless of the national characteristics of models of bureaucracy and public administration system, a society where economic, technological, cultural and spiritual development is a priority goal (L. Kirsanova and O. Korotina, 2014), politicians and lawyers strive to design and develop a completely new model of public management, in the key properties of which “genetic code” of administrative optimality and bureaucratic rationality is placed. Finally, the latest world trends show that the number of states enter the third phase of the formation of the architecture of the E-Government, called smart government. Based on the content of research in recent years, this stage involves the creation of a fully interactive government that meets the requirements of mobility, openness, full electronic availability of participatory mechanisms of interaction between society and the (S. Melloulia et al., <http://iospress.metapress.com/content/x0921055457568t0>, 2014).

Meanwhile, in the Genesis of the “ideal” state, there are two main problem areas for countries in the first stages of E-Government institutions. First, this is generation and the introduction of fundamentally new technological tools in the public administration system. In this sense, the processes of formation and development of E-Government are associated with the technological development of societies, the development of the global information space, new technological means of communication, digital literacy, society and bureaucracy. Accordingly, in this plane problem of our study is the legislative innovations, introducing in the practice of states with the new tools of public communications. Second, a more fundamental problem for Russia is the architecture of the model of state power, which traditionally tends to be of authoritarian structure of public administration, patrimonial system of interaction between state, society and irrational bureaucracy. However, it should be noted that the state apparatus itself acting in the cultural archetypal national field is shorted to the need of finding an effective political and legal controls of the Russian society. The latter in its turn leads to the impossibility of implementing successful Western model of the state in its pure form (A. Mamychhev, 2014). For example, all states, where historically stable authoritarian political systems were formed, are characterized by the absence of systemic self-organization of national societies, at simultaneous archetypes of a “strong state” and “ward

society". At the same time, the social matrix of social relations in Russian society is bind mainly by system of informal (shadow) links, creating a dual reality, where one of them form official state institutions, their legal status and legal processes of public administration. The second reality, hidden from the outside observer, is not immersed in the context of real political and social practices reality, is alternative to legal field and public policy. As a result of a significant development of corruption phenomenon, that Russian for society adopts a more narrow meaning than for Western European and American models of interaction between the personality of the state (T. Yudina, 2012), reducing corruption to bribery, at simultaneously discharging a lot of informal communications, not persecuted by law only due to the limitation of the regulatory formulas of the national legal system.

Also this is national-usual socio-illegal behavior at the household levels - from obtaining medical services introduction to informal requests between superior and subordinate in a commercial or public institutions.

A significant role in the choice models of social behavior lying within the field of legal regulators has public views about justice, good and evil.

Accordingly, in a situation of conflict between social values and legal field, the priority is often given to the first.

Meanwhile, such axiological priorities make legislation unstable and arbitrarily applied and approved by the regulator. Public faith in government as the most effective form of organization of society that displays quasi public institutions and shadow sliders in the predominant form of social communication are not a characteristic of Russia. It is obvious that such an objective national-cultural conditions force the state to resort to authoritarian methods of individual management and to shorten to themselves the greater part of public functions, which in Western societies is traditionally in the public self-regulation. Hence the difficulties of held IT reforms, aroused not only due to systemic corruption and bureaucratization of the state apparatus, but also the natural state of society itself that must be considered at the legislative implementation of E-Government institutions.

## 2. Literature Review

Giving a description of the scientific elaboration of the theme of our article, it should be noted that considered problematic issues are associated with certain theoretical contradictions and practical problems. Thus, in various scientific sources, the term "Smart government" is understood rather broad and does not have an unambiguous interpretation. Western European researchers understand this term with the highest level of E-Government development (Melloulia et al., <http://iospress.metapress.com/content/x0921055457568t0>, 2014), and many Russian scientists generally do not share these concepts, which probably explains the very limited amount of scientific literature devoted to this subject . Meanwhile, there is the third point of view on the trend of "smart government" as a special system of electronic communications between the authorities and society, providing intelligent, fully interactive mode of interaction of the authorities, the authorities of society, government business (Hassan et al., <http://d.researchbib.com/f/>, 2014). However, it is obvious that the concept of "smart government" is at the stage of formation which is also fair for IT architectures of the most advanced countries in the field of information and legal regulation of information relations. The second problem addressed in Russian scientific journals is a range of problems in the implementation stages of the genesis of E-Government. Here such scientists as: (O. Astafiev and V. Savinkov, 2013; and E. Dyakova, 2014) illustrate in their works problems of regional development of information communications of public authorities, legal regulation of computerized procedures, digital rights and responsibilities of citizens and officials, an interim legislative measures on the operation of the digital infrastructure of the government. Cultural and archetypical phenomena reflecting national identity of formation and development of the Russian state is investigated in the scientific article of Mamichev (A. Mamichev, 2014). Threats to network forms of organization of state power and society are discussed in the article of (A. Ovchinnikov, 2014).

## 3. Methods and Materials

Theoretical and methodological basis of research of article is based on universal, scientific, special and specific scientific methods. Among the general methods, used in the study for analysis of state legal reality, the following can be distinguished: a systematic approach, dialectic-materialistic method, phenomenological and hermeneutic method.

In addition, in the work comparative legal, historical legal, specifically sociological and formal-legal (dogmatic) methods, and methods of political-legal modeling required for the formulation of the forecast of the further institutional development of the technologies of E-Government were used. The materials for research of the article became the scientific literature, normative acts regulating public relations in the field of public administration, the empirical basis consisted of: judicial practice, official sources of statistical data (rating of UN), social surveys of the Foundation of public opinion.

#### 4. Results and Discussion

However, the legal policy of the Russian state held a course for the architecture of the “E-Government” and therefore the task is to establish the legal, political and administrative conditions of the electronic transit of state communications to the modern forms. In this regard, the President of the Russian Federation, the Parliament of the Russian Federation and the Government of the Russian Federation developed and put into force a set of conceptual and provisional regulations, which in their turn reflected regional authorities. It is noteworthy that, despite the pronounced centralized nature of the Russian Federation, some regional legislative initiatives ahead on development the legislative base and innovative elements of IT services of the system of Federal state control system. Thus, in particular the Moscow region has made significant progress in the systemic organization of technological chains of provision of public services to the population.

If we consider the legislative novels of recent years highlighting the most significant normative acts on the formation of elements of the infrastructure of E-Government can be identified according to the relevant branches of government the following:

1. In the sphere of the concept of E-Government - Federal law dated 06.04.2011 # 63-FL (edit. from 28.06.2014) “On electronic signature”; Decree of the President of the Russian Federation dated 21.08.2012 # 1202 (edit. from 25.07.2014) “On approval of the Regulations of the President of the Russian Federation on the application of information technology and the development of E-Democracy; Regulation of the RF Government dated 25.04.2012 # 394 “On measures to improve the use of information and communication technologies in the activities of state bodies”; the Federal law of 27.07.2006 # 149-FL (edit. from 21.07.2014) “On information, information technologies and protection of information; Resolution of the Government of the Russian Federation from 15.04.2014 # 313 (edit. from 21.02.2015) “On approval of the state program of the Russian Federation “Information society (2011-2020)”.
2. In the formation of electronic and mobile justice - resolution of the Government of the Russian Federation of 27.12.2012 # 1406 (edit. from 25.12.2014) “On the Federal target program “development of the judicial system of Russia for 2013 - 2020 years” including regulating the establishment and operation of electronic archives of litigation and remote access to them.
3. In the sphere of formation of the electronic infrastructure of the executive authorities of the Russian Federation Government dated on September 22, 2009 # 754 “On approval of the Regulations on the system of interdepartmental electronic document”; the Decree of the RF Government dated 08.09.2010 # 697 (edit. from 05.12.2014) “On the common system of interdepartmental electronic interaction” (along with “Regulation on the unified systems of interdepartmental electronic interaction).
4. In the sphere of provision of public services - Federal law dated 27.07.2010 # 210-FL (edit. from 31.12.2014) “On the organization of public and municipal services”.
5. In the field of organization of E-Democracy - the Federal law dated 10.01.2003 # 20-FL (edit. from 12.03.2014) “On the State automated system of the Russian Federation “Elections”.
6. In the sphere of public control over the activities of public authorities - the Federal law from 21.07.2014 # 212-FL “On fundamentals of social control in the Russian Federation”.

Of course specified regulatory framework, uniting under itself more than hundreds of normative acts, governing digital forms of organization and functioning of public authorities is by no means perfect, including normative acts are regulatory fragmentary, partly not agreed among themselves. But somehow, in the last three years, it should be recognized that IT reform entered the second phase, and a separate electronic tools of bureaucracy began to take shape in the system model of E-Government (E. Dyakova, 2012). This also is reflected in legislation and the creation of appropriate E-infrastructures enabling the participation of citizens in planning of laws, the evaluation of activity of bodies of state power, remote access to a wide range of public services. In fact, Russia has moved to the planning of open government, which eventually should ensure full transparency of the activities of public institutions, with some exceptions.

However, the rate of introduction of IT technologies in the system of state control of Russia is still far behind the global dynamics. If to assess the level of development of the first and second stages of the formation of e-Government at the moment under the current law and a functioning of IT infrastructure, Russia ranks 27 th place in the ranking of UN among the leading E-Governments of the world and for the last 2 years its position is not strengthened (E-Government Development Index, 2014). From our point of view, assessment methodology of UN does not allow to capture the true state of affairs of Russian reality, because domestic bureaucracy has deep historical tradition and experience in imitation of successful activity. From this point of view no matter whether we talk about Khrushchev reports about “harvest of corn”, “Potemkin villages” or the creation of IT infrastructure technologies in the system of state institutions. In Russia the presence of formally established institutions and infrastructures of E-Government does not mean their effective

166 functioning, and this peculiarity the researchers of UN apparently do not take into account.

167 The second flaw of assessment methods of development of national E-Government architectures of UN of world  
168 level is putting an equal sign between the level of development of IT technologies and the development of democratic and  
169 legal institutions of the state. In this regard, it should be noted that "E-Government" itself is only an effective technological  
170 tool of public administration, and does not mean a guarantee of playback of democratic values and ideas of the legal  
171 state. Thus, assessing high-tech from the point of view of information-communication technologies in the government of  
172 Singapore, rather we can talk about playing "model of law (police) state" that differs from the "legal state" by absence of  
173 real recognition and protection of the rights and freedoms of the individual in the legal field, but a high level of adherence  
174 to the law in society and developed legal technology. The government does not meet also the common Western  
175 standards of democracy. In this sense, a little bit strange are rating and assessment methodologies of UN of development  
176 of national models of E-Government where Singapore is ranked 3rd in the world index e-Government (in our opinion here  
177 is the myth of democracy of E-Government which is " by default" in tune with the myth of the strong economies only in  
178 democratic countries, in recent cases, in recent cases as examples can be used China's authoritarian political regime).  
179 Essentially, however, these indices only take into account technological tools, reproduced by states, avoiding the  
180 evaluation of paradigm maintenance of systems of public administration. As a consequence of this a general  
181 understanding of the concept of "electronic government" is distorted, reducing it to purely technological means of  
182 administrative work.

183 Meanwhile, contemplated by the Europeans a fundamental difference in the models of E-Governments has such  
184 significant meaning as the distinction between law-abiding Nazi Germany and any modern European country. After all, in  
185 both cases the level of law and order has had a significant level, with the only difference that in the Nazi political regime  
186 generally accepted rights and freedoms did not admit and was not guaranteed.

187 In this context, critically evaluating the ongoing transformation of legal fields and the creation, practice of operation  
188 of certain digital items of "E-Government" in Russia should be paid attention to several key problems, which do not let the  
189 current model of the Russian state transfer to democratic model of "E-Government". So, for example, electronic means  
190 have been used by the bureaucracy in direct analogy with the "paper", "oral" form of communication, often reproducing all  
191 the same architecture irrational bureaucracy. As a consequence paper replies were replaced by electronic, without any  
192 efficiency gains. Simultaneously, there was a new "effective" instrument of the traditional bureaucracy, for example, the  
193 facts of violation of the terms or facts to the lack of public services are justified by electronic systems failures (A. Didikin,  
194 2013).

195 A major stumbling block in the advancement of E-Government became gaps of technological chains in the system  
196 of government communications, in which the subjects of public relations only at certain stages resort to electronic forms  
197 of interaction. This is certainly makes easier in some cases the work of state institutions and citizens ' efforts to obtain  
198 public services, but does not solve the fundamentally important tasks assigned to IT by the reform of the Russian state.  
199 In particular, such tasks as anti-corruption environment of public communications, de-bureaucratization of the official  
200 procedures and processes, interactivity (feedback) of state authorities, public accountability of state and municipal  
201 institutions remain partially achievable. It is obvious that the existence of such practices in the transition to electronic  
202 forms of interaction itself does not create conditions for the rationalization of the Russian bureaucracy, does not provide  
203 optimal algorithms of functioning of systems of public administration, it is initially assumed in the concept of e-  
204 government. On the contrary, facing with national sustainable cultural archetypes in the public administration, borrowed  
205 from Western examples models of progressive institutions of E-Governments are either limited or distorted, changing its  
206 purpose in the service of corruption, bureaucratic or political interests. A serious obstacle to the expansion of the IT  
207 infrastructure in the state management system is the high level of information inequality, although judging by the findings  
208 of the public opinion Foundation, the percentage of active involvement of citizens in the Internet technology is growing  
209 steadily and as for 2014 it was 51% of respondents (The public opinion Foundation, <http://fom.ru/SMI-i-internet/11889>,  
210 2014). However, a serious problem in the development of digital communications experience remote from cities, rural  
211 settlements, which presents a considerable part of the population. Even fewer people use in their daily life the electronic  
212 communication when interacting with state and municipal institutions, such in 2012, according to public opinion  
213 Foundation was about 68% (The public opinion Foundation, <http://fom.ru/SMI-i-internet/10850>, 2012). Here social surveys  
214 of the public opinion Foundation show the real picture of the involvement of Russian society in the processes of  
215 functioning of E-Government and indicate the magnitude of the digital divide (A. Didikin, 2013). The digital divide in its  
216 turn correlates with the traditional socio-political passivity of the Russian population that actually paralyzed the initiative of  
217 the Government of the Russian Federation on carrying out participatory mechanisms, which means the organization of a  
218 network of state and interactivity of power in the interaction with society (Y. Kayl and V. Epinina, 2012).

219 Of course, not all the reasons for the delay in the development of E-Government are called by the national



peculiarities of the Russian mentality and established a stable system of illegal relations contrary by its nature openness of the information society. Not solved remain technological issues, including the provision of digital security. Both social and expert fears, that weak protection of network communications may be subject to distortion of the will of the citizens, digital fraud, with spoofing identity of personality, finally, concerns that civil rights may be part of a network attack, have not groundless basis. (A. Ovchinnikova, 2014).

Meanwhile, the above allows to conclude that for Russia the completion of the second stage in the formation of E-Government and the transition to its third - system-final stage is the most important and fundamental question (O. Astafiev and V. Savinkov, 2013). Let us argue that without going to the level of smart government, IT reforms will only create an effective bureaucratic elements, but will not resolve such key public problems such as bureaucracy, corruption and politicization of administrative procedures and judicial processes.

## 5. Conclusion

Thus, summarizing our research, it is important to stop on the key findings and conclusions of the prospects for legislative modeling of "smart government" in political and legal realities of Russia and world trends:

1. By the beginning of 2015 in the system of Russian legislation were introduced key institutions of the e-government sector in providing of public services. At the same time legitimized elements of "service government" is not provided with electronic forms of legal safeguard of the rights of citizens and organizations, the system of electronic communications inter-regional and nationwide level is not established. And regional public service systems are predominantly local in nature.
2. The subsystem of "e-government" - E- democracy, is in initial development, and its most promising elements, including electronic voting is under question due to the concerns of both citizens and representatives of public authorities in terms of providing digital security.
3. The introduction of digital technologies in the system of state management is still very low. The system of E-planning, control of electronic communications between the public authorities is under development and staging deployments. Accordingly, the legislative framework is overly abstract, does not contain detailed legal regulators of electronic forms of interaction between public authorities, the use of electronic systems of mass surveillance and so on. The latter aspect is only to legislatively formulate legal boundaries between public safety and personal rights.
4. Today, the Russian Federation reproduces a patrimonial system of government based on irrational bureaucratic model. Thus, the use of electronic communications can contribute to the transformation of traditional systems of public management in Russia only with unconditional playback of continuity of the whole technological chain of e-governance, meeting the requirements of transparency, public accountability, availability of legal protection of the legitimate interests of the individual.
5. The latest world tendencies of the leaders of the introduction of IT technologies in the public administration system suggest the emergence of new forms of government communications, but also the transformation of the rational bureaucracy in an online form. However, the latter is formed in states not only with the advanced architecture of e-government, undergoing the stage of formation of smart government, but also meeting the standards of democracy, legal state and internationally recognized human rights and freedoms.
6. Under the conceptual plan for "smart government" should be understood systematically completed version of "e-government" that meet criteria such as: public openness, accessibility, interactivity, technological and legal security. Thus, "Smart government" is based on the network architecture of the state authorities, consistent with the principles of democracy and unconditional compliance, the higher priority of human rights and freedoms, and safety of society.
7. Smart government is expressed in forms of mobile accessibility, full electronic identification and electronic forms of communication with state institutions. Interactivity of "smart government" includes qualified to provide information to the consumer of public services at all levels, legal and public protection of the person directly in electronic communications, accountability of public institutions public institutions and the political and administrative practices of the intellectual potential of the society in socially significant questions (smart citizen).
8. The nearest international perspectives in the field of scientific research and development of the concept of "smart government" is a simulation of the system of state administration, responsible for global forms of rights and freedoms not because of his nationality and area of residence The trend to create a single electronic interstate space within the European Union and the United States is obvious. It is not excluded that after this the formation of a regional system in the developed countries in the Eastern part of the world: South Korea,

Japan, Singapore, etc. will take place.

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# Influence of Regions Innovative and Investment Activity on Their Social-Economic Development: Results of an Empirical Study

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## Abstract

In this paper, the authors analyze methodological approaches to evaluation of innovative and investment activity and social-economic development of regions as well as subsequent methods to measure mutual influence of the factors. The obtained results allowed the authors to point out factors which influence regions' innovative and investment activity. The study discusses the experience of regional strategies' implementation through the example of the most innovatively active regions. The authors have carried out an empirical research related to creation of innovative territorial clusters. The methodology of mutual influences evaluation worked out during this study can be used to introduce changes into budget strategy and programs of regional innovative development and to evaluate how efficient is the implementation of cluster-based development programs.

**Keywords:** Russia, regional economics, evaluation methodology, innovative activity, investment activity, financing, innovative territorial cluster

## 1. Introduction

During the last decade, the global scientific community has been paying much attention to an innovative way of economic development. Leading economists and experts agree that innovative way of development can result with an increase in territorial competitive ability and economic growth.

The European Union has gained a specific experience in observation of innovative activity. The CIS concept is used in annual reports called European Innovation Scoreboard. It is also a basis for the EU's scientific research connected with innovations.

Nowadays the Russian system of innovation statistics has two directions of development. The first direction is a harmonization of the methodology with advanced international experience while the second is an improvement of those lines of research which have no equivalent in international practices.

In this respect, the methodological issues of evaluation of regions' innovative activity and national innovative system have become crucial recently. Literature review has shown that there is no any common approach to the scoring system for such an evaluation, and to the rules which describe the procedure of data collection and processing. Such aspects make innovation monitoring process more complicated for the European counties and Russia.

In our opinion, in order to work out recommendations for the increase of regional innovative activity, it is reasonable to compare and analyze interconnections between investment activity and innovative activity of regions. As a rule, an efficient implementation of innovations is connected with the need of investment, and thus the dependence of innovative activity on investment processes is explained. The specificities of such interconnections characterize "economic health" of a region to a certain extent.

### 1.1 Research Objective

The objectives of the present study are the following:

- to define factors which influence innovative activity and determine investment attractiveness of the Russian

- 56 regions;  
57 - to discuss examples of the most successful implementation of the innovative development strategies of the  
58 Russian regions;  
59 - to find connections between regions' innovative and investment activity and their social-economic  
60 development.  
61

## 62 2. Literature Review

63

64 A lot of modern scientific works are dedicated to problems of regional innovative and investment activity. For instance, R.  
65 Antonietti (2015) studies influence of greenfield FDI on the level of innovative activity of host territories. D. Hart (2001)  
66 examines the role of innovations in the increase and maintenance of territorial competitive ability. In this respect, the  
67 author points out paradoxical features of that process: as in companies, in an effort to raise their innovative activity,  
68 subject themselves to great risks and bring into question further operation and competitive ability.

69 A great number of research gives attention to an effect of FDI on social and economic state of host regions (Lipsey  
70 et al., 2004, Driffield et al., 2013). S. Menghinello (2010) compares the influence of production agglomerations and FDI  
71 on the regional development, studying what outcome these two phenomena have when occurring simultaneously. N.  
72 Driffield (2010) in his work emphasizes an important role of foreign investments and knowledge migration in regional  
73 productivity enhancement. J. Jones (2008) discusses consequences of FDI for the economic development of the regions  
74 with high share of businesses with foreign ownership. In the study mentioned the attraction of foreign investment is  
75 considered as a part of regional strategies.

76 Many authors point out a strong connection between investment activity and advancement of regional cluster  
77 structures. M. Giblin (2008) studies how FDI and regional cluster-based development are connected, considering  
78 government as a key element in the discussed process. N. Phelps (2008) highlights controversial results obtained  
79 through attempts of the government to create "artificial" production agglomerations though the attraction of FDI into  
80 regions.

81 What concerns connection of foreign investments and innovative development of the Russian regions is that  
82 investment does not have a great effect on innovative development according to the results of our research of the  
83 Siberian Federal District regions. Share of foreign investment in total financial sources of innovative companies accounts  
84 for 0,1-0,4% and during the last years there has not been any data on this indicator in statistical digests at all. Foreign  
85 investments, including those from the EU, can be found basically in the regions with advanced base materials sector such  
86 as Kemerovo Region, Irkutsk Region, Tomsk Region, Krasnoyarsk Krai (Tyuleneva, 2013 - Peoples' Friendship University  
87 of Russia).

88 In terms of what has been said above, the most efficient and promising model nowadays is a so called improved  
89 R&D model developed by A. Akaev (2014) for the purposes of forecast analysis of economic growth's total productivity  
90 factors. Along with a number of workers engaged in R&D the model considers expenditures per 1 worker engaged in  
91 R&D and a personnel qualification. However, the model only regards a national innovative system and doesn't involve  
92 regional level studies.  
93

## 94 3. Methodology

95

96 Having studied the most successful international practices in the field of counties' and regions' innovative activity  
97 evaluation we have worked out a methodology for identification and evaluation of connections between innovative and  
98 investment activity and social-economic development of regions. Our methodology includes three correspondent groups  
99 of indicators. We have made calculations according to the methodology based on two groups of indicators where the first  
100 group characterizes resources of innovative activity and the second group describes the results of such activity.

101 As a part of the study, we have carried out a comparative analysis of the Russian regions on the basis of statistical  
102 data over the period of 2011-2013. The study also involves rating scale analysis of the most innovatively active regions,  
103 ranking according to the final values of the indicators shown by the regions. There is also an interpretation of regional  
104 innovative and investment activity rankings published by the Russian organizations. To identify connections between  
105 indicators we have conducted correlation analysis and done statistical evaluation of significance.  
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#### 4. Specific Features of the Innovative and Investment Activity and Social-Economic Development of the Russian Regions

##### 4.1 Innovative Territorial Clusters and Their Role in Transition to Innovative Development

A background for the development of cluster-based programs in the Russian regions and a comparative analysis of the innovatively active Russian regions (evidence from the Siberian Federal District) with the use of a cluster analysis methods are described in our previous works (Tyuleneva, 2013 - ERIEP).

Innovative development of the Russian economy characterized by the leading role of knowledge and hi-tech industries is only possible under conditions of economical diversification, increase of enterprises' innovative activity on the basis of new forms of business and government interaction. In The Concept of long-term social and economic development of the Russian Federation until 2020 (Ministry of Economic Development of the Russian Federation, 2008), a stimulation of activity of emerging territorial-production clusters is presented as one of the key guidelines. The concept of a cluster-based regional economy management allows to identify the factors of regional competitiveness and helps develop priority sectors which determine investment attractiveness of the territories.

In 2012 the work group for private and state partnership development in the innovation field under the Governmental committee for hi-tech and innovation has made a List of twenty five innovative territorial clusters (ITC) according to the results of a competitive selection (Ministry of Economic Development of the Russian Federation, 2012). The List comprises two groups of clusters. The first group involves clusters which will be receiving federal budget subsidies during a five year period whilst clusters in the second group will not receive subsidies from the federal budget. Table 1 shows the federal districts where these clusters are located and the number the clusters mentioned.

**Table 1:** Innovative Territorial Clusters by Federal Districts

Federal District	Number of clusters which took part in the selection	Number of clusters which were included in The List	Share of clusters which received the ITC status, %
European Russia			
Central	26	6	23
Northwestern	11	3 (5 not including merged clusters)	45 (not including merged clusters)
Southern	8	–	–
Volga	22	9	41
North Caucasian	1	–	–
Asian Russia			
Ural	6	1	17
Siberian	18	5 (7 not including merged clusters)	39 (not including merged clusters)
Far Eastern	2	1	50

**Source:** Russian Cluster Observatory (2013 - Pilot Innovative Territorial Clusters in the Russian Federation)

As table 1 shows, most of the applications were submitted by the Central, Volga and Siberian federal districts. At the same time these districts lead in number of the clusters that gained the ITC status.

After the selection of pilot clusters in 2013, there has been a start of a new selecting procedure for the financial support of particular events from the development programs of ITC (Russian Cluster Observatory, 2013 - Territorial Clusters. News Digest). It is interesting to note that the Russian subjects claimed more than 1,9 bln. rub. as financial support of cluster projects and that exceeded the amount of subsidies (1,3 bln. rub.) set in the federal budget of 2013. Such a big difference in sums can be explained by the various approaches used by regional authorities when claiming financial support and by the different level of preparation of the projects.

Among the most popular requests in the applications were financing of the development of innovative and educational infrastructure, support of the cluster organizations' operation, professional retraining and internships of the workers. According to the Government Executive Order 2,5 bln. rub. should have been given as a financial support of development programs of ITC in 2014 (Government of the Russian Federation, 2014). The results of these measures and the application efficiency of appropriated funds will be announced in 2016 after the analysis of reports by authorized bodies.

The selection has shown that the regions with a relatively developed innovative system gain leading positions in the use of new forms of innovation support. This statement is confirmed by the fact that 19 out of 25 innovative territorial clusters are located in the regions which head the list of the regional innovative development rankings.

#### 4.2 AIRR Member Regions

We note that regions' innovative activity has an uneven distribution. Up until recent times regional authorities have not been taking an active part in the development of innovative processes at their territories. However, today many Russian federal subjects have established legislation on innovations and innovative activity, where they also reveal the mechanisms of innovative activity support at regional level.

Many of the highest indicators of innovative activity have been shown by the AIRR (Association of Innovative Regions of Russia) member regions. The Association was created in 2010 and today it has 14 member regions from 85 Russian federal subjects. The purpose of the Association is to stimulate experience exchange in order to create a positive legal, economic and social environment for innovative development, as well as to organize and promote joint innovative, economic, science-and-technological and educational projects amongst the members of the Association and authorities.

In 2014 the Association published a Ranking of the Russian regions' innovative development which comprised 23 indicators of innovative activity, including R&D and social and economic conditions, and analysis of 83 regions of the Russian Federation (Association of Innovative Regions of Russia, 2014). According to the results they formed 5 groups of investors: strong, medium-strong, medium, medium-weak and weak. Table 2 shows the positions of the AIRR member regions in the overall ranking of regions' innovative development.

**Table 2:** Ranking of the AIRR member regions' innovative development

Regions	Position in Overall Rating	Group
Republic of Tatarstan	3	Strong Investors
Kaluga Region	5	
Tomsk Region	8	
Perm Krai	10	
Novosibirsk Region	11	
Ulyanovsk Region	13	Medium-Strong Investors
Samara Region	15	
Republic of Bashkortostan	16	
Krasnoyarsk Krai	18	
Republic of Mordovia	21	
Irkutsk Region	30	Medium Investors
Lipetsk Region	34	
Tyumen Region	39	
Altai Krai	54	

**Source:** Association of Innovative Regions of Russia, 2014

The ranking demonstrates high positions of the AIRR regions in comparison with other Russian regions. All the regions discussed belong to groups of strong, medium-strong and medium investors.

AIRR member regions actively conduct work towards fundraising. In order to attract investors, regions resort to different tools and activities including organization of different forums and investment platforms.

The regions also work out cluster-based development programs. For example, one of the key directions of production modernization proposed in the Strategy of Social and Economic Development of Novosibirsk Region is a transition to cluster programs. It is emphasized that the top priorities of the long-term development of Novosibirsk region will be implemented by means of a set of policies initiated by the authorities. This set will include innovative, social, production, cluster and investment policies. The authorities plan to implement effective economic and financial measures aimed at supporting the real sector of economy and the most competitive clusters. The work towards building a Cluster campus is conducted under the terms of the Concept of Cluster Policy of Novosibirsk Region.

Altai Krai has also set a course for cluster development. According to the Program of Social and Economic Development of Altai Krai until 2017 production policy of the region is aimed at the growth of industrial products' competitive ability in the national and international market. This is planned to create and develop competitive industrial

clusters, a zone of advanced economic growth which will result in a structure diversification.

Among the middle-term goals set in the Development Strategy of Tomsk Region there is a formation of innovative and complete economy. To reach this goal, the government has worked out three main tasks: to create favorable investment climate and contribute to economical internalization; to contribute to growth of competitive ability and innovative activity of organizations; to contribute to development of high-tech production and clusters. The third task comprises creation of ten new high-tech clusters and more than 135 thousand high-performance workplaces.

Cluster policies implemented in all regions generally share the orientation to high level of employment maintenance, job creation, new types of products development, extension of small businesses' opportunities and increase of regional budget revenues.

One of the most reliable rankings of the Russian regions' investment attractiveness is an annual ranking publishing by the "Expert RA" rating agency (Table 3). So far they have issued the reports over a period of 1996-2014. Rankings of the Russian regions' investment attractiveness are based on the official information provided by the Federal Service for National Statistics, also known as Rosstat (Expert RA Rating Agency, 2014).

**Table 3:** AIRR regions: innovative territorial clusters and regional investment attractiveness ranking

Region	Name of an Innovative Territorial Cluster	Region' Investment Attractiveness Ranking
Kaluga Region	Pharmacy, biotechnology and biomedicine cluster (Obninsk city)	1A Maximum potential – minimum risk
Perm Krai	Rocket engine building innovative territorial cluster: "Technopolis "New Stellar"	2B Medium potential – medium risk
Republic of Bashkortostan	Petrochemical territorial cluster	2B Medium potential – minimum risk
Republic of Mordovia	Energy- efficient lightning technology and intellectual systems of lightning management	3B2 Minimum potential – medium risk
Republic of Tatarstan	Kamsky innovative territorial and production cluster	1A Maximum potential – minimum risk
Samara Region	Innovative territorial aerospace cluster	2B Medium potential – minimum risk
Ulyanovsk Region	Nuclear innovative cluster (Dimitrovgrad city)	3B1 Minimum potential – medium risk
Altai Krai	Altai biopharmacy cluster	3B1 Minimum potential – medium risk
Kemerovo Region	Integrated coal and technology-related waste conversion.	2B Medium potential – minimum risk
Krasnoyarsk Krai	Innovation technology cluster (Zheleznogorsk city).	2B Medium potential – minimum risk
Novosibirsk Region	United application: Innovative territorial cluster in the field of information and telecommunication technologies. Biopharmacy cluster.	2B Medium potential – minimum risk
Tomsk Region	United application: Pharmacy and medical equipment. IT and electronics.	3B1 Minimum potential – medium risk

**Source:** Expert RA Rating Agency, 2014

There are two indicators in the ranking which help estimate investment attractiveness of a region: investment potential and investment risk. The potential shows what share a region has in the Russian market while risk is used to identify the scale of the problems occurring in a region. The total potential consists of 9 individual potentials: labor, financial, production, consumer, institutional, infrastructural, natural-resources, tourism and innovation potentials. The aggregated risk comprises 6 components: financial, social, managerial, economic, ecological and criminal risk. Contribution of every particular risk or potential to a total value is estimated on the basis of a questionnaire survey which involves representatives of expert, investment and banking communities.

Thus, the AIRR member regions are active developers of cluster policy and participants of the selection for pilot

218 cluster support. These regions are characterized by the integration of educational and science-and-technological potential  
219 and industrial sector with state support. Moreover, many of the regions where the pilot innovative clusters are located  
220 have a high level of investment attractiveness. Taking into consideration the results of the research we can assume that  
221 the presence of innovative clusters in a region is an important factor of its investment attractiveness. At the same time, a  
222 development of sustainable investment programs for the pilot innovative clusters along with constant monitoring and  
223 control of their implementation will lead to increase of investment attractiveness of the majority of the regions working out  
224 projects of innovative territorial clusters.  
225

## 226 5. Data Analysis and Results of an Empirical Study

228 The AIRR member regions discussed above have been chosen as a study object in the present research. We have also  
229 included Kemerovo region (Siberian Federal District) in the research, the region which gains leading position in a base  
230 materials sector and actively works out cluster development programs.

231 At the first stage of our research we have used the methodology that analyses how regional innovative and  
232 investment activity and social-economic development are connected. As it was mentioned above, we have worked out  
233 three groups of indicators presented in Table 4.  
234

235 **Table 4:** Indicators for a comparative analysis of innovative and investment activity and social and economic  
236 development of regions  
237

Number of indicator	Innovative activity	Investment activity	Social and economic development
1	Volume of innovatory production, works, services, mln. RUR	Fixed capital investments, mln. RUR	Gross regional product per capita, RUR
2	Expenses of organizations on technological innovations, mln. RUR	Fixed capital investments per capita (at actual prices), RUR	Average per capita money income (monthly), RUR
3	Trade of technologies with foreign countries by fields of agreements, mln. dol.	Fixed assets depreciation rate (end of the year), %	Average annual level of unemployed, %
4	Number of issued patents on inventions and useful models, unit	Share of loss-making organizations (percentage of total number of organizations)	Retail trade turnover per capita, RUR
5	Use of advanced production technologies, unit.	Inflows of foreign direct investments in the economy of Russia, mln.dol.	Dwellings put in place per 1000 persons, sq.m.
6	Innovative activity of organizations (Share of organizations implementing innovations in total number of organizations), %	Accumulated foreign direct investments, mln.dol.	Graduates of higher educational institutions, thou. persons

238 **Source:** Made up by the authors  
239  
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241 The next step is to define the place of each region among the other regions taken into consideration according to their  
242 level of innovative and investment activity and social and economic development over the period of 2011-2013. The  
243 lowest total value means the best position of the region in comparison with the others. The results are presented in the  
244 Table 5.  
245

246 **Table 5:** Ranking of regions according to their level of innovative and investment activity and social and economic  
247 development  
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Regions	Total value								
	Innovative activity			Investment activity			Social and economic development		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
Altai Krai	59	59	59	53	69	68	79	75	54
Irkutsk Region	68	62	61	45	43	53	63	61	50
Kaluga Region	59	56	59	37	37	33	52	47	24
Krasnoyarsk Krai	47	37	36	40	31	28	39	37	30
Lipetsk Region	40	35	48	44	48	38	43	46	21
Novosibirsk Region	42	43	43	47	46	45	43	45	29



Perm Krai	24	21	28	60	54	57	46	47	34
Republic of Bashkortostan	35	29	32	41	49	41	37	36	24
Republic of Mordovia	40	43	47	71	77	71	73	74	48
Republic of Tatarstan	12	9	11	31	28	27	15	15	13
Samara Region	25	33	25	49	40	34	27	24	14
Tomsk Region	56	46	57	42	44	47	58	61	45
Tyumen Region	30	34	45	31	29	27	15	14	9
Ulyanovsk Region	63	67	65	66	66	64	67	65	40
Kemerovo Region	72	62	75	55	49	52	55	59	44

**Source:** Made up by the authors on the basis of data from Rosstat (2011-2013)

On the basis of calculated data we can point out the regions which have shown a number of leading figures. For instance, the best results in innovative activity (in descending order) were shown by: Republic of Tatarstan, Perm Krai, Samara Region and Tyumen Region; in investment activity: Republic of Tatarstan, Tyumen Region, Kaluga Region and Krasnoyarsk Krai; and, finally, the leaders in social and economic development are Tyumen Region, Republic of Tatarstan, Samara Region and Republic of Bashkortostan.

In order to study a dependence of the regions' innovative and investment activity indicators let us draw a matrix of paired correlation coefficients (Table 6). One of the main indicators of the regions' innovative activity is a volume of innovatory production, works and services. In our research we attempt to find out a dependence of volume of innovatory production, works, services (Y) on indicators of investment activity (X1-X6). We use data of 2013.

**Table 6:** Matrix of paired correlation coefficients for regions' innovative and investment activity

	Y	X1	X2	X3	X4	X5	X6
Y	1						
X1	0,989418	1					
X2	-0,03573	0,071316	1				
X3	-0,04744	-0,0678	0,310366	1			
X4	0,024928	0,084281	0,112746	-0,23314	1		
X5	0,992688	0,998153	0,024895	-0,09663	0,082048	1	
X6	0,703352	0,735273	0,307153	-0,05458	0,006749	0,732261	1

**Source:** Made up by the authors

Let us do a statistical evaluation of the calculations. With a set significance level being 0,05 and a number of degrees of freedom being 14 the critical correlation value equals 0,497. Therefore, we can say that there is a correlation between a factor Y and factors X1, X5 and X6 with a probability of 95%. The analysis of the paired correlation coefficients matrix shows that a dependent variable Y (Volume of innovatory production, works, services, mln. RUR) has a strong connection with a variable X1 (Fixed capital investments, mln. RUR), variable X5 (Inflows of foreign direct investments in the economy of Russia, mln.dol.) and variable X6 (Accumulated foreign direct investments, mln.dol.). At the same time the factors X1, X5 and X6 have strong connections with each other which says about their multicollinearity.

In a similar way we investigate the influence of the investment activity indicators on the other indicators of innovative activity. As a result we get the same dependence between the variables. The only exception is an indicator of Innovative activity of organizations (Share of organizations implementing innovations in total number of organizations) which does not correlate with investment activity indicators.

Thus, the obtained results have demonstrated that only a number of chosen indicators influences innovative activity of the regions.

We assume that attraction of investment resources has a favorable effect on general social and economic state of a region. Table 7 contains the results of a correlation analysis for the Gross regional product per capita indicator (Y) and investment activity indicators (X1-X6).

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**Table 7:** Matrix of paired correlation coefficients for regions' social and economic development and investment activity

	Y	X1	X2	X3	X4	X5	X6
Y	1						
X1	<b>0,103326</b>	1					
X2	<b>0,981846</b>	0,066178	1				
X3	<b>0,267792</b>	-0,09955	0,200899	1			
X4	<b>0,174624</b>	0,06668	0,261148	-0,28034	1		
X5	<b>0,069253</b>	0,998413	0,033076	-0,11778	0,070129	1	
X6	<b>0,031031</b>	0,993767	-0,00321	-0,11484	0,052102	0,995913	1

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**Source:** Made up by the authors

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As we can see in the Table 7, the indicators Y and X2 have a strong correlation with a probability of 95%. In other words, Gross regional product per capita is closely connected with Fixed capital investments per capita. Such connection explains the importance of investments into priority areas. Fixed capital investments occupy a great share in GRP of the majority of the regions considered.

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Revealing correlations between the other indicators of regional social and economic development and their investment activity have shown that Fixed capital investments per capita has a strong connection with the other social-economic indicators except for the Average annual level of unemployed (no correlation in that case). Along with that the indicator of Graduates from higher educational institutions has demonstrated a strong correlation with Fixed capital investments and Fixed capital investments per capita.

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Further literature review helped point out another approach to the evaluation of regions innovative activity (Kotsubinskiy et al., 2014). According to this new approach there are two directions for the analysis of innovative activity and two groups of correspondent indicators: the ones which characterize the use of resources (production assets, human and financial resources) and the ones which describe the results of innovative activity (innovative products, influence on operation results). This methodology serves as a basis for the modern form of Rosstat statistical reporting called "#4 Innovation". When used in respect of a region the first group helps evaluate its innovative potential, whilst the second group analyses how efficient are the investments are.

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At the next stage of research on the basis of the approach mentioned above we have developed an evaluation procedure in which we have included the following indicators:

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Indicators characterizing resources:

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- I. Production assets
  1. Fixed capital investments, mln. RUR
  2. Fixed capital investments per capita (at actual prices), RUR
  3. Fixed assets depreciation rate (end of the year), %
  4. Use of advanced production technologies, unit

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- II. Human resources
  1. Number of researchers and engineering and technical workers engaged in R&D, person
  2. Expenditures per 1 worker engaged in R&D, RUR
  3. Number of researchers with an academic degree, person

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- III. Financial resources
  1. Share of gross domestic expenditure on R&D in GDP, %
  2. Expenses of organizations on technological innovations, mln. RUR

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324

Share of expenditure on technological innovations in gross volume of production, works, services, %

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Indicators characterizing results of innovative activity:

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- I. Indicators of innovative activity
  1. Volume of innovatory production, works, services, mln. RUR
  2. Share of innovatory production, works, services in gross volume of production, works, services, %
  3. Trade of technologies with foreign countries by fields of agreements, mln. dol.
  4. Number of issued patents on inventions and useful models, unit

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- II. Indicators of social-economic development of a region

- 333 1. Gross regional product per capita, RUR
- 334 2. Average per capita money income (monthly), RUR
- 335 3. Average annual level of unemployed, %
- 336 4. Retail trade turnover per capita, RUR
- 337 5. Dwellings put in place per 1000 persons, sq.m.
- 338 6. Graduates of higher educational institutions, thou. persons

339 Following the algorithm of the previous calculations we define the place of each region, among the other regions,  
340 taken into consideration. The total value for each of the regions is presented in the Table 8.

341 **Table 8:** Ranking of regions on the basis of indicators of resources and results of innovative activity

Regions	Indicators characterizing resources									Indicators characterizing results of innovative activity					
	Production assets			Human resources			Financial resources			Innovative activity			Social-economic development		
	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
Altai Krai	49	50	46	18	27	34	26	33	39	42	42	42	79	75	54
Irkutsk Region	32	33	38	14	18	18	22	28	24	56	52	53	63	61	50
Kaluga Region	30	30	30	4	11	15	13	22	18	51	44	52	52	47	24
Krasnoyarsk Krai	22	17	17	11	19	23	7	10	7	46	35	35	39	37	30
Lipetsk Region	35	39	31	15	29	44	17	24	32	34	24	39	43	46	21
Novosibirsk Region	29	31	32	5	6	8	11	20	23	33	31	30	43	45	29
Perm Krai	39	38	36	5	15	17	12	15	13	19	18	22	46	47	34
Republic of Bashkortostan	27	30	29	7	12	23	18	26	27	31	28	30	37	36	24
Republic of Mordovia	42	42	44	14	29	43	21	29	33	28	26	28	73	74	48
Republic of Tatarstan	19	23	21	3	6	18	6	8	10	11	7	7	15	15	13
Samara Region	27	28	26	2	13	21	7	11	5	21	23	23	27	24	14
Tomsk Region	34	33	37	8	10	9	20	28	24	42	35	44	58	61	45
Tyumen Region	17	16	17	9	15	21	12	20	22	37	45	55	15	14	9
Ulyanovsk Region	45	45	46	8	21	31	22	33	33	38	44	43	67	65	40
Kemerovo Region	30	25	30	18	30	35	26	27	36	63	62	68	55	59	44

344 **Source:** Made up by the authors on the basis of data from Rosstat (2011-2013)

345 The obtained results have demonstrated that current approach makes it more difficult to compare regions because of the  
346 greater number of indicators. In this case, Tyumen region leads in the use of production assets and social and economic  
347 development, Novosibirsk region has the best results in the use of human resources, and, finally, the Republic of  
348 Tatarstan gains a leading position in the use of financial resources and innovative activity.

349 Correlation analysis of the first group of indicators and the indicators of innovative activity from the second group  
350 revealed the following. The Volume of innovatory production, works, services, Trade of technologies with foreign  
351 countries and Number of issued patents correlate with Fixed capital investments, Use of advanced production  
352 technologies, Number of researchers and engineering and technical workers engaged in R&D, Number of researchers  
353 with an academic degree, Share of gross domestic expenditure on R&D in GDP and Share of expenditure on  
354 technological innovations.

355 Correlation analysis of the first group of indicators and the indicators of social and economic development from the  
356 second group showed the following results. Fixed capital investments per capita correlate with Gross regional product per  
357 capita and Average per capita money income. At the same time Graduates of higher educational institutions correlate  
358 with Fixed capital investments, Use of advanced production technologies, Number of researchers and engineering and  
359 technical workers engaged in R&D, Number of researchers with an academic degree, Share of gross domestic  
360 expenditure on R&D in GDP and Share of expenditure on technological innovations.

## 361 6. Conclusion

362 The analysis of the influence of regions innovative and investment activity on their social-economic development allows to

367 make the following conclusions. Firstly, taking into account a long-term experience of cluster-based programs  
368 implementation it is required to use the best international models of innovative territorial clusters' formation considering  
369 the Russian specificities. Innovative and investment activity of the Russian regions is the main driver of their economic  
370 growth and social well-being. Secondly, today Russia aims to use advantages of a cluster approach in solving problems  
371 of modernization and innovative development of regions. There has been a process of adaptation of a "cluster policy"  
372 term to the Russian conditions and specific features of public authorities, science, education, business and society.  
373 Thirdly, considering a poor development of market institutions, a key role in the creation of innovative territorial clusters  
374 being factors of competitive ability growth belongs to government. In this respect, it is important to work out a conceptual  
375 and methodological base and a regulatory framework for cluster policy at the federal level and create favorable conditions  
376 by means of public-private partnership and establishment of specific financial institutions. Fourthly, implementation of  
377 cluster policy implies coordination of actions of federal state government bodies, executive authorities of the Russian  
378 federal subjects, local governments, business and scientific and educational centers. The use of state development  
379 institutions' resources should become a significant mechanism for cluster investments projects' financing. Finally, one of  
380 the conditions needed for successful innovative development is a presence of a developed innovative infrastructure. In  
381 this regard, it is necessary to accelerate formation of new networks of technology parks and increase operating efficiency  
382 of existing technology parks. Taking part in such projects will allow Russia to occupy a rightful place in the world  
383 economic system.

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## The European Union and Albania, The Relations between them

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### Abstract

The European Union (EU) is the most achievement of European states that after World War II, was approached forms of international cooperation to ending military conflicts between them. The union now represents an advanced form of cooperation between the countries with a high level organization attended and rules which are subject to most of the countries of the European continent. The paper deals some of the unique features of the EU as organizational and institutional solutions that it has adopted to coordinate and rewarding economic interests of its member states and to sort out the political tensions between them. An important part of this paper will take a hold Albania in relation to the European Union (EU), showing the importance of integration in the European Union, Albania and strategic aim of Albania as a country that seeks respect for the rule of law, guarantee independence of independent institutions, the consolidation of democracy, strengthening of a functioning market economy, guaranteeing respect for fundamental human rights and minorities that constitute the main values on which the European Union is founded

**Keywords:** The European Union , the integration, agreement, Stabilisation and Association Agreement (SAA ), dialogue

### 1. Preamble

European integration led to achieving tangible results after Second World War, when European countries headed to international cooperation methods to end military conflicts between them. The European Union (EU), is the most important achievement of this integration. The union now represents an advanced form of cooperation between the countries with a high level of organization which is attended by and rules which are subject to most of the countries of the European continent. Seen in the context of globalization process we get the impression that we are dealing with one of the numerous cases of regional integration leaving so incorrectly out of the meaning of this organization a number of features that define the nature and true role of the EU.

So, we can mention briefly some unique features of the EU as organizational and institutional solutions that it has adopted to coordinate and reward economic interest of its member states and to smooth out political tensions between them ;

- Unique market and common currency that have produced in years considerable economic growth for Member States;
- The EU citizenship and the relationship it has created between European citizens and the EU by overcoming traditional notions of state and nation.;
- The process of converting its treaties to constitution and production of a legal doctrine on which rests the entire edifice of the EU.

These and other features speak of the uniqueness of the EU and identify similarities or differences between her and traditional political entities of the international arena such as States and international organizations. In this context, it is necessary that the features of the EU to be analyzed in advance in order to accept from the beginning a concept for the EU and to create a context within which it should be understood. So, this part answers the question what is the EU.

Various researcher have seen the EU from different perspectives. So, some of them have identified it with a regional cooperation system (Haas 1966). Others have defined it as "condominio and consortio" where the two dimensions of the territory and functionality, which, in a state are united and create an entity, in the case of the EU they vary in such a way that create a variety or variation between functions related to territory and those associated with institutions (Schmitter 1996). Taking the state as comparison unit, other authors have seen the EU as a post-national alliance with distinctive sopranational features (Eriksen).1, but also as an intergovernmental organization (Morasvick).

57 However, most of the theories which had as its object of study the character of the EU arrive at the conclusion that the  
58 EU is a form of organization and international cooperation that is the only of its kind.<sup>2</sup> So it can be understood as a sui  
59 generis organization where are united supranational elements, features of national and international regime. But how can  
60 we test uniqueness of the EU? What we today know is a very complex political, economic and social entity which has  
61 common and special features with other forms of organization or political and economic cooperation of the modern world.  
62 In the following section will be explained the nature of the EU and will be treated the differences with other forms of  
63 political organization.  
64

## 65 2. A Brief History of the EU

### 66 2.1 The importance of studying the history of the EU

67 The EU is called for the first time with this name in 1993 in the Maastricht Treaty. But of course that this denomination  
68 does not specify the origin of the union nor the definition of its political finality. It is important to understand that the EU, as  
69 we know it today, is the product of political ideologies that have developed over the years and have their roots in the early  
70 ideas of cooperation in Europe mainly those after Second World War .  
71

72 The study of the EU in a historical context is pertinent for a variety of reasons:

- 73 - Firstly, the study of evolution of the institutional edifice of the EU highlights the supranational characteristics of  
74 this organization ,the functions performed by each body and the way of separation and balancing of powers.
- 75 - Secondly, the treatment in a historical context of the clashes of interests of states with supranational ones,  
76 indicates the legal order and the special role of the ECHR as a promoter of normative authority of the EU.
- 77 - Thirdly, by stopping particularly at the main stages of economic and trade cooperation we can analyze the  
78 reasons that have led to the transformation of an economic union in an advanced political union.
- 79 - Fourthly, the study of the history of the expansion of the EU indicates its geopolitics and real opportunities for  
80 the integration of Western Balkan countries for what our country is directly interested.
- 81 - Fifthly, only evolutionary appearance of the EU enables the reader to understand the constituent processes  
82 taking place today in Europe and the importance of its political definition.

83 Precisely, the issues mentioned above and others will be treated below in such a way that treaties and other  
84 important events can be accommodated and understood within a historical, economic and political context.  
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## 87 3. The Foundations of European Integration - the ECSC Treaty and the Rome Treaties

88 The regional and global shares of the late '40s briefly discussed above, whose philosophy was generally an economic  
89 cooperation in return of peace, created a favorable climate for the formulation of concrete proposals for European  
90 integration. A historic contribution proposal for the foundations of the EU is the declaration of the French Foreign Minister  
91 Robert Schuman made in May 1950, which in fact had as an originator and creator Jean Monnet, a visionary politician of  
92 the united Europe. This statement, which later was called Schuman Plan submitted the functioning scheme of the ECSC,  
93 which would be established a year later. Schuman Plan proposed that the Franco-German coal and steel production be  
94 placed under a common authority of the two countries, called the High Authority. In the political background of this  
95 proposal were the efforts of French politics at the time, to decide Germany's war industry under a reliable control and not  
96 "overshadowing" the role of France regarding the anti-Sovietic block.  
97

98 The European Coal and Steel Community (ECSC) Treaty was signed one year later, on April 1951 in Paris from six  
99 countries respectively France, Germany, Italy and the Benelux countries, with a validity period limited to 50 years. He  
100 created an institutional scheme where supranational features are mixed. High Authority, consisting of nine persons  
101 appointed by the governments of the six member states, was the authority which protected the interests of the  
102 Community and was charged with his executive functions. The main aim of the ECSC Treaty, which is the predecessor of  
103 the organization of today's EU, was the establishment of the common market of coal and steel. However, this did not  
104 have all the features of the common market. It contained rules for repealing of customs duties, prohibition of  
105 discriminatory practices or the support and state aid, prohibitions related to free concurrence of the agreements for the  
106 market share, but does not set a common fee for products which enter from third countries. So ECSC was a trade  
107 liberalization project conceived by its member states as a form to arrange war industry in a narrow space of states with  
108 shaft states France and Germany.

109 Based on the recommendations of the Spaak report, was drafted the Treaty of the Constitution of the European  
110 Economic Community (EEC) that was signed in Rome on March 1957 together with the European Atomic Energy

Community Treaty,( EAEC known as Euratom). Rome Treaties entered into force on January 1958. EEC goals were the establishment of a common market, approximation of the economic policies of the Member States, promotion of economic activities , rising of the economic standards and creation of close relations between states. The establishment of the common market was predicted to pass through several phases where customs duties would be abolished between Member States, would be placed a common tariff against third countries, would be ensured free movement of production factors, would be implemented a common policy in the transport and agriculture sector.

#### 4. The Maastricht Treaty - Establishment of the European Union

The European Union was founded by the Maastricht Treaty, which entered into force on 1 November 1993. It was the result of two actions taken by Member States to achieve two objectives; on one hand the economic and monetary union and on the other hand the political union. But while the first objective, economic and monetary union, constituted a natural result of the trade liberalization project launched by AUE The second objective represented a new and brave step towards formalization of the efforts to establish a political unity in Europe, which in most cases needed to rise over difficult compromises.

The Economic and Monetary Union (EMU) was declared in the European Council in Hanover in June 1988 as community engagement and was asked to the Commission, which at that time was headed by Jacques Delors, to prepare a report on the measures to be taken regarding this. Delors report was greeted with enthusiasm in the Madrid European Council of June 1989 where it was confirmed that the Community will soon begin to find legal solutions for the realization of the unity.

Intergovernmental Conference and Political Union on EMU produced two draft treaties, which were later consolidated in the Maastricht European Council on December 1991 in a single text, Treaty on European Union (TEU), which was signed on February 1992. TEU was the result of two negotiating processes which were developed in a parallel way, separately and at different rates. This made TEU be conceived in a very special way in which are mixed supranational and Intergovernmental elements. TEU preserves institutional architecture of the Community (Parliament, the Council of Ministers, the Commission, ECHR, the Court of Auditors) and adds two financial institutions, respectively the European Central Bank and the European Investment Bank. This structure is based on three pillars:

1. Community pillar Title II, III and IV of the TEU
2. Pillar of a Common Foreign Security Policy , (CFSP) predicted on Title V
3. Pillar of cooperation in Justice and Home Affairs (JHA),predicted on title VI. TEU which also formalized the concept of the EU citizenship.

Regarding the first pillar should be noted that the Community competence was extended in such areas as economy, environment, social protection, economic and social cohesion as well as in terms of increasing the standard of living (article 2). This extension of competence was reflected in the Treaty of Rome. From European Economic Community Treaty was renamed European Community Treaty (ECT) and now includes new provisions on EMU and on financial institutions established recently.

The other two pillars had intergovernmental character. Their legal basis was TEU and issues covered by them were outside the institutional umbrella community. CFSP goals were protection of common values, the EU's security, peace in the framework of international organizations and strengthening cooperation internationally (article 11, ex –article J.1)

Regarding JHA this covers asylum policy, immigration issues and the acceptance of third country citizens, police cooperation, judicial cooperation in civil and criminal cases (article K.1). In the framework of this cooperation was created a new institution the European Police Office (Europol).

TEU hadn't the purpose to be the EU Constitution and the difficulties encountered in the process of ratification found a number of problems related to its legitimacy. Entry into force of TEU was anticipated on January 1993 but it was postponed until November of that year because of the difficulties that some countries faced in ratifying the treaty and the oppose of European Parliament to a number of its provisions. Danish hesitation on the common currency led to the failure of the referendum held on June 1992 to ratify the treaty. After a real battle between the center-left opposition and center-right position in France, referendum on ratification resulted positive on September 1992 , with only a few points ahead. In Germany TEU was accepted only after the change of the German Constitution. In Denmark and United Kingdom only after these two states were assured that they were not obliged to submit to the treaty arrangements for the common currency , those on defense and security, TEU was voted by referendum on May 1993 in Denmark and was ratified in the Communes Chamber immediately thereafter

One of the moments that deserves attention in the years after the ratification of the TEU is the third expansion of



165 the EU. Austria, Sweden, Finland became members of EU on 1 January 1995 after signing the accession act in the  
166 European Council of Corfu 1994. Norway, although had applied for membership remained outside the EU, after the  
167 failure of the referendum in 1995.

## 169 5. Treaty of Nice

### 171 5.1 Institutional and procedural reforms

172 Treaty of Nice was signed on February 26, 2001 and came into force on February 1, 2003. Changes that made TN in  
173 institutional and legal system had positive effects not only for the improvement of the functioning of the EU and its  
174 preparation for expansion but above all, they pulled out that it was the time to be taken concrete steps regarding the  
175 determination of the political finality of the EU and the drafting of a constitution.

176 TN reformed community institutions and consequently the first pillar mutated. Number of seats in the Parliament  
177 increased from 700, to 732. Starting from 2005 the Commission will have only one Commissioner per member state and  
178 their total number since the EU had 27 member states would be smaller than the number of member states and will be  
179 determined according to a rotation system decided unanimously by Council. Despite TN didn't brought substantial  
180 changes in the composition of the ECHR or in the First Instance Court, changes that this treaty made in their jurisdiction  
181 reinforced the hierarchical ratio between this two and also reinforced the features of a particular system in the EU area  
182 where ECHR is the highest instance of judgment.

183 But the main achievement of TN is definitely reforming the decision-making process through the resetting of the  
184 number of votes in the Council for each member state and the redefinition of the qualified majority. Increasing the number  
185 of member states after the expansion of 2004, most small population, would affect representation in the Council of States  
186 with large populations. This was the reason that the number of votes in the Council was revised from TN in order to  
187 establish a fair ratio between the number of votes and the population of the member states. Large member states was  
188 recognized a greater number of votes than smaller states. According TN qualified majority calculated according to the  
189 formula majority of votes in the Council plus a majority of member states, and in some specific cases plus most of the  
190 population of the Member States. Although TN maintained unanimity voting in some areas such as taxation and social  
191 policy, he predicted the instant deployment of voting in qualified majority in a number of areas such as free movement of  
192 citizens, judicial cooperation in civil matters, industrial policy and the extension after 2005 asylum and immigration issues  
193 and common trade policy and other. TN also determined substantial and procedural arrangements for the process of  
194 "closer cooperation" set by the AT.

## 197 6. Drafting and Approval of the Constitutional Treaty

198 TN stated that the EU had already entered a stage where it was necessary "to improve democratic legitimacy and  
199 transparency of institutions so that they were closer to the people". So, it was accepted that the moment of establishing  
200 legitimacy for the political community and the institutions built in Europe had arrived.

201 Constitutional Treaty (Constitution) was signed in Rome on 28 October 2004 from 25 EU member states.

202 From the viewpoint of international law, the Constitution as well as other founder acts of EU is a treaty that would  
203 be subject to the procedure of ratification by member states (article IV-447 of Constitution). Despite that the Constitution  
204 will replace the EEC and TEU Treaty (Article IV-437) remains debatable whether it has succeeded to transform the EU  
205 from an organization established under principles of international law such as to have the ability to grant powers to EU  
206 institutions independently and without the necessary approval (ratification) by the Member States. However Convention  
207 managed to transform post Agenda - Nice from an agenda looking institutional legitimacy to a constitutional agenda for  
208 Europe. It also replaced the traditional way of revising the treaties exclusively from representatives of the governments of  
209 the Member States.

## 212 7. The Importance of the Constitutional Treaty

213 The EU is already at the stage of adoption of its constitution. Constitutionality phase follows a fifty-year history of the  
214 constitution of the political community, institutional and legal order of the EU and represents a major effort to increase the  
215 level of legitimacy of the political and legal community. As noted above post agenda - Nice whose ambition was to find  
216 ways to increase the legitimacy of EU generated this constitutional moment, which after works Convention materialize in  
217 the text of the Constitutional Treaty.

219 *But has this treaty reached to embody the desired legitimacy?* Regarding this point has been given many pros and  
220 cons arguments and legal literature is more committed than ever constitution building processes in the EU. As its starting  
221 point of this analysis can accept three basic features of the legitimacy of a supranational organization, respectively:

- 222 - delegation of authority from the member states to the EU institutions
- 223 - representation of all interested in the EU institutions
- 224 - Consensual decision making, equal and proportionate. Changes brought about by the Constitution in each of  
225 these fields are present and visible. Thus, the supremacy of EU law toward the legislation of the Member  
226 States (Article I-6) implies simultaneously devolution of power and empowerment as well as principle of  
227 subsidiarity and proportionality, which guarantee the legal limits of delegation (Article I-11).

228 Then, the representation with democratic character in the Convention that produced the constitutional treaty,  
229 strengthening the role of parliament according to the text of the treaty, establishing a majority voting in the Council as a  
230 rule despite the unanimous decision increase the degree of legitimacy of the EU. On the other hand if we accepted that  
231 for a constitution is essential not only to recover sufficiently political, institutional and legal tensions but also have a  
232 constitutional body that supports it, then maybe we have to acknowledge that the constitutional phase in which Europe is,  
233 lacks a process where there is an international civil society, and European public sphere of political and cultural debate  
234 Constitution in France and the Netherlands, respectively on May and June 2005, showed exactly the reluctance of  
235 citizens of these countries to the EU organization and also highlighted the legal deficiencies and difficulties to understand  
236 the complexity of the text of the Constitution. The constitutional bombing on ratification phase of the Constitutional Treaty  
237 has undergone a significant weakening and entry into force has been seriously questioned.

238 Member states of the EU and its institutions themselves are subject to a moment of reflection in order to ensure the  
239 cooperation of all stakeholders to establish EU constitutional stage in a safer ground and narrowed the distances  
240 between the EU and European citizens.

## 241 242 **8. Overview over the European Union Institutions**

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244 To understand the system of governance of the EU is necessary to study its institutional structure and how the political  
245 power is distributed to institutions.

## 246 247 **9. Commission**

### 248 249 *9.1 The composition and organization*

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251 The currently Commission is composed of 25 commissioners, one from each EU country, (article 213(1) of ECT). Method  
252 of forming the Commission testifies to the supranational character of this institution. The President is nominated by the  
253 European Council. The Council also appoints the other Commissioners in agreement with the nominated President. The  
254 appointment of all Commissioners, including the President, is subject to the approval of the European Parliament.

## 255 256 **10. The Competencies of the Commission**

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258 Functions of the Committee are provided at section 211 of the ECT. In order to understand the nature of the functions  
259 and limits of competence of the Commission is important to quote the full article 211 of the ECT.

260 "In order to ensure proper functioning and development of the common market, the Commission:

- 261 - ensures the implementation of the provisions of this Treaty and the measures taken by the institutions.
- 262 - formulate recommendations or deliver opinions on matters covered by this Treaty if it provides expressly so or  
263 if the Commission deems necessary
- 264 - has its own competence of decision and participates in the drafting of measures taken by the Council and  
265 European Parliament in the manner provided by this Treaty.
- 266 - exercising the powers that gives the Council for implementing the rules set by the latter. "

### 267 268 *10.1 Council of the European Union*

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270 Council of the European Union (the Council) is the central body of the EU architecture. He plays a very important role in  
271 policy development community and is the main EU intergovernmental activity in the framework of second and third pillar.  
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## 11. Organization and Functioning

The European Council brings together the heads of state or government of every EU country, who are authorized to make commitments on behalf of their states (Article 203), the Commission President and the European Council President, who chairs the meetings (Article 204). Characteristic of the Council Presidency is that it is not constant, but varies every six months under a rotation system.

## 12. The European Council

It was said above that the treaty does not prevent the Council, in certain and limited cases as eg fulfillment of the criteria for adopting the common currency to meet in formation of Heads of State or Heads of Government member. However the collection of these high-ranking politicians of the Member States constitutes a separate body of the EU called the European Council. Together with the Council of the European Union, it constitutes an intergovernmental arm of the EU institutional structure. Establishment and strengthening of this institution occurred outside the institutional structure of the Community and to this day continues to be so. As noted in the first chapter of this organ has its origin to summits (conferences) of the Heads of State or Government of the Member States, which have been operating since 1961 to 1974. At the Paris Summit of 1974 was declared the establishment of the European Council Forum in order to provide a new impetus to political cooperation in the community that in the 70s was not hardly sustainable. The legal basis for the European Council was created in EUA (Article 2) but EUA did not specify what would be the functions of this forum. It was the Maastricht Treaty that formally clarified and defined the role of the European Council as responsible for ensuring the development of the EU and to determine the political direction of this development (Article 4 TEU).

### 12.1 The composition and functions

Besides heads of state or government of the member states in the meetings of the European Council participate the President of the Commission, and they are assisted by the foreign ministers of member states, and a member of the Commission. Meetings are held at least twice a year. European Council meetings are led by the Head of State or Government of the Member State that has the rotating Presidency in Council .

## 13. The European Parliament

The European Parliament is the EU organ that best embodies the supranational character of the organization and to whose history identify traces the development of the institutional structure of the EU. He is the only supranational body formed by members who are elected directly from peoples of Member States.

History of empowerment of this organ symbolizes the history of deepening of the greater integration on the continent. Assembly delegates to the national parliaments from a supervisory body of the ECSC was transformed over the years into a built structure and operates on the principles of parliamentary democracy.

## 14. The European Court of Justice and Court of First Instance

Unlike the Parliament, the ECJ has been a powerful institution since the establishment of the European Community. So true is this that the ECJ has often termed as the engine of European integration because of its jurisprudence has fulfilled the legal principles of the community being put at the forefront of changes in treaties and established typical constitutional principles for a federalist system. As will be analyzed below, the jurisdiction of the ECJ and the Court of First Instance (CFI) in most cases matched even in matters of prejudgement rulings . This has made the ECJ has to stay on top of the judicial system of the EU and in many cases resembles a constitutional court.

## 15. The Judicial System under the Constitution

From a structural standpoint The Constitution consolidates the judicial system in a single court "Court of Justice of the European Union"

which includes the Court of Justice, the General Court and specialized courts" (article I-29) where the first will substitute the ECJ and the second CFI. While specialized courts may be established by a special law approved by ordinary legislative procedure with the proposal of the Commission or the Court of Justice (article III-359).

The question that arises regarding this new organization is how it has come The Constitution to improve the efficiency of the judicial community issues. The solution adopted by the Constitution to build a justice system, concretely a court which itself is composed of three courts, undoubtedly deepened the features of a judicial hierarchical system where the quality of the decisions of the lower court is guaranteed by the review by a court of high.

## 16. Types of Legal Instruments

16.1 The main instruments through which community institutions exercise powers are:

- The Regulations
- Directives
- Decisions
- The recommendations

These instruments are the most typical forms of exercise of competence under the first pillar, but not only because the EU institutions can adopt the other acts, so-called soft law, which have no binding character that characterizes most great first four instruments. In this second group included institutional arrangements, statements and conclusions of the European Council, press, green books and white books of the Commission. Another group of instruments that are adapted to different forms of interstate cooperation in the framework of second and third pillars are the strategies, joint decisions and joint positions in CFSP or decisions's and conventions in the field of JHA.

The regulation has general application. It is binding in its entirety and directly applicable in all Member States.

The Directive is mandatory, about the outcome to be achieved, for each Member State to whom it is directed, but leaves the national authorities the choice of form and methods.

The decision is binding in its entirety to those whose addresses".

Recommendations and opinions have no binding force.

## 17. Albania and the EU Relations

Currently Albania's relations with the European Union developed on Trade and Cooperation Agreement, which entered into force, on 1 December 1992.

This agreement is still in force between Albania and the EU, and contains a clause under which is determined that:

*"The agreement will contribute to move on towards the target for an association agreement, at a proper time, when conditions are fulfilled, as well as further development of relations between them: "*

Albania was the first country in the Eastern Europe to sign a Trade and Cooperation Agreement with the EU.

In 1996, Albania was close to signing a new contractual agreement with the EU, but the contested parliamentary elections of May 1996, together with the deep financial crisis and social that followed in early 1997, made this process stops.

In May 1999, EU approved a new initiative to the five countries of the Southeast Europe such as (Albania, Croatia, Former Yugoslav Republic of Macedonia, Bosnia and Herzegovina and the FRY) called Stabilization and Association Process (SAP). For Albania after the declaration made at the session of the political dialogue of April 1999, the meeting of foreign ministers of the EU on 21 - 22 June 1999 held in Luxembourg, European Commission asked to Council to develop a valid feasibility study for signing a Stabilization and Association agreement EU-Albania.

In November 1999, the European Commission presented a feasibility report on the opening of negotiations with Albania for a Stabilisation and Association Agreement, and amounted to the conclusion that Albania still did not fulfill the conditions for such agreements. The European Commission asked from our part the completion of a number of requests / preconditions and determining the deadlines for implementation.

*In general lines these requests had to do with:*

- Strengthening of public order and security in the country;
- Improving governance and strengthening law enforcement;
- Continuation of macro-economic stabilization and acceleration of structural reforms.

Can be said that the main difference of the Stabilization and Association Agreement with the European ones (signed from 10 former candidate countries) lies in the fact that the first ones are designed specifically for the five countries of our region, taking into account their level to the lowest economic development, democratic deficits and

381 specific difficulties evidenced more after conflicts in Bosnia, Kosovo and Macedonia, which make necessary element  
382 involvement of the "stabilization"

383 It is to be noted that from the whole Albanian political spectrum, public union and consequently Albanian  
384 governments the process of Stabilisation and Association was seen as a priority, as the most significant project for  
385 Albania, valuable investment for the present and the future.

386 A new page of relations with the Western Balkan countries with European Union was opened at the Zagreb  
387 Summit on 24 November 2002 which gave the message that the path towards integration in the European Union is open  
388 to all countries of the region and the future of them is in the United Europe. This Summit, which was initiated by the  
389 French Presidency of EU was aimed to achieve a common opinion on major orientations of a global political of EU in the  
390 Western Balkans region and harmonization of instruments in the framework of the Stabilisation and Association process.  
391 In this Summit was launched also the Community Assistance for Reconstruction, Development and Stabilisation  
392 programme (CARDS) with a package of 4.6 milliard euros for the period 2000-2006. Important in this process is the  
393 establishment of free trade areas between the countries of the region and between the region and the EU and the  
394 deepening of regional cooperation in general.

395 At the Zagreb Summit was created a high-level steering group EU-Albania, at the end of the work which the  
396 European Commission would have to prepare and to introduce to the Council of EU Ministers a report before the end of  
397 the Swedish Presidency in order to prepare the opening of negotiations on Stabilisation and Association Agreement EU-  
398 Albania. During the three meetings of the high-level steering group from both sides was discussed for a very large  
399 number of issues to general development of the country. These meetings are characterized by open dialogue to identify  
400 the progress achieved, but also the areas where we will need to work yet. At the end of the process, after a positive  
401 report of the European Commission in Gothenburg Summit at the end of the Swedish Presidency of the EU was  
402 recommended the opening of negotiations on Stabilisation and Association Agreement with Albania.

403 The Göteborg European Council (June 2001) invited the Commission to present draft negotiating directives for the  
404 negotiation of Stabilisation and Association Agreement. In accordance with the request of the Council in December 2001,  
405 the European Council presented to the Commission a draft mandate to start negotiations of Stabilisation and Association  
406 Agreement.

407 On 7 June 2001 the European Commission publishes a report on the conclusions of the three meetings of the High  
408 Level Steering Group EU-Albania (HLSG) set up after the Zagreb Summit. In this report the Commission estimates that  
409 Considering progress and positive direction towards reform could open negotiations on a Stabilisation and Association  
410 Agreement. However, the report noted that Albania has not fulfilled yet the obligations arising from the implementation of  
411 this Agreement, while the opening of negotiations is considered as a way to encourage Albania to continue with  
412 implementation of reforms.

413 On 28 January 2002 Council confirms once again the political will for the beginning as soon as possible  
414 negotiations with Albania, meanwhile says that "attention is removed from the implementation of reforms in the country".  
415 Finally on 21 October 2002 the General Affairs Council of the European Union authorized the European Commission to  
416 open negotiations for signing Stabilization and Association Agreement between the European Community ,EU member  
417 states and Albania. On 31 January, Commission President officially launches the negotiations for a SAA between the  
418 European Community and EU member states on the one hand and Albania on the other.

419 November 2010: Commission draws its opinion on Albania's application for EU membership, including a group of  
420 12 key priorities that must be met on the eve of the opening of accession negotiations.

421 December 2010: Traveling without visas in Schengen area for Albanian citizens.

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### 423 *17.1 Political Dialogue with the EU*

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425 Is emphasized mainly on achieving a common viewpoint concerning security and stability in Europe and in the countries  
426 covered by a common external policy of the European Union.

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### 428 *17.2 Regional cooperation*

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430 After the signing of the Stabilisation and Association Agreement Albania should begin negotiations with countries which  
431 have signed this agreement with a view to reach bilateral agreements for a wider regional cooperation with these  
432 countries.

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435 17.3 *Approximation of legislation and enforcement of law*

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Agreement shall include schedules for the gradual approximation of the Albanian legislation with EU standards. But Albania should start with assurances that its legislation will be suitable with (acquis communautaire) elements especially in the field of Internal Market legislation. This approximation process will be realized with the coordination of the European Commission which will monitor the progress step by step in this direction by determining strict limits on judicial reform, competition, intellectual property rights, industrial and commercial, procurement, standardization and certification, financial services, road transport, legislation on commercial companies, state monopoly, accounting, consumer and data protection, health and occupational safety, etc.

17.4 *Justice and Home Affairs*

17.4.1 *Strengthening of institutions*

In order to achieve a position to affirm that the rule of law prevails in the country and ensure the necessary level of legal security for Albanian citizens as well as for foreigners involved with Albania. Laws should be apply in a correct way and imposed. To achieve this it is necessary to be strengthened the Albanian public administration and judicial system. The agreement will include a paragraph noting that the parties will give special attention to the formation of institutions and especially the independence of the the judicial system, police structures development and level rise of other structures of law enforcement. It will emphasized the exchange of information on legislation and practices of increasing the institutions efficiency, security of passports and other travel documents. etc.

Prevention and control of legal migration, readmission

Mutually Albania and every country of the European Union shall readmit without formality their citizens who have emigrated illegally to respective territories.

17.4.2 *Money laundering*

Parties in agreement shall cooperate that their financial systems are not used to money laundering which come from criminal activities and in particular from drug trafficking.

Also the parties in agreement shall cooperate in the fight against any crime or illegal activity particularly in the fight against;

- trafficking in human beings
- drug trafficking
- illegal economic activities
- arms trafficking
- terrorism
- Cooperation policies

Even at this point of the agreement the Commission did not provide for any specific requirement or preference for Albania. Cooperation Policies, EU has kept unchanged in the previous agreements with Macedonia and Croatia.

**18. Risks and Assumptions**

The basic assumption Strategic Document for Albania (CSP) is that Albania and the broader region will be increasingly sustainable in the the coming years. The election of democratic governments in the region in 2001 and 2002 was expected to help strengthen of democracy and the reduction of separatist tendencies. On the other hand, a regression on any of these countries would have a negative impact on Albania, which is particularly inclined towards the tendencies and regional impacts. The bilateral relations of Albania with its neighbors should continue to improve and develop.

The strategic document assumptions that there will be a growing commitment to reform EU integration process, including the willingness to develop the institutions of the state and to put also available to agencies and key services necessary human resources and materials. While there may be a danger because of unstable public order, weak economic base and corruption (especially in court) nevertheless expected do not endanger seriously the work of government.

Another assumption has to do with what the judiciary reform efforts will be successful and will also have a growing

488 public credibility to the legal system.

489 Although Albania will continue to remain highly dependent on external financing, it is assumed that the level of  
490 international assistance for Albania will decrease significantly in the the coming years and this will affect growth rates.  
491 There is a risk that despite Albania will perform several key reforms, it will still continue to have difficulties to attract  
492 foreign investment. Levels of unemployment is possible to be reduced significantly in the medium term. Is supposed that  
493 Albania will achieve other agreements free trade. There is a risk that Albania industry will not be able to benefit fully from  
494 the opportunities that these developments will provide. Public finance management should be improved while the  
495 incomes should give higher results.

496 In fulfilling the European Community assistance must be shown special attention to changes in the assumptions on  
497 which it is based Strategic Document for Albania (CSP) while identification of projects should take into account new  
498 circumstances. In some cases the situation may require that a certain program is deferred or do not undertaken. Multi-  
499 annual Indicative Programme takes into account this possibility by presenting programs with a total value 15% higher  
500 than the indicative allocation for Albania. Where appropriate, a review of the Strategic Document for Albania can take  
501 additional in accordance with the CARDS rules.

## 502 503 **19. Joint Structures Albania-EU and Monitoring Instruments**

505 The most important structure common to the EU in this process remains the Joint Consultative Group EU-Albania

506 The Common Consultative group meetings treat progress in the performance of sectoral reforms in all directions:

507 Stability of institutions guaranteeing democracy, legal state, human rights, respect and protection of minority rights,  
508 good relations with neighbors and consultative policy in the region.

509 - Full functioning of the market economy, privatization of strategic sectors, improving the tax system and ability  
510 to confront the pressure of competition and market forces within EU.

511 The ability to take over implementation of the obligations of membership, including the aim to achieve political,  
512 economic and monetary union.

513 Task Force meetings are followed by common recommendations that reflect the discussions during the meetings,  
514 diplomatic issues raised in it and should be resolved accompanied in most part with clearly defined deadlines for their  
515 fulfillment. Tracking and implementation in time of these recommendations is in the focus of the Institution of the State  
516 Minister for Integration as coordinating and monitoring structure of this process, in collaboration with line ministries  
517 through the Negotiating Group set up for this purpose.

518 Another structure of monitoring is a joint committee Albania -European Union, organ that is set up under the  
519 Agreement on trade and cooperation in the field of trade and economy of 1992, Which treats the progress achieved by  
520 the Albanian institutions during 1 year in the fields covered by the trade and economy agreement. Within this committee  
521 operate several working groups that examine issues related to infrastructure, economy and finance approximation of  
522 legislation and agriculture.

523 European Commission reports for Albania in Stabilization and Association Process are another control instruments  
524 of reform process undertaken by Albania. In these reports are treated in detail and realism situation of the country in all  
525 political and economic aspects and outsourced suggestions on where to focus attention during the next 12 months. The  
526 situation for Albania in this report in the majority is critical and more problems. For this purpose, this report is made  
527 available to all departments (through the negotiators networks) asking to prepare sectoral evaluation studies on the  
528 problems raised by the report to clearly reflect the progress made since the publication of this report until today and  
529 measures that have been taken to treat various problems that still exist. Obviously, the further performance of the  
530 integration process after the signing of the Stabilization and Association Agreement will depend on the progress of  
531 reforms in the country and the extent to which Albania would be able to implement its commitments arising from the  
532 signing of the Agreement. For this purpose and in support of this process, the Albanian government undertook the  
533 preparation of the strategic plan for the pursuit of the Stabilisation and Association process in May 2002 , to open  
534 negotiations and termination of them with signing the Agreement. The main goal of this plan is that defining strategic  
535 goals, operational objectives and relevant measures, firstly to clarify roles and tasks for each participant in this process  
536 and secondly, to achieve understanding, commitment and dedication of all the participants in this strategic project.

## 537 538 **20. On some Sensitive Issues Discussed during the Negotiation Rounds**

540 During the conduct of the technical round for signing of the Stabilization and Association Agreement are discussed a set  
541 of problems and sensitive issues, but those that deserve special attention are mainly related to transitional periods

542 proposed by the Albanian party for certain articles of this agreement.

543 Given that the majority of the proposals has aimed at maximizing the transitional period allowed, the reaction from  
544 the European side to this problem has consisted in the fact that "the transitional periods should not be determined  
545 systematically for 10 years, but it needs to establish a balance between the proposed periods and that this agreement is  
546 intended to help the Albanian party coming under pressure to achieve other reforms ". This would mean that the  
547 proposed transitional periods should be ambitious and achievable simultaneously. *In July the old law makes 10 years old  
548 and such a law shows that it has not been implemented. By reading Article 1 of this law it is understood that it has ceased  
549 to operate, because it speaks for the SAA process, at a time when we all hope that at the end of the month Albania will  
550 have the candidate status*

## 551 **21. Integration Chances of Albania - the Advantages and Costs**

552 The Copenhagen Summit in 1993 provides the criteria of the membership of new countries in the EU. The Copenhagen  
553 criteria are mainly three:

- 554 1. Any country that aspires must fulfill the parameters of a democratic state based on the rule of law and to  
555 guarantee respect for human rights and minorities.
- 556 2. To have a functional market economy, that fits and can face the free concurrence of the European market.
- 557 3. Accept and of course apply European legislation.

558 These criteria should also be fulfilled by Albania. And obviously these criteria and so-called "Roadmap", the sketch,  
559 the map and route of the process we should follow to achieve our purpose, have already been transformed into agendas  
560 and work programs for the government, institutions, for different sectors of civil administration to the judiciary system.

561 This agreement aims to establish closer relations between the EU and Albania.

562 The purpose of the Stabilization and Association Agreement was the establishment of political and economic  
563 stability of the candidate state (Albania). Exactly for this reason this agreement contained of asymmetric obligations in his  
564 favor.

565 Albania during the negotiations for the Stabilization and Association Agreement treated in details economic  
566 aspects, commercial, political, institutional, legislative, environmental and cooperative relations in all aspects between  
567 Albania and the EU. Stabilization and Association Agreement which was negotiated with the EU included other areas  
568 such as:

- 569 • Political Dialogue
- 570 • Regional Cooperation
- 571 • Movement of workers, right of establishment, provision of services and movement of capital
- 572 • Approximation of legislation, enforcement of law and the rules of concurrence in the EU standard
- 573 • Justice and home affairs, namely, the fight against crime, the effectiveness of the police and other anti-criminal  
574 agencies
- 575 • Cooperation policies
- 576 • Financial Cooperation

577 The agreement provided the creation of common special structures Albania-EU, which will control its  
578 implementation step by step. The unavoidable condition of the agreement is functioning of a state based on the rule of  
579 law and well-structured democratic institutions. Without a civil administration, without executive, legislative institutions of  
580 justice and other fields that lead to media and non-governmental organizations which operate and disseminate the  
581 European normative, the agreement does not apply and the integration is delayed.

582 The EU, in a rational way and more the counterpart requires deep and effective institutional reforms and in turn  
583 they constitute an absolute priority of the Albanian state.

584 The Stabilization and Association Agreement (SAA) is based on an appropriate legal basis that opens the way  
585 towards full integration in the EU. It comes to Article 310 of the European Community Treaty (ECT), which is also the  
586 legal basis of the European Agreement which provides "Community may sign with one or more states or international  
587 organizations, agreements that create an association characterized by reciprocal rights and obligations, joint actions and  
588 special proceedings" Article 1 of the project-agreement provides the establishment of an association between the parties,  
589 creating a new legal relationship that exceeds the relations between Albania and the European Community established  
590 on the Agreement of 1992.

591 On the basis of this association offered by Stabilization and Association Agreement, the parties will be a recipient  
592 of reciprocal rights and obligations as:



595 Respect of State and the law and democracy, human and minority rights and the rules of a free market economy.  
596 This obligation is regarded as essential clause of the agreement (Article 2, Title 1), the violation of which may justify  
597 measures that lead to the suspension or cancellation of the agreement.

598 Creation of a free trade area between the European Community and the associated state, which will be achieved  
599 with asymmetrical concessions by the parties based on coil theory , basic theory of the development of the European  
600 Union (Article 16 of the Stabilisation and Association Agreement Project). Regional cooperation, an obligation and an  
601 essential clause for the country associated in favor of peace and stability, as well as the development of good  
602 Neighbourhood relations.

603 Cooperation in the field of justice and home affairs (Title VII of the Stabilization and Association Agreement).

## 604 **22. Political Feature of the Stabilisation and Association Agreement**

605 Political feature Stabilization and Association Agreement stems from the obligation to establish a political dialogue (A)  
606 and a regional cooperation (B) between the countries involved in the Stabilisation and Association Agreement.

### 607 *22.1 Cooperation in priority fields*

608 These provisions relate to, on the one hand, the cooperation in the field of justice and home affairs and on the other  
609 hand, numerous sectoral policies

610 a) - The cooperation in the field of justice and home affairs

611 Cooperation in the fields of justice and home affairs provides another particular on the Stabilisation and  
612 Association Agreement. Treaty on European Union was he who introduced the third pillar on cooperation in the fields of  
613 justice and home affairs. In some association agreement, made before the entry into force of this treaty, this collaboration  
614 is not anticipated. Another reason for the introduction of this collaboration is partial communitisation of third pillar of the  
615 Amsterdam Treaty, Which provided in the Title IV of ECT. This crossing from the third pillar to first pillar of the Treaty,  
616 added importance of the field regarding visas, asylum, immigration and other policies related to free movement of  
617 persons.

618 This collaboration requires that Associated State to strengthen institutions at all levels, but especially those related  
619 to law enforcement and the administration of justice. The key points of this collaboration focused on the legal regime of  
620 visas, asylum and migration, on the one hand and on the other hand, in the fight against organized crime through police  
621 cooperation and judicial cooperation.

## 622 **23. The European Commission's Decision on the Candidate Status of Membership**

623 After the visa liberalization Albania applied in the European Union to take candidate status.

624 The European Commission has concluded that Albania has made good progress on its path towards EU  
625 integration, especially with the adoption of measures that have been identified as essential for obtaining the candidate  
626 status of membership and continued for implementations of reforms associated with the key priorities of the Commission  
627 Opinion for year 2010. Albania has taken initial steps towards improving the efficiency of investigations and prosecutions  
628 in the fight against organized crime and corruption. Parliamentary elections of 2013 were conducted in a generally  
629 peaceful and orderly. Considering this, European Commission recommends to grant Albania candidate status for  
630 membership, with the understanding that Albania will continue to take measures in the fight against corruption and  
631 organized crime. In order to pass to the next stage and to open accession negotiations, Albania should complement other  
632 key priority, with particular focus on administrative reform, rule of law and fundamental rights. Constructive and  
633 sustainable political dialogue will remain essential for a successful process of reforms.

634 It's based on the Progress Report dated on 16 October 2013.

635 Firstly, as regards political criteria, Albania has made further progress towards fulfilling Copenhagen political  
636 criteria for EU membership. The government and opposition have cooperate to adopt a number of important legal acts in  
637 parliament, including the Law on Civil Service, Amended Law on the Supreme Court and The regulation of Parliament. In  
638 relation to freedom of expression, legislative framework is improved with the adoption of the Law on Audio-Visual Media.

639 The international mission to supervise the parliamentary elections of June concluded that the elections were  
640 conducted in peaceful and orderly way. It made significant progress in improving the treatment of detainees and are  
641 further steps in the reform of public administration. There have been important steps to reform the judiciary, improve the  
642 fight against corruption, increasing asset seizure of narcotics and criminal activities and the implementation of

649 recommendations for fight against money laundering. Amendments to the Criminal Code have treated the issue of human  
650 trafficking. Anti-discrimination measures have been taken to promote the protection of human rights. Albania's  
651 constructive engagement in regional cooperation remains essential.

652 Although, stable additional efforts are needed to fully meet the political criteria. As regards democracy and rule of  
653 law, it is essential to refer to recent progress and ensure that the political dialogue and joint efforts to be sustainable  
654 reform. Concrete measures are needed to strengthen accountability, independence and efficiency of the judiciary.  
655 Achievements in investigations, prosecutions and convictions of corruption cases at all levels must be strengthened  
656 based on the initial results. The fight against organized crime should be improved further. Should ensure sustainable  
657 implementation strategy of property rights. Public administration reform should be pursued vigorously. Legislative and  
658 policy tools in the field of human rights, especially with regard to Roma people, must be implemented further and better.

659 Economic criteria: The Albanian economy has continued to maintain macroeconomic stability. Albania has made  
660 further progress towards becoming a functioning market economy. It must be capable to withstand competitive pressure  
661 and market forces within the European Union over the medium term, on condition to accelerate structural reforms,  
662 including strengthening the rule of law and property rights, fight against corruption, the treatment of overdue payments, as  
663 well as development of infrastructure and promoting human capital.

664 With regard to EU legislation, Albania has made moderate progress in improving its ability to assume the  
665 obligations of membership by approximating its legislation and standards with those of the EU, particularly in the areas of  
666 public procurement, statistics, justice, freedom and security and customs union. But efforts should be added albeit  
667 progress has been limited in other areas, such as intellectual property law, taxation, energy, environment and climate  
668 change. Sustained efforts are needed to strengthen administrative capacity for implementation and enforcement of  
669 legislation and improving transparency and accountability.

670

## 671 **24. Conclusions**

672

673 Based on what we have argued and submitted above, we think that Albania is making progressive steps regarding upon  
674 its entry into the European Union and at the end of June, we believe and hope that the fulfillment of political, economic  
675 and institutional criteria, our Country will win EU candidate status.

676

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## Implication of Boko Haram Terrorism on Northern Nigeria

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### Abstract

Terrorism has been a global menace which affects economic, political and social status of the country experiencing it. The political dimension of terrorism and insecurity have been examined in this study which moribund political regime of President Goodluck Jonathan in Nigeria. Many lives and properties have been destroyed in Northern Nigeria by the Boko Haram deadly attacks. It is evident from this study that Boko Haram terrorist insurgency invigorated as a result of pronouncement of Goodluck Jonathan as president of Federal Republic of Nigeria. Since the inception of this political regime, Boko Haram has been disrupting and destabilizing government activities mainly in Northern Nigeria. The political implication of terrorism has been deadly in Nigerian democratic governance. The study found that North-Eastern Nigeria witnessed a monumental influx of Boko Haram deadly attacks (115), followed by North-West with (13) attacks while North-Central experienced (12) attacks since last four years, consequently culminated into epileptic socio-political activities in these geo-political zones; many lives have been lost while the Nigerian political environment continue to produce social insecurity and enduring political diaphragm. The challenges of terrorism and insecurity have been traumatizing President Goodluck Jonathan's administration in Nigeria while many political gladiators hide under the siege of Boko Haram insurgency in terrorizing existing political regime in Nigeria which makes it difficult to actualize governmental policies and programmes in Nigeria. Boko Haram terrorism is an ethnic political tool aimed at causing political chaos by political elites in Nigeria; therefore this study makes a prognosis for reawakening of militancy in Niger-Delta if President Jonathan is denied second term presidential political contestation in Nigeria. Regardless of political affiliations, all the political stakeholders should rally round the Jonathan's administration to proffer solution to the current security conundrum in Nigeria. The pull-down political syndrome should be shunned for the sake of general well-being of the citizenry which serves as a bedrock of statecraft.

**Keywords:** Terrorism, Political Violence, Economic Consequences, Population Displacement, Relative Deprivation and Boko Haram.

### 1. Introduction

Terrorism which has become a global phenomenon is a deliberate and systematic use of violence to destroy, kill, maim and intimidate the innocent in order to achieve a goal or draw national/international attention or demands which ordinarily may be impossible or difficult to achieve under normal political negotiation or on the battle field against a government army. Terrorism whether internationalized or localized is always politically motivated. Though it may also show other auxiliary motives include religion, economic or social reasons. These motives constitute the ideology of a case for which terrorism seeks solution or sympathy of all terrorist groups that have ravaged Nigeria. The Boko Haram is undoubtedly the most blood thirsty and destructive both in terms of its demonic brutality, mindless savagery and increasingly in scope of operation (Obioma, 2009). From Harmless group of 12 has in recent times increased to more than 10,000 violent members (Akpan et al, 2012). According to Innocent and Ibietan (2012) "Boko Haram is an indigenous salafist group which turned itself into a salafist Jihadist in 2009. The group was founded by Mohammed Yusuf in 2002 in the city of Maiduguri with the aim of establishing a Sharia government in Borno State under former Governor Ali Modu Sheriff. He established a religious complex that included a Mosque and a school where many poor families from across Nigeria and from neighbouring countries enrolled their children". From the beginning, the group made its manifest known: Rejection of western education, institutions, and agencies that go with it, including government institutions. It prefer to have a sharia law applied all over the country, but if that is difficult to grant, they would rather have a separate Islamic state carved out

58 of Nigeria, where they can practice their religion unhindered. If this is not granted Nigeria will be made ungovernable.  
59 Government saw these demands as reasonable, unreasonable and unacceptable and in an attempt to purge the  
60 group of its excesses their leader Mohammed Yusuf died in 2009 from that year onwards under the assumption of a new  
61 leader named Abubakar Shekau, Boko Haram reinvented violence and began what can best be described as the  
62 bombardment of Northern Nigeria with such frequency and intensity that are quite unprecedented in history of violence in  
63 Nigeria. Those who escape death by day, sleep with one eye open by night. The Boko Haram has created widespread  
64 tension across Northern Nigeria and between various ethnic communities, interrupted commercial activities, frightens  
65 investors and generated concerns among Nigerians northern neighbours. This unprecedented state of terrorism by the  
66 Boko Haram sect in Nigeria has ruined the tranquility of the northern atmosphere and high rate of insecurity pervading  
67 northern region in particular and the nation/Nigeria in general is alarming and is a cause for serious concern to well  
68 meaning Nigerians. It is for this reason that this paper is set and aimed at speculating the possible negative effect of Boko  
69 Haram terrorist activities on the economy of Northern Nigeria and by extension Nigeria.

## 70 71 **2. Statement of the Problem**

72  
73 From the activities of Boko Haram ,Nigeria has now been certified as a full fledged terrorist state, a classification that  
74 brings untold odium on us all. Several violent attacks by the Boko Haram have affected economic activities in Maiduguri,  
75 Kano, Yobe and other cities in the north-east many resident has fled their homes while others who could relocate hardly  
76 go about their normal business. Shooting and bombing linked to Boko is forcing people to hunker down in their homes or  
77 abandon/the northern region. Business activities are fizzling out, most residents are living on their savings, and there is  
78 ban on motobikes which is the main means of transportation, growing unemployment among traders. Recession has set  
79 in. To this end this work will be bounded by these research questions:

- 80 (1) What was the state of northern economy before the activities of the Boko Haram?
- 81 (2) What is the present state of the northern economy since, the commencement of the Boko Haram activities?
- 82 (3) What are the possible/future negative effect of Boko Haram terrorist activities on the economy of northern  
83 Nigeria and by extension Nigeria.
- 84 (4) What steps and policy measures can be taken to alleviate and combat the negative effect of the Boko Haram  
85 terrorist activities on the northern economy and by extension Nigeria and subsequently stop their activities.

## 86 87 **3. Objectives of the Study**

88  
89 The general goal of this study is to speculate the possible negative effect on Boko Haram activities on the northern  
90 economy and by extension Nigeria, while the particular aims and objectives of this study are:

- 91 (1) To find out the state of northern economy before the activities of the Boko Haram.
- 92 (2) To examine the state of northern and Nigerian economy since the start/operation of the Boko Haram sect in  
93 Nigeria.
- 94 (3) To speculate the possible negative effect on Boko Haram terrorist activities of the economy of the northern  
95 Nigeria and by extension Nigeria.
- 96 (4) To make recommendation with a view to alleviating and combating the already existing negative effect of Boko  
97 Haram activities on northern economy and by extension Nigeria and subsequently stopping their activities.

## 98 99 **4. Methodology**

100  
101 The area of study is to speculate on the possible negative effect of Boko Haram Terrorist activities on the economy of  
102 northern Nigeria and by extension Nigeria. Data for this research were generated using the secondary data – Books,  
103 Journals, Newspaper articles, Magazines, Seminar and Conference papers and internet materials. Data was analyzed  
104 using content analysis method. The population of the study is Nigerian while the target or sample population is the  
105 northern region.

## 106 107 **5. Contextualising Terrorism**

108  
109 Terrorism is a complex issue that has been studied and debated for several decades. In fact, there are dozens of  
110 competing definitions of the term, not only among scholars but among policymakers and government agencies as well.  
111 But one thing holds constant terrorist attacks do not occur in a vacuum, but are instead a product of complex interactions

112 between individuals, organizations, and environments. Further, there are many different kinds of terrorism, defined  
113 primarily by ideological orientations like ethno-nationalism, left-wing, religious, and so forth. And just like there are many  
114 different kinds of terrorism, there are many different kinds of contexts in which terrorism occurs (Forest, 2012). Terrorism  
115 is increasingly understood as a political act meant to inflict dramatic and deadly injury on civilians and to create an  
116 atmosphere of acute fear and despair (generally for a political or ideological, whether secular or religious, purpose), but  
117 the term is notoriously difficult to define. The use of violence to create fear, often through the targeting of third parties and  
118 with the elements of surprise and the undermining of very personal security, is a tool used by a variety of historical and  
119 contemporary actors (Large, 2005). Terrorism is a term used to describe violence or other harmful acts. Walter Laqueur  
120 in 1999 counted over 100 definitions of terrorism and concludes that the only characteristics generally agreed upon are  
121 that terrorism involves, violence and the threat of violence (Laqueur, 2003 cited in Eke, 2013). The etymology of terrorism  
122 is derived from Latin words "terrere" which means "frighten". Terrorism is a special crime associated with violent,  
123 victimization, threatening, frightening, and disruption of socio-political atmosphere in a particular society. It is an act of  
124 bombing, killing, kidnapping, maiming and destruction thereby creating socio-political tension, extremely fear, and  
125 destabilizing existing government or political opposition. It implies deadly attack on government agency and functionary,  
126 international organization, military and civilian in order to gain international recognition.

127 Terrorism is the use of violence and intimidation to achieve political ends. Terrorists want to change the way  
128 governments and politicians behave. They do not do this by voting or by trying to convince people of their arguments.  
129 They do it by frightening people into behaving the way the terrorists want (BBC, Monday July 11 2005). Kydd & Walter  
130 (2006) cited in Atere & Alao (2012) define terrorism as actions focusing on harming some people in order to create fear in  
131 others by targeting civilians and facilities or system on which civilians rely (Eke, 2013). Terrorism may be viewed as a  
132 method of violence in which civilians are targeted with the objective of forcing a perceived enemy into submission by  
133 creating fear, demoralization and political friction in the population under attack (Schmid & Jongman, 2005). In most  
134 cases, their actions do lead to the loss of innocent lives. Just as non-state actors and rogues states are known to commit  
135 terrorism at home and abroad, democratic countries also do the same in order to achieve political, religious, or other  
136 objectives (The Punch Newspaper, May 23, 2012). Terrorism, in the most widely accepted contemporary usage of the  
137 term, is fundamentally and inherently political. It is also ineluctably about power: the pursuit of power, the acquisition of  
138 power, and the use of power to achieve political change. Terrorism is thus violence or, equally important, the threat of  
139 violence used and directed in pursuit of, or in service of, a political aim (Hoffman, 1998). As a form of unconventional  
140 warfare, terrorism is sometimes used when attempting to force socio-political change by convincing a government or  
141 population to agree to demands to avoid future harm or fear of harm, destabilization of existing government, motivating a  
142 discontented population to join a mutiny, escalating a conflict in the hope of upsetting the status quo, expressing an  
143 injustice, or drawing attention to a cause. The United States Federal Bureau of Investigation (FBI) defined terrorism as  
144 involve violent acts or acts dangerous to human life that violate federal or state law; appear to be intended to intimidate  
145 or coerce a civilian population; to influence the policy of a government by intimidation or coercion; or to affect the conduct  
146 of a government by mass destruction, assassination, or kidnapping.

147 The United States Department of Defense defines terrorism as "the calculated use of unlawful violence or threat of  
148 unlawful violence to inculcate fear; intended to coerce or to intimidate Governments or Societies in the pursuit of goals  
149 that are generally political, religious, or ideological". Within this definition, there are three key elements- violence, fear,  
150 and intimidation-and each element produces terror in its victims

151 Political terrorism is the deliberate use or threats of violence against noncombatants, calculated to instill fear in an  
152 audience beyond the immediate victims. He says that because perpetrators of terrorism often strike symbolic targets in a  
153 horrific manner, the psychological impact of an attack can exceed the physical damage. He concluded that terrorism is a  
154 mixture of drama and dread. Despite the fact that terrorism could not be said to be a senseless violence, rather it is a  
155 premeditated political cum social strategy that threaten people with a coming danger that seem ubiquitous, unavoidable  
156 and sometimes unpreventable (Kegley, 2011 cited in Raji, 2013).

157 The U.S. Department of State defines "Terrorism" as "premeditated politically-motivated violence perpetrated  
158 against non-combatant targets by sub-national groups or clandestine agents, usually intended to influence an audience  
159 (Zumve, Ingyoroko and Akuva, 2013). Terrorism is a failure of political process that begins with in-equalities, corruption  
160 and injustice in a given political system, and moves from a frustrated attempt at reform that breed fear and anger, to  
161 political confrontation and conspicuously erupted into violence. This can be exploited to rationalize the use of any form of  
162 violence against any target. It seems that solutions to terrorism could be found at any stage of the evolving, or  
163 deteriorating political and social processes (Dempsey 2006 cited in Isyaku, 2013). For this paper, political aspect of  
164 terrorism shall be considered. In terms of political terrorism, Shultz & Sloan (1980) cited in Oviasogie (2013) defined it as  
165 the threat and/or use of extra normal form of political violence, in varying degrees, with the objective of achieving certain

political goals or objectives. This is to influence the behaviour and attitude of certain groups. It has basically political motives. Cline and Alexander (1987) cited in Oviasogie (2013) defined terrorism as a deliberate employment of violence or the use of violence by sovereign states as well as some national groups, assisted by sovereign states in order to attain strategic and political objectives through the violation of law.

## 6. Eight Signs of Terrorism

The New Hampshire Department of Safety suggests 8 signs of terrorism which include the following:

- Surveillance – Someone recording or monitoring activities. This may include the use of cameras, note taking, drawing diagrams, annotating on maps, or using binoculars or other vision-enhancing devices.
- Elicitation – People or organizations attempting to gain information about military operations, capabilities, or people. Elicitation attempts may be made by mail, e-mail, telephone, or in person. This could also include eavesdropping or friendly conversation.
- Tests of Security – Any attempts to measure reaction times to security breaches, attempts to penetrate physical security barriers, or monitor procedures in order to assess strengths and weaknesses.
- Funding – Suspicious transactions involving large cash payments, deposits, or withdrawals are common signs of terrorist funding. Collections for donations, the solicitation for money and criminal activity are also warning signs.
- Supplies – Purchasing or stealing explosives, weapons, ammunition, etc. This also includes acquiring military uniforms, decals, flight manuals, passes or badges (or the equipment to manufacture such items) and any other controlled items.
- Impersonation – People who don't seem to belong in the workplace, neighborhood, business establishment, or anywhere else. This includes suspicious border crossings, the impersonation of law enforcement, military personnel, or company employees is also a sign.
- Rehearsal – Putting people in position and moving them around according to their plan without actually committing the terrorist act. An element of this activity could also include mapping out routes and determining the timing of traffic lights and flow.
- Deployment – People and supplies getting into position to commit the act. This is the person's last chance to alert authorities before the terrorist act occurs.

## 7. Theoretical Framework

The theories guiding this work are: Systems theory and Relative deprivation theory. The system analysis of the political system popularized by David Easton is adopted as a theoretical approach underpinning the study. The system theory is an analogy that shows a collection of interrelated parts which forms some whole. The idea is that if all the parts are working effectively the overall objectives can be achieved. A system can be open or closed. Nigeria is an open system. A key feature of open systems is their interdependence on the environment which may be relatively stable or relative uncertain at a particular point in time. This feature is of considerable importance to political and economic system which needs to adapt to the changing environment if they are to flourish. Nigeria needs the Northern economy to achieve her economic objectives. The focus of the approach is on the analysis of factors and forces that engender stability and instability in the political system strengthens its relevance to explaining the deep linkage between the dysfunctionality in governance and the challenges of poverty, inequality and insecurity in Nigeria. The political system within the Eastonian framework is an input and out-put mechanism which deals with political decisions and activities and performs integrative and adaptive functions relevant to the transformation of the society (Johari, 2011). Moreover, the mix of the environment, citizens' demand and support (inputs), and the policy output from the system are core factors that affect the structures and processes involve in the authoritative allocation of values and are thus fundamental to the stability and survival of the political system (Johari, 2011).

The centrality of citizens' demand and support (inputs) and policy output to the failure of democratic governance in Nigeria and the attending social tensions and security threats it provokes is the major concern of the study. The inputs in the political system according to Easton consist of citizens' demands on the polity and the support they extend to the system. Supposedly, inputs in this context refer to those demand made by the Boko Haram. Demands made upon the political system by the political elites and leadership is with-in inputs. Meanwhile, supports entail the structures that enable the political system to manage demands put on it, while outputs relate to those demands that are converted into authoritative policies and decisions. Importantly, obtaining a balance among these critical variables of the political system

is germane to its capacity to overcome inevitable challenges pose by the various forces from within, as well as the maintenance of stability and survival of the polity. Conversely, the inability of the political system to address critical demands from the Boko Haram, or respond positively to important feedback from its policy outputs have the capacity to undermine support for it. Moreover, intra-elite conflicts regarding policy articulation or allocation of scarce resources, preference for elites demands and inability of the structures and institutions of the system to manage citizens' demands equitably can engender popular distrust, instability and stresses of the political system (Johari, 2011).

The political leadership is characterized by blatant personalization of power, predatory, parochial, prebendal and patrimonial dispositions (Jega, 2007). These ills no doubt undermine popular participation and the critical role of the masses in setting the agenda of governance. The dominant role of the political elites in setting, shaping and articulating governmental policies at the expense of the general interests of the populace erodes public support in democratic governance and policies as the masses perceive and equate democratic governance with representing the interest of the ruling elites (Olaniyi, 2001). The fact that in most cases the outcome of the elitist imposed policies consist of widespread unemployment, corruption and poverty tend to worsen the peoples' sense of alienation and frustration in the political system, which often translate into disobedience of the state and the resort to violence as a means to challenge the legitimacy of the state. This explains in part the Boko Haram militancy in the North. It is within this context that the worsening social tensions, economic inequality, poverty and increased spate of insecurity in the country since Jonathan's administration.

Relative deprivation is the experience of being deprived of something to which one believes to be entitled. It refers to the discontent people feel when they compare their positions to others and realize that they have less of what they believe themselves to be entitled than those around them (Davis, 2011). Some scholars of social movements explain their rise by citing grievances of people who feel deprived of what they perceive as 'values' to which they are entitled. Similarly, individuals engage in deviant behaviour when their means do not match their goals. Relative deprivation theory holds that instead of an absolute standard of deprivation, a gap between expected and achieved welfare leads men to violence (Claire, 2011). Claire went further to provide a psychological approach to explain how collective discontent is manifested in violence. According to him, the primary source of human capacity for violence appears to be the frustration aggression mechanism. The anger induced by frustration is a motivating force that disposes men to aggression, irrespective of its instrumentalities. In the words of Omer Taspinar (2012), Relative deprivation is the gap between high expectations and missing opportunities. To him, social, cultural, political and economic awareness grows at the heart of relative deprivation and this in turn fuels expectations. When these expectations are not forthcoming, the deprived could resort to violence to seek redress. All the views expressed boils down to the major thrust of the relative deprivation theory which holds that 'when people are deprived of things which they deem valuable in the society whether money, justice, status or privilege join social movements with the aim of redressing their grievances'.

When applied to the Boko Haram insurgence in the north, we submit that the loss of a spiritual leader in the person of Mohammed Yusuf deprived the sect members of a role model, source of inspiration and a spiritual guide whom the sect boldly needed at the formative stage to nurture and grow the new faith. The arrest and subsequent death of some sect members in the hands of security agents was to the group, a deprivation of the right to life of their loved ones and brotherly love and affection which those deceased provided while they were still alive. Furthermore, the refusal of the Federal government to fully abolish western education and allow for an Islamic model was to the sect, a deprivation of the right to home grown model of education which will conform to the custom and tradition of the Islamic faith. The refusal of the Federal government led by Dr. Goodluck Jonathan to sign and thus make way for the immediate establishment of the Islamic state for the entire north was to them, a deprivation of the right to self-governance/ rule as Jonathan's presidency was seen by them as an imposition of an unbeliever to rule over the Muslim territory. Also, the refusal of Christian minority to leave the north was to the sect, a deprivation of the right to a territorial integrity devoid of sinful infidels who according to the sect pollute and profane a holy territory of 'Allah' the only God.

## 8. Method of Data Collection

For this study, information was collected using secondary sources of data collection. The secondary source of data used for this research work comprises of those collected from published textbooks, papers, Journal such as social sciences, business, management and government Journals, online materials, articles as well as seminar papers were used to get relevant information.

## 9. Findings

From our research and study, these are our findings:

- (1) That the northern economy before Boko Haram terrorist activities was and used to be a bubbling and thriving economy but now is grounded to a halt; consider these examples.
  - (a) The transport sector – road and air – thrives very much. Road transport fetch a transporter of 13 seater bus the range of N40 – 45, 000 a week on two trips while the Nigeria air line industry was estimated to be making about N3 billion very day. But now analysts say that half of this amount is lost daily. Passenger traffic to north has reduced drastically dealing a big blow to this sector (Madlion, 2012, Innocent and Ibietan, 2012). It takes much more effort to get passengers to fill just a 13 seater bus going to the North.
  - (b) The tourism sector which ranked first in the country Nigerian and generates approximately N80 billion annually has been held stand still. The famous Argungu fishing festival, Yankari Games Reserves, the Mambila Plateau, the tomb of Othman Dan-Fodio, all of which attracts tourists from within and outside the country have been paralyzed alongside the various economic activities within value chain (NTDC, 2012).
  - (c) The infrastructural sub-sector of the northern economy has been devastated. This is because a good number of foreign and local contractors across the various northern states engaged in the construction of roads, bridges, housing estate development, the dams, National Integrated Power projects and rail way track rehabilitation have either abandoned sites or relocated to other states. This represents real setback to the economy of the region and pushes unemployment higher as thousands of youth who would have been engaged by them now sit idle.
  - (d) The commercial sector which was once booming now witnesses a dwindling fortune. The commercial sub-sector which covers the small and medium scale enterprises, local markets, road side shops and stores within the affected states have been closed down because most of these businesses are owned by southerners most of whom are Igbos. Chinedu (2012) noted that 73.3% of business has partially closed operations in northern Nigeria because of this insecurity. This represents huge capital flight from northern economy in both human and financial terms. The most affected states in this regard are Borno, Yobe, Kano and Sokoto. Kano for example serves as a commercial nerve centre not only for the north but also neighbouring Countries like Chad, Niger, Cameroon and Western Sudan for past 500 year before evolution of Nigeria. Obeche (2012) noted that some \$15 billion do flow through Kano's market each year and two million traders used to arrive daily from Nigeria and neighbouring countries selling goods from factories in the south or imported from Asia. It has the oldest and biggest multi billion naira textile market known In the sub-Saharan African – The Kanti Kwari market. But now because of the Boko Haram activities the market is stifled. Kano economy has crashed, Business is fizzling, income generated has dwindled. People find it difficult to make ends meet. Most times people come to market without selling anything. (Babajide, 2012) (IRIN news 2012, Eme and Ibietan 2012).
  - (e) In the core service sector, schools, hospitals, hotels, parks and recreational outfits are going down. Foreign students are relocating down to the south; many doctors have transferred to other peaceful states, hotels and parks now records low turn-out of visitors. All these portend losses to northern economy. Before now there are more than enough Human resources for business and production including professionals in different service sectors. But now some of them have lost their lives resulting in mass exodus from the north to the south for safety. As of now, there is no direct evidence that those who migrated because of insecurity have returned to the northern states they fled. The Health, banking and insurance, and Education sector have crumbled. Even vacancy announcement with attractive salary and benefits are not responded to (Madlion, 2012).
  - (f) The Agricultural sector is not left out. Most northerners are known to be engaged in this sector. Agricultural output is dwindling greatly. Farmers in Kaduna, Plateau, and Sokoto no longer go to farm for fear of what will happen to them. Presently, the northern economy is crippled.

It will take 20 years to recover from the current predicament the north has found itself (Chiendu 2012).

In summary the negative effect of the of the Boko Haram terrorist activities to the northern economy now is that it has stifled normal process of trade and investment to the northern economy, the effect has been intense so much so that presently it has created a suppressive and crippled economy. It will take at least 20 years to recover from the current predicament in which the northern region has found itself (Chiedu 2012)(2) That if the Boko Haram terrorist activities continue the possible negative effect will be a systemic distortion of the existing economic pattern and structure in the northern region, devastated economy as a result of loss of lives, properties, mass exodus of non-indigenes as well as



indigenes, death/decline in investments and tourism, transportation, agriculture and commercial activities, dearth of professionals and artisans. The northern economy will be gone and The northern region will gradually disappear.

- (3) On the Nigerian economy – historically each region in Nigeria complements the other. What the north lacks the South provides if this Boko Haram activities persists it will alter this economic symphony. If the suppression, crippling and systematic distortion done to northern economy is transmitted to other regions of Nigeria, the negative effect it will have on the Nigerian economy are: Bad macro economic environment and instability suppressive economy which will complicate Nigeria business climate and make it investor unfriendly- both foreign and local, widening of the gap between the north and other regions greatly, cost of living and value of properties will be very high at the back of pressure. Reduction in the flow of foreign Direct investment, break down of industrial production, hindering greater productivity and meeting the nations production target, wastages, exacerbate the already bleak years for investors in the Nigerian stock exchange, decline in economic growth and development – already the Nigeria GDP is regressing -, high incidence of poverty and unemployment, foreign investors will fold their mats for exodus.

In conclusion, if this Boko Haram terrorist activities continue the northern economy will collapse completely because trade and investment will be stifled, the economy and the economic objectives of Nigeria including the vision 20:2020 will be a mirage and will not be achieved and consequently the Nigerian economy will collapse, the nation will no longer compete favourably in the global marhen this happens, Nigeria will attain the status of a failed state.

## 10. Recommendation

Our study showed that Boko Haram capitalizes on popular frustration with leaders, poor government service delivery, and dismal living conditions of many northerners. Based on these insights we hereby make the following recommendations:

1. The Boko Haram crisis is already having domestic domino effect concerted effort is needed at this stage so as to forestall a spillover effects to the other region. The economic cost of government's inaction would be utterly calamitous. To this end, a fact-finding commission, involving all major stakeholders should be convened to interact with all those who are directly or remotely connected to Boko Haram so that the spate of violence can stop.
2. There is also urgent need to make leadership in the north to show deeper concern for the problem at hand. They must reach out to Boko Haram leadership who live among them and find ways of talking to them to drop their guns and bombs. This is important because the economy in the north and indeed Nigeria is under great threat and the time to act is now.
3. Since poverty and unemployment are among the root cause of Boko Haram insurgency there is an urgent need for a robust social protection scheme with special preference for the north. Food, shelter, health care and employment creation should be the bedrock of this scheme. Women, children and youths should be the target they should be empowered through vocational training. While mosque, churches, and NGOs should be utilized. The North need to know that the president is going extra-ordinary length to fix their problem.
4. Government should redouble its effort at Nation building, take a hard look at the root causes of the current problems in order to find lasting solution to Boko Haram insurgency and other terrorist group.
5. An improved intelligence gathering is needed to curb future violence. What we are witnessing in Nigeria are the consequences of lack of national intelligence security system that fails to recognize that contemporary system demands more reliable and timely intelligence than guns and armoured personnel carriers.
6. Government should as a matter of urgency review its current approach and expand its effort to combat the militant activities and be more responsive to issues of security by genuinely tackling them to minimize their dangerous implications, thus improving the investment climate.
7. The popular claim by the top northerners that disgruntled and unscrupulous extremists from Chad and Niger constitute the majority of the sect members should not be treated with kid gloves. With regards to this; the federal government must strengthen our custom service to tighten our borders and solicit for the co-operation of the government of Niger and Chad to check border movements.
8. There is need for a comprehensive national data base to capture relevant data which would aid in documentation and monitoring of the general populations.
9. Government will have to develop a new social compact with its northern citizens and evolve an economic recovery strategy to complements its security strategy.
10. We reject in its totality the call for amnesty for the Boko Haram Sect as it will send a bad signal to other militia groups like OPC and MOSSOB to the effect that the government of Nigeria understand only the language of

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violence and they will want to toe the same line.

11. We support the current state of emergency declared in the most affected states. However, the defense headquarters must ensure that their operations are in line with internationally recognized best practices to avoid gross violation of human rights.

To this end the researchers are very confident that if these recommendations which are unambiguous, down to earth and far reaching are implemented religiously, in no distant time, Sokoto- the Seat of the Caliphate will regain its spiritual relevance, Kano will become a bedrock of economic activities again, the beautiful savannah of Adamawa will blossom and a dew of peace shall calm the boiling atmosphere of Borno while the economy of the northern region will flourish again, the whole nation will be better for it.

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## Towards the Evolution of Right to Reparation for Loss of Housing and Property of Internally Displaced Persons (IDPS) in Nigeria

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### Abstract

During internal conflicts, displaced victims are confronted with wide range of physical and psychological trauma to their persons coupled with loss of their homes and other life time investments. Relocating these victims to safe place (IDPs camps) alone will be far from given them much touted hope for returning to normal lives. At the international level, there is a growing recognition of the significance of extending reparation (which comprises of restitution, relocation, reintegration and compensation) to internally Displaced Persons (IDPs) as means of assuaging the impact of wrongful acts committed against them in accordance with the time honoured legal aphorism – *ubi jus ibi remedium* which means where there is a wrong there must be a remedy. In Nigeria, owing to multiple factors compensating victims for loss of homes and other tangible properties in particular is yet to arouse the needed attention that it deserves as government primary attention has continually been overwhelmed by the need to provide immediate succour. This article as a conceptual discourse attempt to x-ray the various context that reparation can be gauged for internally displaced persons arising from recurring internal crisis in Nigeria. The paper concludes that beyond the traditional reparation sufficiently entrenched in applicable international, regional and domestic regimes, namely provision of temporal shelters and other humanitarian needs, an intervention that can hardly approximate to reparation capable of enthroning durable solution for internally displaced persons (IDPs), there is an imperative need for a new twist that recognizes the importance of reparation for movable and immovable properties lost in the heat of internal crisis. This article is significant as it contributes conceptually to the untiring search for durable solutions by government, policy makers and relevant stakeholders as a way of engendering enduring protection and assistance for internally displaced persons (IDPs) in Nigeria.

**Keywords:** Internally Displaced Persons, Conflict, Reparations, Durable solution, Nigeria

### 1. Introduction

Within the web of contesting vulnerability today, internally displaced person's plight is more worrying and precarious. Uprooted from their homes or habitual place of residence due to internal violence, human rights violations, generalized violence, development projects and natural disasters but continued to live in another part of the country in striking pains that renders return almost impossible. Unlike refugee they have not crossed to another country for their status to attract the necessary protection existing at international law.<sup>1</sup>

Reparation is the means by which harm or injury arising from wrongful act is remedied so as to place the victim in the position he would have been had the harm or injury not been done. It is a recompense or reimbursement. In situations of internal displacement especially owing to internal armed conflict, there is bound to be colossal injury or loss to either the victim's persons, homes or other immovable property such as land. It becomes obvious and natural that such victims

<sup>1</sup> Under the United Nations Convention Relating to the Status of Refugee 1951 (hereinafter simply called Refugee Convention) refugees are specifically protected as well as under the institutional mandates of the United Nations High Commissioner for Refugees (UNHCR).

52 would seek remedy from or against the perpetrators of the raging harm.<sup>2</sup> Reparation could take the form of restitution,  
53 resettlement, rehabilitation, compensation and satisfaction.

54 The right to remedy is firmly seated and settled in history as exemplified in the legal aphorism- '*Ubi Jus Ibi*  
55 *Remedium*' which means where there is a wrong there ought to be a remedy. But the questions is does such right exist  
56 only for the internally displaced persons or the entire universe? While it is true that international law be it human rights,  
57 humanitarian and criminal laws revere the right to remedy for the entire citizens (including internally displaced persons)  
58 who would unfortunately become victims of violations of their respective standards, the UN Guiding Principles on Internal  
59 Displacement<sup>3</sup> and the new African Union IDPs treaty<sup>4</sup> tend to have strengthened the basis of an ideal remedial regime  
60 for internally displaced persons only in a very hasty manner.

61 In Nigeria, the right to reparation exist against unlawful acts that tends to deprive citizens of their right to own  
62 movable and immovable property and in certain instance there are laws that guarantee payment of adequate  
63 compensation in an event of state led deprivations in relation to immovable properties. Just like the position under  
64 existing international law, they are not specifically directed to favour internally displaced persons alone but the entire  
65 citizen who are victims in particular.

66 This article seeks to take a bird eye scrutiny of the foregoing positions with a view to espousing on the need for  
67 reparation for loss of homes and other properties as a means of making durable solution meaningful to internally  
68 displaced persons in particular especially in the face of intermittent violence in Nigeria which has occasioned colossal  
69 losses and damage to properties of victims.

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## 72 2. Research Methodology

73

74 This study is conceptual and doctrinal in nature. It involves an analysis of international and regional conventions, Nigerian  
75 legislation, scholarly article/journals and internet resource. This methodology is adopted because of dearth of accurate  
76 and reliable statistics on internally displaced persons (IDPs) in Nigeria coupled with the fact that this work looks at the  
77 problems necessitating the study from analytical/comparative perspectives of the applicable legal rules and principles.

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79

## 80 3. Right to Reparation in International Law

81

82 International law which for this purpose is limited to the trigonometry of international human rights law (IHR), international  
83 humanitarian law (IHL) and international criminal law (ICL) proposes reparations generally for victims of injury or harm  
84 following breach of its rules and principles from two perspectives even though with different boundaries of culpability in  
85 respect of state actors and non-state actors. It provides for three type of reparation such as restitution, satisfaction and  
86 compensation. Whereas restitution seeks to return the victim to the period (*ante*) before the harm or injury, satisfaction is  
87 aimed at a non-pecuniary remedy such as apology and acknowledgement, while compensation revolves round financial  
88 award only where by fundamental change of circumstances restitution becomes impossible to achieve.<sup>5</sup>

89 Firstly that state bears responsibility to ensuring that all the consequences of illegal usurpations or breach of rights  
90 engendered by its principles is appropriately wiped out. This connotes that reparation is a natural consequence of  
91 wrongful act perpetrated by the state as borne out of the principle of international law which provides that "any breach  
92 of an engagement involves an obligation to make reparation".<sup>6</sup> Under this regime wrongful acts which can constitute injury  
93 or harm are in exhaustive.

94 In the second instance right to reparation lays for injury or harm notwithstanding the legality of such acts as liability  
is imputed to have arisen strictly or absolutely. But nature of injuries or harm covered by this regime is restricted to  
activities that are hazardous or potentially risky.<sup>7</sup>

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<sup>2</sup> Veronika Bilkova, "Towards a General Right of Reparation for Internally Displaced Persons" *Canadian Yearbook of International Law, CYIL*, 2 (2011), 95-112 available at [http://www.files.cylil.eu/200000046-91e9492e32/CIMP\\_2011\\_08-Bilkova.pdf](http://www.files.cylil.eu/200000046-91e9492e32/CIMP_2011_08-Bilkova.pdf). [accessed on 7 January 2015]

<sup>3</sup> United Nations Guiding Principles on Internal Displacement 1998 available at [www.drc.dk/fileadmin/uploads/pdf/IA\\_PDF/facts/C6.%20Guiding%20](http://www.drc.dk/fileadmin/uploads/pdf/IA_PDF/facts/C6.%20Guiding%20). [accessed on 16 February 2015]

<sup>4</sup> African Union Convention for the Protection and Assistance of internally Displaced Persons in Africa, (2009) entered into force on 6 December 2012 (hereinafter referred to as Kampala Convention) available at <http://www.unhcr.org.50f9551f9.pdf>. [accessed on 16 February 2015]

<sup>5</sup> Article 35 and 37 of the Articles on Responsibility of States for International Wrongful Acts UN Doc. A/56/10;

<sup>6</sup> See Article 31 of the Articles on Responsibility of States; Bilkova, 98

<sup>7</sup> Such as space activities and other modern high-tech exploration.

95 This trend in international law represents a somewhat gradual process of the strong recognition that internally  
96 displaced persons deserves reparation for the injury to their persons and their properties due to conflicts.

97 International Human Rights (IHR) regards all human beings as repository of some inalienable rights which are  
98 naturally attributes of their being. Therefore state as primary bearer of responsibility towards their citizens within the  
99 defined territory is under a duty to protect internally displaced persons as part of the civil population and also provide  
100 machinery that recognizes the existence of the right to seek remedy against unwarranted violations of their rights  
101 enshrined in applicable human rights instruments especially those that have assumed *erga omnes* status.<sup>8</sup> IHR being  
102 treaty law based binds on State Party alone<sup>9</sup> nevertheless individual victims can complain where violations has arisen  
103 from situation of internal displacement.

104 The law regulating the use of force in international law simply called international humanitarian law (IHL)  
105 recognizes the right of reparation for victims of armed conflicts. This supports only internally displaced persons (IDPs) as  
106 a result of armed conflict in particular.<sup>10</sup> Armed conflicts could either international or internal but certainly the extent of the  
107 application of the rules regarding right to reparation for victims depends on which of the divide they belong. Unlike IHR,  
108 this rules applies to both state actors and non -state actors. Reparation for individual victims under IHL is still doubtful as  
109 its rules and principles are mainly targeted at inter states relations.<sup>11</sup>

110 From the perspectives of international criminal law (ICL), it frowns at atrocious international crimes such as “war  
111 crimes”, “crimes against humanity”, and “genocide”<sup>12</sup> by imposing criminal responsibility from the point of individual  
112 perpetrators of these crimes which is a form of satisfaction as a specie of reparation. Similarly it criminalizes “forcible  
113 transfer of population” as well as other unlawful acts to which internally displaced persons (IDPs) may be exposed during  
114 situation of internal displacement.<sup>13</sup> The ICC statute prescribes award of reparation against perpetrators of heinous  
115 crimes mentioned earlier through its decisions<sup>14</sup> and from the Trust Fund<sup>15</sup> created under it. These are clearly accessible  
116 to internally displaced persons (IDPs) who are victims of international crimes. However the extent of the application of the  
117 relevant rules differs with the forum from which reparation is sought.

118 A passionate look at this three branches of international law will reveal that the right to seek reparation, albeit not in  
119 general but limited form, exists but the extent of its application and type that can be sought depends on the facts and  
120 circumstances of each case and the forum that the right is ventilated. International law does not *expressi verbis* concede  
121 or pretend to authorize a general right of reparation for internally displaced persons per se.<sup>16</sup>

#### 122 4. Reparation in the Guiding Principles and the African Union IDP Treaty

123 That the need for a general right of reparation for internally displaced persons (IDPs) is compelled by the necessity to  
124 enthrone durable solutions needs no further academic flogging.<sup>17</sup> It has become the ultimate goal going by the gradual  
125 benevolence of existing international law regarding reparation to the effect that an individual focused regime ought to  
126 apply to internally displaced persons.<sup>18</sup>

127 This gradual revolution starts with the Guiding Principles on Internal Displacement drafted by Francis Mading  
128 Deng<sup>19</sup> endorsed by the UN Commission on Human Rights<sup>20</sup> and finally adopted by the United Nations Generally

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<sup>8</sup> For example the UN Convention on the Rights of the Child, aspires to be one of such because of the wide ratification of over 193 countries as of today.

<sup>9</sup> Article 2 (1) (a) and (g) of the Vienna Convention on the Law of Treaties 1969 available at [http://www.legal.un.org/ilc/texts/instruments/english/conventions/1\\_1\\_1969.pdf](http://www.legal.un.org/ilc/texts/instruments/english/conventions/1_1_1969.pdf). [accessed on 17 February 2015]

<sup>10</sup> Article 3 of Hague Convention IV of 1907 and Article 91 of Additional Protocol I (1977) to the Geneva Convention do not apply to non-international armed conflicts.

<sup>11</sup> *Bilkova*, 98-99.

<sup>12</sup> Articles 6, 7 and 8 of the Rome Statute of the International Criminal Court, A/CONF.183/9 of 17 July 1998 entered into force on 1 July 2002.

<sup>13</sup> *Ibid.*, Articles. 7(1) (d) and 8 (2) (e) (viii).

<sup>14</sup> *Id.*, Article 75.

<sup>15</sup> *Id.*, Article 79.

<sup>16</sup> *Bilkova*, 105.

<sup>17</sup> Absence of general right to reparation have manifested in the complexities of practical problems faced by internally displaced persons (IDPs) in their search for safe return to their original or habitual place of residence.

<sup>18</sup> *Bilkova*, 105.

<sup>19</sup> Former Sudanese Diplomat and the then Representative of the Secretary General; See also UN Doc. E/CN.4/1998/53/Add.2, Report of the Representative of the Secretary General submitted pursuant to Commission Resolution 1997/39. Addendum: Guiding Principles on Internal Displacement, 11 February 1998 available at <http://www.refworld.org/docid/3d4f95e11.html> [accessed on 16 February 2015]

131 Assembly.<sup>21</sup> Though not binding in themselves,<sup>22</sup> the principles, thirty in number restates existing international law by  
132 analogy by synchronizing the scattered and limitless grey areas in favour of international protection and assistance of  
133 internally displaced persons (IDPs).

134 Section 5 of the Guiding Principles deals with issue of reparation where it provides for return, resettlement and  
135 reintegration. Competent authorities in ensuring safe and voluntary return or reintegration of internally displaced persons  
136 are under a duty to establish favourable conditions and provide means to enable them elect whether to return to their  
137 habitual place of residence or to resettle to any other part of the country.<sup>23</sup> With respect to other form of reparation, the  
138 principles recognize restitution and compensation by imposing responsibility on competent authorities to ensuring quick  
139 recovery of property and possessions of internally displaced persons (IDPs) left behind or dispossessed in the course of  
140 displacement.<sup>24</sup>

141 A cursory look at the reparation regime established in the Guiding Principles reveals that there are no specific  
142 mention of the requisite bearer of the right, emphasis is placed on holders of responsibility (states) to provide the  
143 appropriate remedy. In similar vein, the class of reparation that can be sought by right holders is somehow restrictive. In  
144 other words, a general right of reparation for internally displaced persons (IDPs) though not firmly entrenched in the  
145 Guiding Principles, it has encouraged progressive advancement in matters pertaining to reparation following consistent  
146 debates on the best approach to solving problems associated with displacement bearing in mind the specific needs of  
147 internally displaced persons.<sup>25</sup>

148 The African Union Convention for the Protection and Assistance of Internally Displaced Persons in Africa (Kampala  
149 Convention) is a binding treaty (hard law) and the first to originate from regional arrangement worldwide. It focuses  
150 primarily on internally displaced persons (IDPs) within the continent of Africa as guarantees stipulated therein are not in  
151 the nature of general entitlement of all citizens. This convention made impressive provisions for reparation by imposing  
152 responsibilities on States party to provide satisfactory conditions that will aid "voluntary return", "local integration and  
153 relocation".<sup>26</sup> It went beyond the traditional limits of existing reparation regimes by providing for effective remedy for  
154 internally displaced persons (IDPs) whose rights are affected by displacement by apportioning liability to State party  
155 where they refrain from putting in place needed measures aimed at preventing displacement.<sup>27</sup>

156 As further guarantee, states are under a duty to provide the required legal machinery that will ensure just and fair  
157 reparation as appropriate in consonance with international standards.<sup>28</sup>

## 159 5. Reparation under Nigerian Law

160  
161 In Nigeria, the right to reparation is well entrenched in the ground norm<sup>29</sup> itself and in the law relating to administration  
162 and management of land.<sup>30</sup> The Constitution recognises the right of the citizens to own movable and immovable  
163 property<sup>31</sup> and institutionalized the judicial process of settlement of disputes pertaining to the same.<sup>32</sup> In the same vein

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<sup>20</sup> UN CHR, UN Doc. E/CN.4/RES/1998/50, *Internally Displaced Persons*, 17 April 1998.

<sup>21</sup> UN GA UN Doc. A/60/L.1, 2005 World Summit Outcomes, Para 132.

<sup>22</sup> Walter Kalin, "Flight in Times of War" (2001), 646; Lauren Groth, "Engendering Protection: An Analysis of the 2009 Kampala Convention and Its Provisions for Internally Displaced Women", *International Journal of Refugee Law*, Vol. 23, No. 2 (2011), 227. Available at <http://www.ijrl.oxfordjournals.org>. [accessed on 7 December 2014]; Ekpa Shedrack, "From Voluntary Principles to Binding Precedent: African Union Convention for the Protection and Assistance of Internally Displaced Persons Comes into Force", *Journal of Law, Policy and Globalization*, Vol. 27 (2014), 20.

<sup>23</sup> Principle 28 of the Guiding Principles.

<sup>24</sup> *Ibid.*, Principle 29.

<sup>25</sup> For example Art. 5 and 9 of the *International Law Association, London Declaration of International Law, Principles on Internally Displaced Persons* adopted on 29 July 2000, the declaration ambitiously went beyond the mere compilation of legal rules for the very first time to provide for a truly IDPs centred reparation regime, available at <http://www.refworld.org/docid/42808e5b4.html> [accessed on 16 February 2015]; Similar awareness raised in the Guiding Principles also influenced incorporation of reparation regime for internally displaced persons (IDPs) under art. 1(8) and 8(2) of the Great Lakes IDP Protocol on the Property Rights of Returning Persons 2006 available at [http://www.brookings.edu/wp/projects/idp/GreatLakes\\_IDPprotocol.pdf](http://www.brookings.edu/wp/projects/idp/GreatLakes_IDPprotocol.pdf) [accessed on 16 February 2014]

<sup>26</sup> Article 11 (a) of the Kampala Convention.

<sup>27</sup> *Ibid.*, Article 12 (1), (2) and (3).

<sup>28</sup> *Id.*, Para 2.

<sup>29</sup> Constitution of the Federal Republic of Nigeria 1999 available at <http://www.nigeria-law.org/ConstitutionOfTheFederalRepublicOfNigeria.html> [accessed on 15 February 2015] (hereinafter simply called Nigerian Constitution).

<sup>30</sup> Land Use Act Cap L5 Laws of the Federation of Nigeria 2004 (hereinafter simply called LUA).

<sup>31</sup> Section 43, 44 (1) (a), (b).

164 under the Land Use Act individual's right to own land is also recognised and it is further protected through a recourse to  
165 judicial remedy by the courts established to act as a check on the excesses of the statutory grantor in an event of  
166 revocation.<sup>33</sup> In all these instances the adjudicatory functions of the court is unfettered and include the power to decree or  
167 order any appropriate remedy that will meet the justice off each case including but not limited to compensation,  
168 restitution, and award of damages.

169 In Nigeria, experience has shown that properties such as houses belonging to citizens as well those displaced by  
170 conflicts are subjected to brazen impunity of reckless wreckage due to internal armed conflict without corresponding  
171 compensation from either the state who bears primary responsibility for protection of internally displaced or perpetrators  
172 of the harm on grounds of individual responsibility.

173 Under the Abandoned Properties Act<sup>34</sup> instead of payment of reparation to victims of internal violence or situations  
174 which renders return to their homes or properties impossible, right of ownership is forfeited instead in the process as the  
175 state is empowered to declare such property abandoned and to order sale to third parties without any prescription of  
176 recompense to the original owners.<sup>35</sup> This approach is rather harsh to victims especially internally displaced persons  
177 more so that their sudden movement which is characteristically forceful and involuntary is viewed as an act of  
178 relinquishment of property necessitating forfeiture by the state.<sup>36</sup>

179 It is submitted that properties lost or damaged as a result of internal violence deserves reparation not necessarily  
180 because of the nature of the flight which characterized situations of displacement but as citizens generally. A close  
181 scrutiny of the state of Nigerian law as evidenced from the foregoing will persuasively reveal that there is of course no  
182 general right of reparation for victims of internal displacement in well-defined context though this right can be imputed  
183 from the broad perspectives of citizen's entitlements to enjoyment of fundamental rights as guaranteed by the  
184 constitution.<sup>37</sup>

185 The exercise of such powers by the state which negates right of reparation is in itself constitute blatant affront to  
186 the constitution as illustrated in plethora of judicial decisions, prominent among whom is the celebrated case of *Ojukwu v.*  
187 *Military Governor of Lagos State*<sup>38</sup> where the court brilliantly granted a mandatory order that the property of the plaintiff  
188 located at No. 2 Queens Drive, Ikoyi Lagos be returned back to him after many years of cessation of hostilities that  
189 greeted the Nigerian civil war.<sup>39</sup>

190 Within jurisprudence of criminal laws in Nigeria, reparation in the nature of an imposition of term of imprisonment or  
191 payment of fines or both for criminal offences such as murder, causing grievous hurt, assault and arson or mischief by fire  
192 and sexual related offences which are usually committed during internal violence against displaced persons is only  
193 intended to satisfy the object of punishment designed by the state unless the court of competent criminal jurisdiction  
194 orders payment of compensation in favour of victims (internally displaced persons).<sup>40</sup>

195 For internally displaced persons in Nigeria their precarious situation is further compounded by the lack of financial  
196 wherewithal to pursue rigorous legal process against the state or individual in order to press for reparation for loss of their  
197 homes and other properties wrecked by internal violence.

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## 199 **6. Reparation for Internally Displaced Persons (IDPs) and the Challenges**

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201 It is no longer in doubt that the right to reparation exist for internally displaced persons upon an assessment of the letters  
202 of the law but amidst this gala there are obvious issues that pose problems in the realization of this much touted right.

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<sup>32</sup> *Ibid.*, Section 46.

<sup>33</sup> Under sections 39 and 41 of the Land Use Act, jurisdiction is conferred on the High Court and the Area Court respectively to inquire into adequacy of compensation payable to right holders under section 29 upon revocation of right of occupancy by the Governor pursuant to section 28.

<sup>34</sup> Sections 1, 2, and 3 of the Abandoned Properties Act Cap A1 Laws of the Federation of Nigeria 2004.

<sup>35</sup> *Benedicta Daudu, Legal and Institutional Framework for the Protection of Internally Displaced Persons in Nigeria, PhD Thesis, Faculty of Law, University of Jos, Nigeria (2010), 73-74.*

<sup>36</sup> For the definition of internal displacement, see article 1(l) of Kampala Convention. Contrast this definition with relinquishment which means "an abandonment of a right or thing" see Bryan A. Garner (ed.), *Black's Law Dictionary*, 9<sup>th</sup> ed. (St Paul: West Publishing Co., 2009), 1405.

<sup>37</sup> See chapter IV of the Nigerian Constitution.

<sup>38</sup> *CAL/195/85*

<sup>39</sup> *Daudu, 75-76.*

<sup>40</sup> Under the Criminal Procedure Code Cap C23 Laws of the Federation of Nigeria 2004, a court of competent criminal jurisdiction can in addition to term of imprisonment or imposition of fine or both order that pecuniary compensation be paid to victim of crime.



203 These are the venue or forum where the newly recognised right can be properly ventilated and the precise holders of duty  
204 to provide reparation and for what type of wrongful acts, injury or harm that it covers which are undeniably jurisdictional  
205 issues.

206 There is no privileged judicial or quasi-judicial body that can grant access to internally displaced persons the right  
207 to reparation at international law.<sup>41</sup> It all depends on which branch of international law and the rules that have been  
208 breached. Under human right regime, the appropriate forum can either national courts or specialised courts<sup>42</sup> provided  
209 the court is seized of jurisdiction and the conditions of admissibility are met.

210 Individual claims for reparation under international Humanitarian law can be brought before domestic courts as well  
211 international bodies.<sup>43</sup> The clog posed by doctrine of jurisdictional immunities among others makes recourse to national  
212 courts a bit problematic. Reparation under international criminal law are instituted before national courts especially where  
213 the said international crime has also been criminalized in local legislation<sup>44</sup> or before regional courts<sup>45</sup> and the  
214 International Criminal Court (ICC).<sup>46</sup>

215 Unlike the reparation regimes in international law that focuses on previous violations of existing norms which  
216 incidentally also applies to internally displaced persons (IDPs), the emerging trend is no longer based on the existence of  
217 previous unlawful acts but on harm or injury to their persons and properties by virtue of the unfortunate situation they  
218 have been plunged into.<sup>47</sup>

219 Similarly, there is no unanimity in the traditional reparation regimes entrenched by three branches of international  
220 law considered earlier in this work as regards who is responsible to provide reparation to internally displaced persons  
221 (IDPs) in a verified case, but the near conclusion that can be deduced is that it could either states, non-state actors or  
222 individual perpetrator depending on which branch the harm or injury finds expression.

223 However under the gradually evolving IDP centred reparation regime in the Guiding Principles and the African  
224 Union IDP treaty there is much emphasis on the need for consensus as far as the duty of state as bearer of responsibility  
225 to protect and provide reparation for internally displaced persons (IDPs) who at all times remained within the territory of  
226 their own state is concerned.

## 228 7. Concluding Remarks

230 In Nigeria by reason of the fact that Kampala Convention is yet to be domesticated after its due ratification,<sup>48</sup> reparation  
231 for internally displaced persons in Nigeria is still incubating in the shred of the scattered provisions of applicable local  
232 legislation and international law which are in the nature of general entitlement of all citizens not meant to benefit only  
233 internally displaced persons (IDPs) in Nigeria.

234 That a right to reparation per se exists and that the same is exploitable for loss of home in particular and other  
235 properties of internally displaced persons (IDPs) is no longer doubtful as there is a strong indication that beyond the  
236 classic form of reparation provided in the three traditional branches of international law, a much more general right of  
237 reparation is gradually evolving<sup>49</sup> and currently gaining supports from state practices.<sup>50</sup>

238 One may conclude from the foregoing that reparation regimes under Nigerian statutes are too broad and  
239 incomprehensible for a shattered persons in the standing of an internally displaced persons to fully appreciate and exploit  
240 coupled with high rate of illiteracy and poverty which militates against access to justice in Nigeria.

<sup>41</sup> Bilkova, 110.

<sup>42</sup> Such as African Court of Justice and Human Rights, European Court of Human Rights, Inter-American Court of Human Rights etc.

<sup>43</sup> UN Claim Commission.

<sup>44</sup> Nigeria Terrorism (Prevention) Act 2011 is one of such local legislation in Nigeria.

<sup>45</sup> As proposed by the African Union in the newly established African Court of Justice and Human Rights which is expected to try other international crimes beyond the parameters set in the Rome Statute of the ICC; See also Sophie Van Leeuwen, "Africa: Nine Things About the African Court of Justice and Human Rights" The Hague Trial Kenya, 5 February 2015 available at <http://www.allafrica.com/stories/201502060133.html> [accessed on 17 February 2015]

<sup>46</sup> Such powers has been ceded to the Court by the Rome Statute of the ICC.

<sup>47</sup> Bilkova, 111.

<sup>48</sup> Ratified on 17 April 2012 and deposited the instrument of ratification on the 22 May 2012; see List of countries which have signed, acceded and ratified the Kampala Convention available at [http://www.au.int/en/.../Convention%20on%20IDPs%20-%20diplaced...\\_O.pdf](http://www.au.int/en/.../Convention%20on%20IDPs%20-%20diplaced..._O.pdf). [accessed on 17 February 2015]

<sup>49</sup> With the advent of the Guiding principles and Kampala Convention.

<sup>50</sup> Sri Lanka- National Framework for Relief, Rehabilitation and Reconciliation (2002); and Georgia-Property, Restitution and Compensation for the Victims of Conflicts in the Former South Ossetian Autonomous District in the Territory of Georgia (2006) are few examples of secondment of the new reparation regime at national levels.

241 Considering the gravity of destructions of private properties and the attendant depravity as gleaned from the  
242 recurring crisis in Nigeria, an assurance of perfect reparation packages for all victims may not be perfectly possible so  
243 soon but a gradual journey to utopia once the pre-requisite legal and institutional framework are put in place coupled with  
244 the necessary political will to match words with actions. This is more so that the loss of homes and properties makes  
245 internally displaced persons (IDPs) detest any plan to return to their original place and will always prefer to remain  
246 perpetually displaced in IDPs camps.

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## Extra-Legal and Shadow Functioning of Public Authorities

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### Abstract

*This article discusses the various forms of public authorities functioning and state authorities functioning in particular. The authors argue that in addition to the institutional and regulatory and structural and functional characteristics, public authority realizes in extra-legal form, which acts as a complex concept correlating with such forms as "informal", "shadow", "unlawful." It is proved that this form of governmental authority is not mediated by law and can have both formal public and informal, shadow and non-legal nature. The matter of this article shows that extralegal forms of activity lead not only to negative, but also to positive effects - to the development of the system of state power, political forms and regime, methods of state and legal impact on the political, economic, social and other systems of society. Thus, in some cases extralegal but legitimated by society forms of state influence on the political process can get institutional and regulatory clearance. Moreover, the authors identify the causes and factors of the development of this form, as well as provide a meaningful analysis of the informal authorities' activity, their shadow interaction and shadow forms of relations, illegal practices, unlawful sphere and shadow law.*

**Keywords:** extra-legal activities, the State, political system, public authority, shadow law;

### 1. Introduction

Traditionally, the activity of public authority in the political system is considered in the institutional and regulatory, structural and functional aspects, which, of course, are important for its functioning. Through their analysis one reveals the essence, the main functions and tasks, social purpose and role of the public authority in the life of society. However, it is clear that this is not the only form of public authority and its interaction with other political subjects. There are a variety of forms of representation of public authority, and above all the state authority in the political life of society. Today those forms are studied not enough. Those forms include, first of all, "extra-legal" and "shadow" activities of public authorities in the modern state and legal process.

In this regard A.I. Solovyov correctly points up that the system of governmental authorities, the role and place of the public authorities and the specifics of its functioning in the political system is considered, "usually through a list of its organizational principles and functions (dysfunctions), the activities of the bureaucracy, especially the institutional structure and its parameters that eventually revealing the political, administrative and legal nature of this phenomenon. However, in this quite rightful approach in general one primarily studied the legal space of public administration, and all its other manifestations almost were automatically referred to private deviations and splashes of "birthmarks" outliving by its evolution"(A.I. Solovyov 2011). Actually, well-known researcher Stefan Lux rightfully noted that it is quite important while analyzing of the phenomenon of "authority", authorities relations unfolding in society "to take into account those aspects that are least amenable to observation, for power, without a doubt, the more effective the less it is noticeable" (S. Lux, 2010).

Therefore, the analysis of public authority in modern society requires consideration of the various forms of its functioning, which goes far beyond the traditional structural-functional and institutional and regulatory analysis. Moreover, it should be stated that the development of the political system, its form of organization, complexity of the structure of needs, the emergence of new risks and threats at the present stage of evolution of the state and legal activity allow to point out an increasing role of public authorities and, above all, the state authority, as well as public management technologies in people's lives.

## 2. Literature Review

Traditionally, the state authority is analyzing either as the main subject, the central element (subsystem) of the political system (I.A. Ivannikov, 1995), or as a system of state bodies (V.Y. Lyubashits, 2001), specific organizational and legal forms of activity (I.N. Homerov, 2002), or the system of controlling power (A.F. Malyi, 2001) and so on. If one organizes a variety of specialized researches on the state authorities, it is easy to see that it is exactly the legal and institutional, structural and functional approaches prevail in the interpretation of the notion, characteristics and concept of this form of public authority.

The most famous and fundamental research, analyzing extra-legal activities of public authorities, are the works of German political scientist and lawyer Carl Schmitt. For him extralegal activity in general stands for a criterion of "confirmation" of the dominating rule authority in the state; the ability to extra-legal forms of exercise of power is an attributive quality of any state will, its distinguishing feature from other forms of political power. German political scientist believes that the legal regulations provide a mode of law and order, require the homogeneous situation, since the norm is known is regulated by the already existing typical social relations: "Norm requires averaged homogeneous situation. Really this normality is not just external prerequisite which can be ignored by a lawyer; on the contrary, it is directly related to the norm immanent activity rules. There are no rules applicable to chaos. Order must be set first: only then the legal system makes sense" (C. Schmitt, 2000).

In this regard, the meaning and purpose of the supreme, sovereign state authority are in creation of this "normal situation"; chaos, instability, transition, etc. must first be ordered by sovereign authority. Exactly the state authority in its extralegal activities (since the rule of law does not provide and cannot provide forms, methods and modes of operation of authorities in a period of instability, chaos, emergency, here it is powerless), "creates a normal situation". In other words, only the government authority makes the final power-volitional decision, whether the state of normality and certain political order, which expresses this "situation of normality" will reign or not. In this case, every law is "a law which is applicable to the concrete situation". Hence, the essence of state authority, according to Carl Schmitt, "would be correct to identify not as sanctions or power monopoly, but as the monopoly of the solution ... An exceptional case makes the nature of state power clear and more obvious. There solutions differ from the legal norms; the authority demonstrates that does not need law to create law ... An exceptional case is more interesting than the normal case. Last proves nothing, but the exception proves everything; it not only confirms the rule: the rule itself consists of exceptions" (C. Schmitt, 2000).

Even in a relatively steady state of the political system operation, i.e., when, for example, the democratic configuration of public-authoritative interaction between the individual, society and the state is developed, there are periods of so-called "extra-legal agreement" concerning national development strategies, priorities of a legal policy, etc., forming a "political corridor of opportunities" based on the civilian trust and recognition of the political agenda (S.M. Lipset, 1994). This social cohesion and trust can legitimate special activities of no legal clearance aimed at accelerating the solution of acute national problems, needs and interests: "Receiving from the citizens this or that degree of credibility, the state forms some political corridor of opportunities for its administrative apparatus, in which the state performs timely and direct management of public relations" (A.I. Solovyov, 2011).

In modern scientific literature it is proved that forms of government influence on social processes which are extra-legal, but legitimated by society, can gain (due to its success, effectiveness, usefulness, adequacy of socio-political development of the society) institutional and regulatory clearance (R. Barker, 2003; and E.A. Ostrom, 2010; and M.S. Weatherford, 1992).

In this context, it is appropriate to emphasize the fact that at the state level national interests (balanced and harmonized interests of an individual, society and the state) are in themselves quite abstract, their content is like "floating frame of interpretation" that allows state authorities not only to "subjectivized" the managerial emphasis and priorities, but also to choose a more efficient and cost-effective forms and methods of their implementation in respect to technological and bureaucratic type of political rationality.

It should be noted for Russian legal and political mentality extra-legal forms of state authority activities, the practice of creating temporary, emergency and other public institutions of government to address the emerging challenges, risks and threats are quite traditional. For example, according to the well-known historian and political scientist, one of the most important and characteristic properties of the Russian system of public administration is in its extralegal or, more precisely, non-institutional and non-legal character. Here, the "main element, the actor of administration is not the institution but all kinds of "emergency committee"(EC). The difference between the institution and the EC is that the first one is a constitutional body; its existence is enshrined in the basic regulations; it operates within the boundaries of the legal field, its function is not limited in time, the powers are clearly defined and known to the public ... Second ones are created when the problems of administrating cannot be solved by institutions. The existence of the EC is not enshrined in

111 the basic regulations. For these bodies is possible going beyond law; their actions are often of semi-secret (or even  
112 private) character; in any case, the society is not completely aware of the EC activities" (Y.S. Pivovarov, 2006).

113 In the Russian researches extralegal activity of public authorities, related primarily to ideocratic element of its  
114 functioning was also analyzed. There ordinarily political, legal and economic institutions and establishments had no self-  
115 valuable and self-sufficient status as observed in the western political and legal tradition (where the fetishization of  
116 political and legal institutions takes place), and were of secondary values and applied, but provided a representation and  
117 implementation of the values of the primary nature, such as social truth, justice, order, harmony, spiritual and moral  
118 freedom, etc. At the same time the effectiveness of public and legal life was determined by the belief in the truth, in social  
119 justice, as respect for the truth meant much more than reasonable laws and rationally organized legal-political and socio-  
120 economic institutions.

121 These methodological views on extra-legal activity of the government authority are based on the fact that the  
122 existing social, political and legal values are unequal and of different character, have different socio-cultural, spiritual and  
123 moral content and meaning. For example, the specific political and legal order sets and support through legal and political  
124 institutions, mechanisms and means certain order, the desired social and legal status (reconciliational Wednesday -  
125 Kistyakovskiy B.A.), in the context of which political subjects meet private and public interests and needs.

126 However, in this case, the socio-cultural values is the very order of relations; the concrete legal, social, political  
127 institutions and mechanisms are the only means, the instrument of its realization and maintaining, i.e. presented as the  
128 values of the second value. Because of that, the political institutions and government establishments, models and  
129 mechanisms of interaction at the level of public discourse form (must form!) united public-authoritative environment of  
130 social relations development and functioning, which in its turn provides the ordering of social relations and reflects the  
131 specificity and patterns of socio-cultural system development (L. Kirsanova and O. Korotina, 2014).

### 132 3. Methods and Materials

133  
134  
135 Extra-legal form of public authority activity will be considered by us as an inclusive and broad (in terms of content)  
136 concept in relation to such forms as "informal" and "shadow" activities, since the latter are extra-legal by definition, i.e. not  
137 regulated by the rights or violate the legal establishment. It certainly does not mean that these forms of activity are  
138 negative factors of state-legal process development. On the contrary, quite often extra-legal forms of activity lead to  
139 positive effects - to the development of the system of state authority, forms, modes, methods of state and legal impact on  
140 the political system, the social organization as a whole. In other words, extra-legal activity is expressed in a variety of  
141 formal and informal activities of state bodies, their officials, which is not mediated by law, or contrary to it (violates  
142 functioning law).

143 From the theoretical and methodological point of view let's select a set of factors that we believe affect the  
144 development of extra-legal and shadow activities of public authority:

- 145 - extralegal activities associated with the crisis, emergency or other unusual situations, as well as with the  
146 characteristic of the transitive period of social and political effects of anomia and dysnomia;
- 147 - formation in the state and legal practice "extra-legal agreement" concerning national development strategies,  
148 priorities and legal policy, etc., forming a "political corridor of opportunity", based on the civil trust and  
149 recognition of the political agenda;
- 150 - dynamism and sometimes uniqueness of social relations, which are of state concern, form situations in which  
151 not every socio-political phenomena and processes is predetermined by the legal norm and require mobile  
152 extra-legal activity;
- 153 - the emergence and development of deformations in the political and legal mentality of citizens, officials, as  
154 well as effectiveness and legitimacy of the activities of public bodies and government structures reducing;
- 155 - the development of simulation authoritarian democratic political systems, which are quite often using extra-  
156 legal forms of state activity in which in order to legitimize state authority the "ritualization" of electoral system,  
157 virtualization of social and political activity of the state machinery, the illusory nature of submission of the  
158 political elite, "floating frames" of justice and political double standards, "indicative character" of legal activity of  
159 the population, as well as assessment (quantitative, statistical, not quality) of law and order on formal  
160 indicators, etc. are performed.

### 161 4. Findings and Discussion

162  
163  
164 Extra-legal form - is the activity of public authority which is not associated with law or mediated by rights (although in

165 some cases it may not be settled by law, but complies with the applicable constitutional and legal system and the spirit of  
166 the institutional and legal order) and can have both formal and public and informal, shadow and non-legal characteristics.

167 It is important to emphasize that the extra-legal form of public authority, and especially the leading form of public  
168 power - the state authority, just as important and significant as the legal one: in the same way as the legal form of activity,  
169 it expresses the essence and purpose of a political institution, it specifies its essence, methods and means for impact on  
170 public and social processes, etc. From the viewpoint of A.M. Vitchenko real political practice "shows that not all  
171 government commands go through the formalities of the rights. If one accepts that the government operates only within  
172 the law, one has to admit that the lack of legal establishment in any sphere of public life will inevitably lead to government  
173 inaction in cases where the state task cannot be solved due to the fact that it does not fit in the previously published  
174 normative act. Legal registration of state activity is not a comprehensive factor"(A.M. Vitchenko, 1982).

175 In theoretical and practical terms, extra-legal activities of public authorities can be examined in various aspects.  
176 This is due primarily to the fact that the legal regulation, as rightly pointed out by A.M. Vitchenko, does not absorb all the  
177 commands of the state without exception. The possibility of free public authorities will have a discretion in many areas of  
178 its activity. The state also commands if "the law is silent". The reason is not only in complex and multifaceted activities of  
179 the state, but also in dynamic and sometimes uniqueness of social relations, with which the state deals (O. Kononova and  
180 Z. Yakimova, 2013). That is why in public life sometimes there is a situation in which not every case of authority solutions  
181 can be predetermined by the legal norm" (A.M. Vitchenko, 1982).

182 The development of extra-legal forms of government activity is connected with the legal structure of its operation,  
183 namely with emerging deformations in the political and legal mentality of citizens, officials; with low efficiency and  
184 legitimacy of law-enforcement bodies and other law machinery functioning; with effects of legal and political anomia and  
185 dysnomia emerging during the transition period of political organization. In which connection these deformations is  
186 expressed in mass phenomena of political, legal and moral infantilism (disformed and gaped legal and moral, ethical  
187 attitudes, knowledge, sets, ideas, ideals, etc.), nihilism (ignoring the moral values, the law, the denial of social  
188 significance and value of social and legal systems and so on.), criminalization (fusion of legal consciousness of citizens,  
189 law enforcement officials and other authorities with criminal structures).

190 In addition the deformation is conditioned by the processes of stereotyping - the formation of political and legal  
191 cliches and stereotypes in the process of public-authoritative activities. As P.P. Baranov points out, the most typical for  
192 this form of deformation are patterns, for example, of accusatory characteristics in the authoritative-legal interactions of  
193 authorized officials with citizens; presumption of self-righteousness in addressing professional issues; stereotypes of  
194 closeness (almost "legal sacredness") of internal authoritative-legal activities and rigid internal psychological "self-  
195 censorship"; focus on toughening of penalties and so on. (P.P. Baranov, 2005).

196 According to the researcher, these deformations produce not only all spheres, but also all levels of political culture  
197 and consciousness. They invade the area of specialized knowledge enjoyed by citizens and officials, destroy the political,  
198 legal and moral principles, feelings, beliefs, distort the political, legal and moral and spiritual outlook. Modern  
199 deformations of political and legal consciousness is largely correlated with the transitivity of social and political  
200 organization of Russian society, traditional values and ideological orientations of development breaking, spiritual and  
201 moral disorientation and social anomia. All this leads to a nihilistic attitude to the law and current political reality. Nihilistic  
202 attitude to the political order and law, beyond question, is a destructive factor, destroying political organization of society  
203 itself and its values, and stimulate the process of corruption of political and legal consciousness, etc.

204 It is well known that the subjective structure of a nihilistic attitude includes some individuals who are prone in their  
205 legal consciousness and behavior to delinquent and criminal forms of realization of their interests and needs; social  
206 groups organized in order to achieve their ideological and material goals by illegal, immoral or informal means; and also  
207 state officials, officers, departmental management units, etc.

208 In its turn, the shadow relations exist and develop in different sectors of the state and legal activity, which are  
209 characterized by informational untransparentness of certain types and models of authoritative relations of subjects in  
210 society and the state observation. However, their difference from, for example, informal relationships, is that if the formal  
211 and informal authoritative relations are organic processes of social development, which are reinforcing each other (of  
212 course, sometimes contradicting each other), the shadow relations arising out as a result these processes represent a  
213 conscious "retreat" from the existing official legal and regulatory models and authoritative-legal forms of economic,  
214 political, legal activity of society.

215 In other words, the shadow authoritative relations - is interaction on the achievement of certain social and political  
216 objectives and needs implemented in the "shadow (hidden) spectrum of events", there is no information from "outside"  
217 (beyond these interactions) comes in and does not no applied to the official statistics and public control, i.e., in the field of  
218 information untransparentness (R.V. Rvykina 2001). Due to the factor of relations shadowization and their closeness a

219 special world opposing the official institutional system is being created. As part of that special "closed world" of  
220 authoritative interaction a situation in which the shadowy forms of interaction stimulates officials and politicians to finally  
221 leave "the legal space and create centers of resources reallocation out of law control and shadow forms of state  
222 regulation» is formed (A.I. Solovyov, 2011).

223 As part of the functioning of the State machinery unspoken form a network of shadow interaction with a variety of  
224 hidden forms and rules appears. And «the "tacit life of this system is dynamic and diverse," bureaucratic moles "of many  
225 different breeds had dug lots of underground tunnels through which "the sector" intensively communicate, exchange  
226 classified information, personnel continuously flow from the ruling apparatus in the non-state bureaucracy and back ...  
227 Today these pretenders spread so widely that do not cause not only surprise, but even any significant public interest.  
228 Mediocrity of what is going on, obviously dulled the vigilance of society in respect of any bureaucracies of no legal state,  
229 but in fact constitute a single unit wit supporting public administration, constantly communicating with its staff, information,  
230 technology » (A.I. Solovyov, 2011).

231 This opposition to the official order of authoritative-law interaction in modern political systems is primarily not an  
232 open confrontation, but rather hidden, i.e. "invisible" (for official statistics) practices of the institutional and regulatory rules  
233 "bypass". As the famous French anthropologist N. Rouland pointed out today frank violation of the law is fraught with  
234 danger. In most cases one tries to avoid law (N. Rouland, 1988). According to it, the development and expansion of  
235 shadow relations undermine and eventually destroy the formal political and legal foundations of society, destabilize and  
236 randomize the order of authoritative interaction in all spheres of public life.

237 As a rule, shadow relationships arise where there are urgent social problem with no ordinary (official) forms and  
238 methods of solving, or where formal methods are in conflict with the established practice of interaction, shared by the  
239 majority of political subjects and there where the official ways establish a sufficiently complex or unknown (not approved  
240 by social interaction) procedures for the implementation of subjective and collective interests and needs.

241 In this situation, in respect to V. Radaev, there starts the process of continuous deformalization of rules and  
242 regulations in which the formal rules and relationships are largely replaced by shadow and eventually incorporated into a  
243 stable system of informal relations. In this case, most of the political actors do not perform or perform occasional  
244 prescriptions of formal rules and procedures, but it does not lead to their total rejection, "rather, they are incorporated into  
245 a more complex system of restrictions, most of which is informal in nature"; and formal rules and relations act in this case  
246 as the method and language of public justification, camouflage of shadow relations (V. Radaev, 2001).

247 With regard to such concepts as "shadow law" and "non-legal practice", they are a kind of shadow relations in  
248 state-legal society activity. It is obvious that the political and legal functioning of society is a complex concept, reflecting  
249 the totality of forms and methods of political and legal life of the nation. At the same time the spheres of subjects  
250 functioning contain a complex of all political and legal phenomena, including both positive and negative components; it  
251 reflects not only ordered but also disordered (random, spontaneous and so on.) basis of the processes occurring in  
252 society.

253 - Illegal practices of authoritative interaction owe their origin to the existing diverse and multi-vector processes  
254 (socio-cultural, legal, political, economic, and so on.) in society, that develop in parallel, sometimes concur, in other cases  
255 are contrary to each other, forming an insurmountable conflict-between space in the context of which the subjects  
256 interact. For example, L. Friedman believes that the occurrence of illegal practices of private informal systems (shadow  
257 right) in the political life of society is associated with the formation of "voids" or manifestation of "weakness" in the official  
258 system of public-authoritative regulation / management of social processes.

259 In most cases private systems that conflict with the official system, occur because of authority vacuum, a lack of  
260 proper or adequate settlement of certain sectors of social interaction. For example, this "means that there were certain  
261 groups of people who believe that the official law is too weak or fall into the wrong hands" (L. Friedman, 1993).

262 In general, according to L. Friedman's opinion, society, like nature, abhors a vacuum and violations of the  
263 agreement; the collapse of authority system creates a vacuum. In such circumstances there are two ethno-political  
264 process: positive - formation of a vacuum in the resolution of the conflict situation requires abandon informal norms and  
265 create a formal system able to cope with the situation; and negative – occurrence of a in the official system or its  
266 inadequacy in solving social and political problems, conflicts, contradictions forces the society to form a shadow  
267 structures and mechanisms to bypass the formal system.

268 In this regard the formation of informal practices and structures occurs to be a society answer to the problems in  
269 social interaction which does not obtain a suitable solving through the formal system. However, this process acquires  
270 negative characteristics when informal practice transform into illegal practices, i.e. opposed to the formal legal system. In  
271 these cases, the existing formal institutional system loses its justification and legitimacy, credibility and effectiveness, it is  
272 being replaced by natural processes of informal justice, informal procedures and tools for conflict resolution, etc.

Pointing to this, L. Friedman notes that popular justice, which is out-of-control can take many forms, reaching blind, ruthless practice of lynchings, the French popular tribunals, etc. Formation and development of illegal practices, taken as a socio-cultural space, represents a shadow law. In other words, shadow practices as constituted, stable and reproducible system of shadow relations, form the shadow law. In its turn, the illegal space can be defined as a set of illegal practices and prevailing customs of cooperation, different ways of perceiving the world of law and politics, unrecorded in the objectified (positive) law and official political order of interaction or contradiction.

A characteristic feature of informal practices are short-term emerging of authoritative relationships. For example, pursuing a well-defined goal, official, citizen or entrepreneur can use illegal channel of authoritative communication to achieve a particular goal. At the same time, while systematic or long-term contacting between the participants of shadow relations sufficiently strong / stable relationship appear, taking the form of clannish union, almost independent of external political situation or personal preferences of members of shadow relations. However, such local interpersonal formations are capable of widening, self-organizing, hierarching and defence mechanisms forming.

Consideration of informal rules begins with recognition of the principle that the state does not have the exclusive monopoly on the right in a society that, in contrast to the official rules of subjects relationships, there is still quite a large array of rules and regulations governing social and political relations that solving social conflicts and contradictions. However, it is necessary to remember that the term "law" can be applied to various kinds of processes – even to sufficiently informal, very far from the formal legal system. Thus, for example, Friedman notes: "there are quite a number of different kinds of informal courts scattered throughout the country. Some of them are managed by the machinery of religious organizations. Orthodox Jews, for example, can bring the dispute to the court for the rabbinate to settle it down. The Catholic Church has a developed system of canon law. Ecclesiastical courts decide whether the marriage be annulled" (L. Friedman, 1993).

As V.M. Baranov marks out, "shadow law as a negative manifestation of juridical pluralism, a dangerous kind of negative informal rules, a set of anti-social rules has become widespread" (V.M. Baranov, 2002). Meanwhile, the existence of such a phenomenon as a shadow right indicates the process of institutionalization of the shadow authoritative relations, giving them clear contours of coherent anti-system of law and official state policy. At the same time it should be noted that shadow right as the right to the official, there is to streamline complex, but not legal, as the shadow of a hierarchical system that ensures public need for social control. At the same time it should be noted that shadow right as the official right occurs to streamline complex, not legal, but shadow hierarchical system that ensures public need for social control. However, unlike the official law the shadow law represents the interests of particular social groups, contrary to the public interest, creating gaps in the social space. Shadow norms, being hidden from the public, are not corrected in public, which allows the strong political and economic actors to formulate shadow criminal rules of social interaction, contrary to morality, social justice and the public interest.

Due to the nature of the legal system, while translating into the language of rights this or that authoritative relations, existing in society, they not only being corrected, generalized and narrowed, but in principle in such a short time cannot encode the general modality of political management and regulatory structuring of social processes in the rule of law. Therefore, the modern legal regulation is often divorced from the actual practice and by and large is only a guide, the desired outcome, rather than the actual mechanism. From the theoretical and methodological point of view selection and juxtaposition of these two political and legal spaces is associated usually with conflictness of existing formal institutional-authoritative system, which asserts a certain order of relations and practice of subjects, implemented at the level of everyday practices.

## 5. Concluding Remarks

1. The functioning of state authority is implemented through the formal (public and legal) and extra-legal government activities. Extra-legal form of the functioning of authoritative institutions is an activity of public authority, not associated or mediated by right (although in some cases it may not be regulated by law, but at the same time does not contradict the current constitutional and legal system and the spirit of the institutional and political order), having both formal and public and informal character; it is of a broad (generic) concept with respect to such forms as "informal", "shadow", "non-legal" activities, and can have both negative and positive influence on the development of the political system of society. In Russian state-legal process extra-legal forms are consistently reproduced as the immanent characteristics of the state ruling, caused by ideocratical (ideas, images, symbols, spiritual and moral dominants of political and legal consciousness) and practical (the practice of creating temporary, emergency and other public institutions of authorities to solve emerging issues, risks, threats, priority lines) elements of the national political culture.



- 327 2. Reasons of informal practices occurrence are different. *First*, it is illegal (informal) relations arising due to the  
328 inability to regulate certain group of public relations by law. *Second*, informal practices may result from  
329 inadequate institutionalization of public forms of public administration, their discrepancy with established  
330 society types, models of public-authoritative interaction. *Third*, shadow practices may arise as society's  
331 response to the inefficiency of the legal public institutions of authority. *Fourth*, the development of the latter  
332 stimulates the weakness of formal institutions, the growing of costs of regulatory orientation for professional  
333 work of civil servants involved in the solution of complex problems. Furthermore, the processes of informal and  
334 shadow forms of power interaction is affected by the weakness of civil society institutions, which manifests  
335 itself as a low level of civic engagement, undeveloped forms of social control over the functioning of the state  
336 machinery, and the inability (because of legal and institutional - the objective reasons, or because of subjective  
337 one - the lack of proper skills, traditions, political participation, etc.) of public institutions and structures to  
338 participate in decision-making significant managerial, in strategic national programs and in projects in  
339 monitoring the implementation of the latter at various stages of their implementation.  
340

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# Introduction to the Theory of Economic Dysfunction

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## Abstract

The methodological article considers the theoretical and practical aspects of the formation of economic dysfunction in the process of economy's reforming. This article attempts to classify the factors of dysfunctions in detail of basic directions to overcome dysfunctions in economic development. Theory of economic dysfunction is based on the achievements of sociology, biology, physics, chemistry, and is being the result of interdisciplinary research. Consideration of economic dysfunction allows to elaborate the concept of economic development policies and strategies in certain areas of the national economy.

**Keywords:** economic dysfunction, economic development, institution, public-private partnership

## 1. Introduction

Sustainable functioning of any system requires clear interconnection and interdependence of all its elements, aimed to achieve the set goals, whether in economics, biology or other fields. However the notion "system" itself should not be reduced only to its structural elements. It is also a set of relations between these units, which seems fundamental in assessing the system functioning, especially in the long turn. The economic system is an open dynamic system; it implies the existence of institutes and mechanisms which constantly maintain its stability [Silvestrov, 2007]. Aspiration to maintain a sustainable equilibrium state is a characteristic and a common feature organically inherent in all systems, including economic ones.

The concept of "social institute dysfunction" was introduced by H. Spencer (Herbert Spencer (1820-1903) – English sociologist and philosopher. (Sociology as a subject of study. SPb. 1836. Fundamental Basics. SPb. 1897. and ect.)) to sociology as a science of society evolution laws. He considered this concept to reflect a condition when an appropriate institute brings harm instead of benefit to the society. According to H. Spencer dysfunctions occur when there is a redistribution of functions between the newly created and already functioning institutes, under any attempt of an institute to monopolize functions, when some institutes do not comply with social need. Social institution activity is considered functional if it contributes to the stability maintenance and social integration. It can be considered as dysfunctional, if it aims at destruction rather than preservation. Increase of dysfunctions in social institutes activities leads to social disorganization of the society [Zeldner, 2013].

R.King Merton the Nobel Prize in Economics winner was also a follower of biological approach to social life. "In any given case the behavior of an object can have both functional and dysfunctional consequences, leading to a difficult and important issue of criteria development for assessing the clear equilibrium of a complex of consequences. "Functions are observed consequences that facilitate the adaptation of a system; and dysfunction reduce the system adaptation or adjustment" [Merton, 1949]. In fact, the system adaptation to external influences reduces.

## 2. Methodology

The system becomes imbalanced when it deviates temporarily, as a result of random fluctuations, from the norms of its own norms, its own equilibrium in a broad sense. If natural disasters can be estimated as random phenomena affecting

all the global systems, the normal functioning of an economic system is seriously influenced by a set of factors, including subjective ones. Consequences arising from subjective intervention in economic processes, depending on the level of expertise of the subjects making crucial decisions without consulting the wider scientific community and the civil society institutions, lead to the accumulation of destructive trends in socio-economic development - economic dysfunctions. The system disturbance proceeds gradually due to actions of divergent interests, which eventually leads to its misalignment. System loses control and under the Ashby law "uncontrolled parts of any system fall off from it". This is a consequence of differentiated approach to the ways of ultimate goal achievement. By focusing on one object the other one disappears out of sight. If it is a high level of decision-making, there appears a system failure, abnormal functioning, structure distortion - destruction leading to the system misalignment or, in biological terms, to its dysfunction.

It should be said that application of biological terms in social processes can be explained by the fact that in the late XIX - early XX century a new trend emerged and actively functioned in sociology - "social Darwinism". Adepts of this trend explained all social processes on the basis of biological nature of man. In fact, all the laws of human society development were reduced to the laws of biological evolution. In his organic theory of society H. Spencer compared society to a biological organism and stemming from this he believed that social life tends to equilibrium and harmony of class interests which sparked criticism of active Marxist disciples. As the founder of the organic school in sociology H. Spencer interpreted the society class structure and the emergence of various institutions within it through analogy with living organisms, which are characterized by functions division among organs. However, he considered that the basic law of social development is the law of survival of the fittest societies [Merton, 1949].

Famous Le Châtelier principle, saying that a system undergoing external influences tends to return to its original state, helps to understand the impact of dysfunction on the system as an obstacle to the restoration of the system's initial state. From the evolutionary standpoint dysfunction prevents the economic system reform, as the system ability to recover is blocked [Hillman, 2003].

System misbalance means the appearance of activity results opposite to its intended functional purpose. In his book "Social Theory and Social Structure" (1957) R. Merton outlined three types of possible consequences of the system state under functional prerequisites violation: favorable, neutral and unfavorable, i.e. dysfunctional. According to R. Merton, the study of each factor affecting differently on the system needs to establish a "net balance of functional consequences," taking into account not only the favorable and neutral, but also the unfavorable outcomes.

It should be noted that modern foreign economists and sociologists seldom use biological terminology. The phrase "dysfunctional institutes" in relation to economics was used by Joseph Stiglitz, but only in the name of sub-section. In his lecture on the Nobel Prize in Economics receipt, considering the relationship of the state, the market and the "non-market" institutes, Joseph Stiglitz emphasized that, when theoretical understanding of the markets with imperfect information ineffectiveness increased, there have been several arguments against government intervention in the market [Stiglitz, 2002]. However, the analysis showed that the incentives and constraints related to the state operation are different from those operating in the private sector. Therefore, even when the state confronts the same information constraints as the private sector, welfare can be increased. Based on the conducted analysis the conclusion of the speech was that market mechanism may be proved effective only under very certain circumstances. Therefore, it is possible to avoid dysfunctions in the sustainable economic system development through combination of state, market and non-market institutions [Porter and Kramer, 2006; Sachs, 2011; Mulgan, 2008; Barber, 2008]. Hence the so-called market failures and failures of the state are reduced to the issue of combining the existing basic conditions for economic system suitability maintenance.

Among modern Russian economists biological terminology in social processes is limitedly used [Bulyga, 2014; Vorozheykina, 2014]. Dysfunction in the form of reducing economic development rates and living standards happens due to errors in reforms, shock privatization and price liberalization, failures in structural changes of the economy, underestimation of scientific and technical progress and etc.

In general, it should be emphasized that the basis of all dysfunctions are the mistakes made in the choice of development model, in the current system of governance and its impact on the managed object [Krisnawati *et al.*, 2014; Bulyga, 2014; Osipov, 2013], in insufficient professional skills of social and economic processes governance. Given that Russia has not yet chosen the development model, economic dysfunction may increase constantly.

Any dynamic economic system along with the positive results achievement includes inevitable negative costs [Olson, 2000; North *et al.*, 2009]. At different stages of system operation it is noted as a rejection of various social norms, imperfection of institutes, corruption growth and etc.

### 3. Results

We must distinguish corruption and state capture, differences between which are essential depending on economic dysfunction [Bhalla, 2001; Winston, 2006; Rice and Cooper, 2010]. Corruption is more likely the result of economic dysfunction. For example, if an official believes that the fulfillment of a public service costs more than the government plans to spend on its execution, there appears a wish to reward oneself for work. A false illusion of justice arises. From the common sense view point it is perfectly understandable that the government contracts conclusion for large sums of money causes a feeling of injustice, as the state official believes that business receives a contract "from the hands of an official", which means that the official should be remunerated. From the legal point of view it is corruption, but from the psychological point of view it is justice. This dilemma displays that the system of contract distribution includes economic dysfunction which generates unfavorable market-distorting consequences. Researchers N. Parison and N. Manning draw a line between the terms "state capture" and "administrative corruption". By the "state capture" they mean the actions of individuals, groups or companies both in the public and private sector aimed at influencing the formation of laws and regulations, decrees and other public policy for their own benefit. It is the result of illegal transfer of private benefits to public officials or the benefits concentration in the hands of the latter. By "administrative corruption" they mean the intentional introduction of distortion in the established order of existing laws, rules and regulations implementation, in order to provide benefits for the state or non-state actors after illegal transfer or diversion of private funds to public officials [Manning and Parison, 2003].

These deviations can be both a consequence of "trial and error development scheme", of so-called growth pains and of mistakes made by top-managers. Managerial errors in strategic development lead to social needs dissatisfaction, and as a consequence, to increase of social problems. If constructive solution is delayed the social role of the market begins to change in the society. There appears a market of paid services in all spheres, official corruption, shadow economy, lobby of abridged decisions and laws, abuse of monopoly power. Such transformation of the market social role and its impact on social development and consciousness is called dysfunctional market. Within these markets pure redistribution of wealth is performed, or certain benefits creation occurs with extremely high social and economic costs, which leads to economic stagnation rather than development. However the existence of dysfunctional markets has one positive side - they contribute to social stability, as each of these markets is based on a certain social consensus (social contract) between influential social groups. They reduce social discontent and create niches for certain social groups.

It should be noted that this "positive side" turns into control system and consolidation of oligarchy and bureaucracy. In the course of this change competitive conditions decline and, as a consequence, living standards decreases, all ethical norms are violated, development of small and medium-sized business and establishment of civil society institutes is inhibited. Quoting R. Merton "tensions accumulated in the social structure as a result of dysfunction ... will eventually lead to the institutional collapse and profound social changes" [Merton, 1949].

From the evolutionary theory standpoint dysfunctional tendencies are a characteristic of the development process. It is important to minimize the time period between dysfunction detection and solution of the imbalance in the system. Reduction of the dysfunction effects lies in timely analysis of economic system causal mismatch.

These deviations can be as a consequence of errors "development scheme trial and error", the so-called age-related errors growth and mistakes made by managers of the upper level.

### 4. Discussions

Global economic dysfunctions may be generally classified into the following main blocks:

4.1. Underestimation of the role of the state as an institute that defines the global strategy and tactics for the reformed economy. During the transition from command economy to market relations everything that was associated with the Marxist concept of economic theory was rejected. However, the policy cannot be primer to economics. Given the spontaneity of the market economy "invisible hand", state political decisions and laws are necessary to manage it. This means that in the transition the state role increases and transforms into creation of institutional environment or institutional framework. It is important that with weak civil society institutions political leadership of the state would unite well prepared people in terms of moral and professionalism. It is good, when this political set is in the hands of sensible people. If not, then the "economy" change in isolation from all other social spheres, from the society culture leads only to complete disorganization and chaos, thereby undermining the fundamentals of the "economic" life itself. It is the background for all the long-term economic dysfunctions.

It should be recalled that the decline of Russian economy as a result of shock therapy was so deep that the main macroeconomic indicators have not yet reached the level of 1990s when the 2008 crisis happened. The majority of

165 industries faced production simplification and suppression of high added value industries. Then the crisis followed, with  
166 the lag in innovation, refocusing on raw-material model of development and a constant declaration of the need to achieve  
167 the developed countries' horizon in terms of living standards.

168 Unfortunately, Russia failed to avoid serious social and economic consequences in the process of market relations  
169 formation, which are beginning to affect more and more the country development pace. However, with perseverance  
170 worthy of another application, the dogmas of market fundamentalism and the Washington Consensus are being imposed  
171 in Russia, despite their well visible consequences In his book "Freefall: Free Markets and the Sinking of the Global  
172 Economy" Stiglitz wrote: "We have created a society where materialism suppresses moral principles, where economic  
173 growth is not environmentally and socially sustainable, where we do not act as a community united by common goals,  
174 because of animal individualism and market fundamentalism that undermine any sense of solidarity, lead to rampant  
175 exploitation of vulnerable people and increase of social division" [Stiglitz, 2002].

176 The market role in the country development, the "invisible hand" of which was so hoped for by the Russian  
177 reformers, is strongly differentiated depending on the socio-economic level of the country. This leads to differentiation in  
178 approaches to defining the role of market and state. It should be also considered that the market applies modern financial  
179 institutions and corporate law. But according to Jeffrey Sachs it does not allow the modern system of market relations to  
180 provide "three main objectives - efficiency, equity and sustainability. Market system should be supplemented by public  
181 institutes, able to solve these problems. These institutes provide public goods (such as infrastructure), support scientific  
182 research and regulate the market. They provide fundamental justice of income distribution, and provide long-term  
183 assistance to enable the poor to escape poverty. They also contribute to the conservation of non-renewable resources for  
184 future generations" [Sachs, 2011]. Therein lays the solution to the problem of economic dysfunction – failures of the state.

185 4.2. Serious omission of Russian reformers was the underestimation of society interests and weak attempts to  
186 create civil society institutes. The account of the interests of society, not just the state, was considered by F.A. von  
187 Hayek. He noticed "... The conception of a constitution thus became closely connected with the conception of  
188 representative government, in which the powers of the representative body were strictly circumscribed by the document  
189 that conferred upon it particular powers. The formula that all power derives from the people referred not so much to the  
190 recent election of representatives as to the fact that the people, organized as a constitution-making body, had the  
191 exclusive right to determine the powers of the representative legislature" [Hayek, 1978].

192 One representative body sets "the rules of the game", the other produces hierarchy of priorities and social policies.  
193 The main thing is that the executive authority shall behave solely as a non-profit organization whose mission is to  
194 implement public interests. In this sense, government agencies are subject of the market. With regard to establishment of  
195 "the rules of the game", it is the domain of the legislative power, which cannot be subject of the market.

196 It should be agreed upon that the legislative power establishing the rules of the game, cannot act as a subject of  
197 market relations. But the fact that the executive power should be presented exclusively as a certain non-profit  
198 organization is problematic. Firstly, the subjects of the Russian Federation are obliged to participate commercial activities  
199 under crisis in order to support infrastructure through development of various forms of public-private partnership.  
200 Secondly, the municipal government with power, but without the necessary budgetary support, have to actively apply their  
201 potential by developing partnerships with small and medium-sized businesses, therefore maintaining social stability.

202 Separation of authorities' powers is a sign of a civilized state, where law has immutable priority, control over state  
203 activities is carried out by various civil society institutes. With this approach, the executive power acts as an equal to  
204 business subject of market relations. Lack of tangible civil society institutes, clear strategy and tactics of the transition  
205 from a command model to a mixed economy has led to a dramatic expansion of state economic dysfunctions.

206 Large business managed to impose its own rules and institutes on legislation and executive power, which are  
207 primarily focusing on the interests of large capital. At the same time not all the opportunities of rational correlation of state  
208 and market components were considered based on a mixed economy and development of public-private partnership.

209 Chinese experience of economic system transformation showed as gradual economic reform has created the basis  
210 for the formation of mixed economy with a Chinese character. In the process of reforms China managed to implement  
211 what is only constantly talked about in Russia - the economy restructuring by focusing on industrial policy. Combining  
212 high level of development of light industry, food industry and other non-extractive industries China managed to maintain  
213 positive GDP growth even during the systemic crisis (2008-2009).

214 The UN report "World economic and social review. Retooling Global Development" emphasizes that "... the market  
215 without a strong state leads to the replacement of irresponsible state power by unregulated private enrichment, leading to  
216 economic and social decline" [World Economic Outlook Supporting Studies IMF, 2000].

217 4.3. Economic dysfunctions in Russia were laid in parallel with the reforms during the transition from planned to  
218 market system. Weak understanding of the market relations nature by the majority of the population allowed to

219 manipulate their consciousness, to impose the idea of market system, which would automatically provide social and  
220 economic sustainability. As the subsequent experience of the Russian economy showed, the spontaneous transition to  
221 the market was primarily intended solely for diminishing the planned state system, and no goals of economy restructuring  
222 and modernization, aimed at improving the quality of life were set.

223 Rapid redistribution of large property, allegedly an important obstacle to the planned economy restoration, allowed  
224 to concentrate substantial money assets in the hands of people close to the high-ups, but political risks in the period were  
225 rather enough and no one wanted to lose the assets. The property resale began, together with export of capital and  
226 finding ways of its rapid turnover, and this is by no means modernization, construction of new plants, but rather import,  
227 trade, catering.

228 Such reform was accompanied by the emergence of speculative financial sector, preferring quick cash flow and  
229 their minor use for investments in the real sector. This applied both to private capital and partially redundant public funds  
230 stocked in bonds, loans, etc. Focusing on quick profits with the absence of social brakes and appropriate level of culture  
231 stimulates capital outflow from the production sector into various financial speculative instruments. As a result, absence  
232 of long-term economic policy approach is becoming normal. Spontaneous economic reform without a clear development  
233 strategy could not but provide long-term economic disruption and destabilization of the Russian economy.

234 4.4. A serious strategic failure with far-reaching dysfunctional consequences for Russia has become the loss of  
235 rate and quality of scientific and technical progress, cuts of funding and amount of researchers, transition to purchasing  
236 foreign technology and end-stage products. In a stable market economy operating with the development of scientific and  
237 technological progress the role and significance of the main production factors is changing. And unlike Russia the  
238 contribution of developed countries to the progress of science, modernization of economy is constantly increasing. It roots  
239 prolonged dysfunctional social and economic trends in Russia for decades ahead.

240 The study of economic growth conditions and factors of for a significant period of time in developed market  
241 economies showed that traditional factors such as capital and labor, provided only 12% of economic growth in 1909-  
242 1949, according to R. Solow. The major part of growth was predominated by such a complex factor as technological  
243 progress. But technological progress requires significant investments, both private and public. Such factors of economic  
244 growth, as the impact of education and technological innovation, provide labor productivity growth. But it requires  
245 substantial incentives encouraging market entities to adopt new technologies. These incentives, according to neo-  
246 institutionalists, are coming to the forefront and encouraging productive activities. And that, ultimately, determines "the  
247 rules of the game" in society during institutions and mechanisms creation. Incentives from scientific and technological  
248 progress promotion in Russia under insufficient funding for innovation and absence of real competition work poorly. It is a  
249 consequence of the lack of managerial competence, willpower and national pride, which leads to long-term dysfunctional  
250 social and economic consequences.

251 Losing pace of technological development in the context of global coverage of innovation, technology and other  
252 goods world market by transnational corporations leads to the corresponding coordinated tactics of TNCs, allowing to  
253 place goods production and assembly plants in countries with lower costs and to sell with maximum efficiency. Cost  
254 minimization and profit maximization allows TNCs to allocate significant resources for the development of science,  
255 innovation and the latest technology, and to stay ahead of many developing countries (including Russia) in terms of  
256 scientific and technical achievements. So is the backlog in innovations laid with all the related consequences, assigning  
257 the role for Russia as a raw materials supplier for the developed countries with growing imports of products of mass  
258 consumption.

259 4.5. Among the dysfunctions, having prolonged impact on the economy, is also the lack of real competition in  
260 Russia in the process industries, mostly in the oil and gas industry and a number of other industries (an exception is the  
261 competition of large retail chains). Lack of competition is directly affecting the country innovative development, labor  
262 productivity and production costs. If during the reform a clear course was adopted to create conditions for development of  
263 a coherent chain (competition-innovations-modernization-productivity and labor costs) it would not be said that the  
264 Russian economy is stagnating and is actually on the verge of crisis in terms of the costs dynamics.

265 Rising costs with continuous increase of tariffs and prices of natural monopolies, aging assets and too slow  
266 modernization (including financial restrictions) could not but cause increased costs: the whole economic policy of 1991-  
267 1993 reformers led to this. We cannot agree with the fact that a constant source of imbalance remains the advancing  
268 growth of wages purchase power over labor productivity. Russian salaries and pensions can be mentioned in apologetic  
269 mood. Among the world developed countries without Russian natural resources, the country's population (not counting  
270 officials and managers of large companies) is in the end of the list in terms of income.

271  
272

## 5. Conclusion

Prominent German economist and statesman L. Erhard believed that "prosperity for all" and "prosperity through competition" are inextricably linked. One is the goal, the other – the path leading to it. Competitiveness of the economy provides a constantly flowing innovation and modernization process, ensuring labor productivity growth. Innovations are the central factor in labor productivity increase, without which competitive economy cannot exist. That's why the most important criterion of innovation efficiency is the extent to which innovation increases the competitiveness of industry or economy in general. Ensuring free competition is one of the most important tasks of the state based on free social order. It is no exaggeration to say that a law prohibiting cartels would have been the most necessary economic constitution. If the state loses in this area – it will soon be the end of social market economy. "The state should intervene in the market only to the required extent needed to maintain the competition mechanism operation or to control the markets where the conditions for free competition are not feasible ... if economic monopoly are formed, they should be abolished, and to do so they must be subject to state supervision"[Erhard, 1957].

Full-scale monopolization of the Russian economy and the lack of real competition leads to a constant price growth for products and services of natural monopolies and state corporations. Further on this flywheel spins the rising costs and, as a result, prices in the production of consumer goods, with the people being in the end of the chain facing inflation costs and increase of retail prices.

World's leading companies are forces to active modernization and innovation by competition for the consumer and, as a consequence, for profit. In Russia competition is substituted by monopoly collusion, tolerance of authorities and weak penalties. Consequently, it is the state, its ability to create a competitive climate, that is in charge of solving the issue of attracting private investment in innovation activities.

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## Controversies of Corruption

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### Abstract

Corruption is widely conceived as producing negative effects for the society. However, there are still many controversial issues surrounding this phenomenon which may be seen critically. Some consider them the "positive" aspect of corruption. What can constitute corruption in public sector cannot be seen as such in the private sector. Research shows that corruption may not be as harmful for the society in certain stages of development. And yet financial instrument thought to stimulate the economy of a developing country may have adverse effect. Foreign aid has proved a vivid example. This research aims to broaden the prospect of a critical analysis of the role of corruption in society. To do that, this research will see corruption in the context of three sectors, the economy, public investments and foreign aid.

**Keywords:** corruption, developing countries, foreign aid.

*"Indeed corruption is not a taboo topic, but one that policy makers, businesses, civil society organizations, media and donors from all regions are confronting openly"*

### 1. Introduction

Corruption is perceived as one of the main factors rooting the economy worldwide. It has become a problem even in developed countries ( Jolly 2014). The study of corruption got attention of the researchers after the cold war. It was especially on the focus of the international organisations such World Bank in relation to the developing countries. The literature suggests that consequences of corruption are pervasive for the economy of the welfare of poor countries. Corruption's effects are both economic and political. Corruption may increases poverty, erodes public confidence in government, provokes political scandals, hinders private investments and likely to keep the society undeveloped in a prolonged stagnation. Corruption is widely conceived as producing negative effects for the society. However, there are still many controversial issues surrounding this phenomenon which may be seen critically. Some consider them the "positive" aspect of corruption. What can constitute corruption in public sector cannot be seen as such in the private sector. Research shows that corruption may not be as harmful for the society in certain stages of development. And yet financial instrument thought to stimulate the economy of a developing country may have adverse effect. Foreign aid has proved a vivid example. This research aims to broaden the prospect of a critical analysis of the role of corruption in society. To do that, this research will see corruption in the context of three sectors, the economy, public investments and foreign aid.

In the first part, the paper begins with the purpose of the institution (i.e. public or private) in determining whether a motive is ethically justified. The position of parties in a transaction which may involve corruption is crucial for perceiving that action as corrupt or not. In the second part, the research shows that the developing stage of the society should be considered very carefully before defining corruption as a malicious phenomenon. In the last part we move to the opposite side of the argument. We show that while corruption may have some "external" effects, there may be positive financial instruments for the development which may have an adverse effect if the process is corrupted. We take foreign aid as an example.

### 2. The Concept of Corruption in Public and Private Sector

According to Oxford Dictionary<sup>1</sup> corruption is defined as: "Perversion or destruction of integrity in the discharge of public duties by bribery or favor; the use or existence of corrupt practices, esp. in a state, public corporation, etc". Or 'the love of

1 Oxford Dictionary Online, Retrieved January 20, 2011, from [http://dictionary.oed.com/cgi/entry/50050860?single=1&query\\_type=word&queryword=corruption&first=1&max\\_to\\_show=10](http://dictionary.oed.com/cgi/entry/50050860?single=1&query_type=word&queryword=corruption&first=1&max_to_show=10).



54 money is corruption of state' (Benjamin 1875). In other words corruption is regarded as a misuse of public trust, a  
55 situation which public officials use as a 'golden' opportunity to maximize their private income. It is also considered as a  
56 breach of official duty. Bureaucrats take advantage of their public position and put control on public goods.

57 Corruption may be defined differently when it comes to private sector. The concept of 'respecting' someone in a  
58 business relation is likely to be approached differently in a public service engagement. Whereas in the private sector a gift  
59 might be appreciated and hardly prejudiced, gift-giving in public administration may question the intention of gift-giver  
60 whether he is 'fishing' a favor from public service or his gift is given solely as a sign of respect. If the owner of a private  
61 enterprise helps his friend who manages another company by offering a subcontract to him, this favor can be defined as  
62 unjust favor if the same happens to a state agency.

63 Public administration is not driven by the same market concept. In a free market economy, government uses  
64 bureaucracy as an element supposedly to institutionalize public services thus making them legal. Therefore, what a  
65 private company pays to a public servant to smooth the procedures this is called a "facility payment". In public  
66 administration this is likely to be confined as bribery or kickoff (Ackerman 1999, p. 91). The concept of corruption is not  
67 uniform and this depends on the relation between private and public institutions. Both parties have different intentions and  
68 so is their perception on the transaction that may involve some sort of corruption. For instance, where the concept of  
69 favor exchanges sounds reasonable to a private business, this is not the case with public institutions. In other words what  
70 is approached as corrupt action by state institutions this may not be perceived similarly by a private business. The form of  
71 corrupted relations between private and state agencies is a significant indicator of the status of corruption in a society.  
72 Whether it is a bottom up corruption, meaning that private business 'coerce' to corruption, or a top down way, where the  
73 driving force for corruption are state agencies, this differs in different societies. In this regard defining corruption requires  
74 first, to establish what are the parties involved and their intentions and then classify actions as corrupted or not.

### 75 76 **3. Corruption Effects on the Society**

77  
78 Majority of the analysts stipulate that the effects of corruption on a society are destructive. They go even further noting  
79 that corruption may be as deadly as HIV/Aids virus (Bono 2006). However, in this section, the research intends to bring  
80 another view on the way corruption should be approached.

### 81 82 **4. Detrimental Effects of Corruption to Economic Growth**

83  
84 Corruption hampers the free market. Government is in charge for collecting and distributing of tax revenues of the state,  
85 bearing the responsibility to administrate them properly. Allocation of these funds is in the discretion of public officials. A  
86 corrupt public administration diverts public funds to private business which is willing to "purchase" the access to them in  
87 exchange of kickbacks (Ackerman 1999, p 9). Public tenders are a good example. Substantial part of the government  
88 investments goes to infrastructure where private companies bid in open tenders or public procurements. Corrupt public  
89 officials allow illegal payments to determine the winner of these projects. One of the key forms of corrupting the public  
90 bureaucrat is bribes. Ackerman (1999, p 9) shows the negative effects of bribe in the free market.

91 She states that;

92  
93 *First, bribes strike the market which means that government can legalise allocation of scarce benefit to private sector by*  
94 *impeding them from a free competition. In other words, if government is bribed then the market will not be driven by the*  
95 *ratio between the demand and supply but by the best price offered by private parties to public administration for an easy*  
96 *access to public goods. While this is true, however, bribes can create a new "free market" in itself, the market of*  
97 *"bribes". In a sense the concept of the free market does not seem to be challenged here but what it seems troubled is*  
98 *the informality. The formal free market is substituted by an informal "free market". In this context the role of bribe is not*  
99 *that is evading the "free market" conceptually but that it makes relative. It parallels it with an "informal" free market.*  
100 *However, in an "informal" free market there is lack of accountability. The briber cannot accuse the bribed official.*

101  
102 *Second, bribes act as motivation bonuses to public officials. Especially in developing countries where administration*  
103 *employees have low salaries, bribes may slow their incentive to perform public duties correctly for every one and direct*  
104 *their service only to them that offer the bribe. Again while this is also correct there may be something to be considered*  
105 *critically here. In countries with complicated laws or unclear legislation the bribe can help business to minimize the risk*  
106 *of time consuming. And this may help the economy grow.*

107  
108 *Third, bribes lower costs. Private business can switch tax payments, custom duties or other utility bills to bribes if they*  
109 *result to be less expensive than paying regular governmental charges. While this is one negative facet of the bribe,*

another argument to be considered is that paying bribes may compete with paying taxes. And this will make the government change its policies. It may correct the tax system.

Forth, bribes help criminal activities to develop. Illegal business or criminal organisations purchase their 'freedom' by corrupting police forces or other sectors of the state. Again while this is a plausible argument, another one to be considered is that bribe may smooth aggressive forms of undermining the judiciary such as physical and physical harm of judges by criminals.

Earlier academics has contained that corruption constituted an extra-legal instrument which helps bypassing red tape barriers and allowing individuals or groups the admission to decision making process (Leff 1964). Taking the queue-modeling as an example Lui (1985) argues that bribes helps the queue to be rearranged more effectively. Thus, giving people, by purchasing(bribing the queue's manager) a better place in the queue, the chance to move up quicker in the queue setting( Leite and Weidmann 2002, p.162).

Back and Maher (1986) questioned claims on inefficiency of bribe and in defending their statement they compared the outcome of the bribe and competitive bidding in a government purchase arrangement. They find out that there is a fundamental isomorphism between them. The expected value of bribe was equal to expected value of the winning bid and they showed that the same supplier will be more likely to win the contract through both forms of payments. In support to earlier positive approaches there are even modern views loyal to the theory that corruption 'greases the wheels'. This favourable element of corruption works especially in societies with rigid regulations. Yet bribes, according to them, help entrepreneurship to overcome bureaucracy in order to accelerate into the market (Dreher and Gassebner 2007).

In a developing society where politics has to be fused by coherent ideas, where interests and groups are more inclined to be attached to political parties, corruption for Leys (1965) plays the political role of money which is to 'cement' social network relations within the political party or to fasten them. According to Khan (2006) it is not bribe but the 'predation corruption' which is the riskiest form of corruption for developing countries. Predation corruption is the typical scenario of patron-client system. Here public officials use their discretion power to gain in private what is public. It is not forced by any economical obstacle or from the lack of financial resources. It is pure greed and a top down corrupted system from senior state agents to the common public servants.

Many public investments such as highroad, hospitals, airports, enlargements of ports, water pipes lines, just name a few, are very expensive. They are very attractive for public officials to maximise their illicit incomes. Therefore corrupt actions may endanger even advantages identified by the economic experts when it comes to the role of public investment in the economic growth. They say that a strong economy needs capital and capital flow raises as more public investments are made (Tanzi and Davoodi 1998). In this respect a state which has high public investments is deemed to develop its economy quickly. Vito and Hamidi(1998) points out that:

*"Such corruption increases the number of capital projects undertaken and tends to enlarge their size and complexity. The result is that, paradoxically, some public investment can end up reducing country's growth because, even though the share of public investment in gross domestic product (the total of all goods and services produced in a country in a given year) may have risen, the average productivity of that investment has dropped."*

However, even in the most dangerous form of corruption its negative elements may be questioned if other social factors are involved.

## 5. External Effects of Corruption

There is no standing scheme on corruption nor is it clear or unique; it varies from country to country, from culture to culture and from one historical period to another (Huntington and Harrison 2000). There are various opinions about the impact of corruption in society. According to empirical studies some scholars have not seen corruption *per se* as the main factor for distortion of the society. What is significant they say is what the purchased product is in exchange of the payoff. Many economists and political scientists do not consider the small effects of the bribe's amount given to a common public official as significant but what really concerns them most is "the betrayal of ideals". In other words the legacy which corruption installs on the functioning of the society and its impact on ethical and moral norms is the biggest harm (Miller, William, Grodelan and Koshechkina(2001). For instance political corruption can be more danger for open public than a small bribe given to a public employer. Where, the former risks capturing of the state, the latter may have limited effects on the economy as whole.

Nonetheless, bribes can also be seen as having positive roles in the early stages of emerging economies. In many

165 Eastern Asian countries the economic boom could not have been successful without some sort of corruption. J. Edgardo  
166 Campos in his editing volume (Corruption: The Boom and Bust of East Asia, 2001), points out that; "Rents and corruption  
167 have been essential to the credible enforcement of contracts and thus to the large inflows of investment." (Filomeno  
168 2006) In addition, China, Vietnam and India have experienced a steady increase of investments and economic growth in  
169 spite of corruption. In this regard Khan has classified corruption in developing countries from an interesting perspective  
170 (Filomeno 2006, p.5).

171 First, intervention of government in certain processes of economic development has been wrongly perceived as  
172 malicious and as creating an additional possibility for the public sector to accelerate corruption. Instead of market liberalisation  
173 or privatisation, the involvement of the state through rent seeking has been central in order for the governments to  
174 maintain a stable welfare and to control corruption (Filomeno 2006, p.5). As the result Asian countries for instance yielded  
175 successful results especially in the technology implementation policy.

176 Second, corruption is not always a derivative of greed and inappropriate use of power by public servants. Fiscal  
177 constraints like trade protection or custom policies for supporting indigenous agriculture, are an important factor to enhance  
178 and develop the economy. If the economy is stable so is the political system. However, while in developed countries  
179 salaries are high and unemployment rate is low, emerging economies, however face off-budgets and jobs shortage. In  
180 this regard the risk of patron-client relationship is high. Here public servants obey to their 'patron' and the latter in exchange  
181 turns a blind eye for the pay offs to the former by privates as compensations for low salaries. Therefore, it can be  
182 assumed that probably the stage of development and economic factors may condition the government to tolerate petty  
183 bribes in order to maintain political stability.

184 Third, scarce protection of property rights is also another symptom of corruption in developing countries. However,  
185 as above mentioned, economic power is again the core reason. Khan underlines that the cost applied for an immediate  
186 reform to property rights protection can affect the economy and disrupt the system as the productivity is low and unable to  
187 cover the costs of property rights' protection. Filomeno (2006, p.5) points out that;

188 *"...as the examples again of China or Vietnam show<sup>2</sup>, informal institutional arrangements, including innovative incentive*  
189 *mechanisms, can substitute for the lack of formal property rights, with satisfactory outcomes to both the individual and*  
190 *the collective."*

191  
192  
193 In this context, corruption may facilitate economic enhancement in early stages of the democracy in an emerging  
194 economy<sup>3</sup>. Many developing countries like China and India, known for their extensive corruption, yet are not struggling  
195 with their permanent economic growth. This is an important indicator showing that probably corruption has some external  
196 effects. In other words, studying corruption may be more accurate if other social factors like political system, democracy  
197 maturity, history and culture are to be taken into account.

## 198 6. Corruption in Development Assistance

199  
200 We argued that in analysing a factor which harms the economy of a society such as corruption someone should look at  
201 the political and social context. Not every unfair perceived form of enrichment is always harmful. In contrary not every  
202 good perceived financial tool is always helpful. Development assistance is playing a crucial role in assisting developing  
203 countries to enhance their socio-economic process. Development assistance differs in motives, actors and budgets  
204 (Tisch and Wallace 1994). It generally transfers large amounts of capitals from donors to recipients in terms of goods and  
205 foreign exchanges. National governments have the advantage of being directly involved in the management of these  
206 projects and this discretion may lead them to misuse foreign aid. The question arises what is the relation between foreign  
207 aid and corruption?

208  
209 Foreign aid can help corrupt regimes to retain their power and control. Since foreign aid goes from one government to  
210 another, notes Di Lorenzo (2005), 'it inevitably diverts resources from the activity of production to the activity of "rent

<sup>2</sup> World Bank. (2006). *Annual Review of Development Effectiveness*, (p. .xii). Washington D.C.

<sup>3</sup> Democracy is defined as 'Government by the people; that form of government in which the sovereign power resides in the people as a whole; or A state or community in which the government is vested in the people as a whole (Oxford Dictionary Online). Or 'The democracy is a system of governance, but which is free is an individual. An individual is free not just because the system of government is democratic but because none of other organizations of society can fiercely restrict that individual.' (Weaver H. James 1996). See also that democracy is openness. (Wintraub Sidney 1991). This includes economic and political openness.

211 seeking" or attempts to acquire governmental funds'. He further continues that 'it creates a giant patronage machine, in  
212 other words, with all the attendant corruption that such things have always entailed.' Hence corruption remains a great  
213 concern in developing projects. The reason is that national government has limited budget and low salary for their  
214 employers. As development projects involve tenders, procurement and administrative procedures, public officers find  
215 difficult to resist the temptation of bribes which usually is equal or more to their annual salaries. In this respect instead of  
216 allocating the aid to development projects, public workers use them for their unjust enrichment. Looking to vulnerability of  
217 the foreign aid to corruption, many people have questioned the way foreign aid is organised. Mark Thornton (2002) points  
218 out that:

219  
220 *"Alas, Americans are united in their opposition to foreign aid—and with good reason! Foreign aid, military aid, debt*  
221 *relief, economic development assistance, and even disaster assistance money—all with "strings attached" to ensure*  
222 *proper behavior—are associated with "fraud, waste, and abuse."*  
223

224 On the other hand, many potential donors argue that occasionally corruption is an instrument used to protect their  
225 business in developing countries (Thornton 2002). E.g. in 1994, French companies estimated to have paid bribes  
226 amounting to FF 10 billion and German companies more than \$3 billion per year in 1996 (ibid). Yet many donors  
227 condition the aid by requesting recipients to fulfil various criteria such as enhancing of democratic values<sup>4</sup> and strengthen  
228 public institutions<sup>5</sup> aimed at increasing transparency, accountability and reduction of corruption. Donors assert that weak  
229 governments are unable to manage and enforce anti-corruption reforms. Can aid directed at strengthening of state  
230 institutions be at risk in a fragile democracy? Providing foreign aid to empower state institutions in the main stream  
231 economy may endanger private sector's position as former can extend the power through regulation or enforcement  
232 agencies to control the market. This controversial disadvantage of foreign aid is explained by Saxton (1999) who points  
233 out that:

234  
235 *"Literature dealing with foreign economic aid recognizes that government-to-government foreign economic assistance*  
236 *often can (inadvertently) promote those conditions that foster corruption. This is especially the case when a significant*  
237 *degree of corruption is already present in recipient countries."*  
238

239 The 'foreign aid fear' of Saxton is based on the Tanzy's hypothesis arguing that extended power of government in  
240 economy may lead to corruption. The 'extend power' usually refers to increase of taxation, raise of public spending and  
241 extension of regulation on part of the government. Thus, Tanzi claims that the above areas where corruption is mostly  
242 present can gradually become norm of behavior especially in countries with no democratic traditions. The government  
243 may have a different perception of enforcing the rule of law. They can presume that corruption can be reduced by limiting  
244 of public spending including salaries to officials based on assumption that public workers take bribes (routine perception),  
245 rather than punishing them (rule of law perception) (Tanzi 1998, p.6). In this context, the role of foreign aid in reducing  
246 corruption remains questionable. Evidences gathered by Alesina and Weder (2002) showed that corrupt governments  
247 don't appear to get less aid. In contrary boost of aid in developing countries was accompanied by raise of corruption.  
248 Alesina and Weder (2002, p.1130) point out that:

249  
250 *"The variable "changes in aid has a negative and statistically significant coefficient, indicating that an increase in aid is*  
251 *associated with an increase in corruption and vice versa in that corruption appears to be persistent, since the log*  
252 *dependent variable is highly significant."*  
253

254 In short foreign assistance can play a crucial role in improvement of socio-economical factors of a developing  
255 country. However it should also be mentioned that developing aid can stimulate corruption or strengthen corrupt political  
256 regimes. According to Alesina and Weder (2002) the ratio between foreign assistance and corruption stands positive  
257 meaning that increase of aid has been associated permanently with the raise of corruption.  
258

## 259 7. Conclusion

260  
261 Corruption is entrenched in the economy worldwide and is more evident in developing countries. Approaching corruption  
262 and its consequences to the society may entail various factors in order to sort out phases where corruption is likely to

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<sup>4</sup>USAID. *Final Report. EFFECTS OF U.S. FOREIGN ASSISTANCE ON DEMOCRACY BUILDING* form [http://blackboard.gwu.edu/webapps/portal/frameset.jsp?tab=courses&url=/bin/common/course.pl?course\\_id=\\_101218\\_1](http://blackboard.gwu.edu/webapps/portal/frameset.jsp?tab=courses&url=/bin/common/course.pl?course_id=_101218_1)

<sup>5</sup> World Bank (2000, November). *Reforming Public Institutions and Strengthening Governance*, (pp. xi-xx) Washington, DC; World Bank

263 hamper the development and phases where it may not. Thus the role of corruption in the society is controversial.  
264 Corruption may distort the free market or make public investment inefficient to increase economic growth. On the other  
265 hand, corruption may facilitate development in emerging economies in early stages of democracy. In order to have a  
266 clear picture of corruption's role in the society one may consider social factors like political system, maturity of  
267 democracy, history, economy and so forth. Studies of anti-corruption policies may be enriched if a more nuanced  
268 approach about the role of corruption on certain stages of the society's development will be considered.

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# Entrepreneurial Orientation and Performance of Nigerian Banks: The Mediating Effect of Teamwork

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## Abstract

Business environment has become highly competitive, dynamic, and heterogenic. As a result, business organizations are expected to be entrepreneurially inclined. Also, for corporate entrepreneurial activities to have greater impact on organizational performance, organizational members (employees) must work collaboratively as a team. It is against this background that this study investigated the relationship between entrepreneurial orientation and performance of commercial banks in Nigeria and the mediating effect of teamwork on the relationship. Data were collected from 297 bank managers through a self reported questionnaire. SmartPLS-SEM was used to analyse the data collected and test the hypotheses formulated. The results of the structural model indicated a positive and significant relationship between entrepreneurial orientation and performance. Further evaluation of the structural model showed that teamwork fully mediated the relationship between entrepreneurial orientation and organizational performance. Based on the findings, it was concluded that while entrepreneurial orientation may be positively related to organizational performance, its impact on organizational performance will be greater if employees work collaboratively as a team.

**Keywords:** EO-performance relationship; entrepreneurial orientation; Nigerian banks; organizational performance; teamwork.

## 1. Introduction

The general field of entrepreneurship has been remarkably researched over the years. This might be because of the importance of entrepreneurship. Entrepreneurship plays a key role in nation building. Extant literature acknowledges entrepreneurship as the driving force that propels economic growth and development, and also creates job opportunities. Entrepreneurial activities are described as catalysts that speed up economic growth and development of an economy (Antoncic & Hisrich, 2004; Kuratko, 2009). Similarly, entrepreneurial behaviours or activities are important to individuals as well as organizations for wealth creation and expansion.

Entrepreneurial activities contribute to the continued existence and growth of business organizations. Entrepreneurship is acknowledged as a key and distinguishing feature of successful business organizations today. Entrepreneurship scholars have posited that corporate entrepreneurial behaviour is needed for achieving increased profitability, higher market share, strategic renewals, innovativeness, and for achieving a sustainable competitive edge over competitors (Hornsby 2004). Business organizations need to display consistently creative and innovative behaviours for them to grow and succeed. In the light of resource-based view (RBV) theory, entrepreneurial orientation is regarded as an intangible organizational resource that gives an organization a competitive advantage, which, in turn, contributes to superior performance (Barney, 1991).

In this twenty-first century where business organizations compete globally, there is a need for them to behave entrepreneurially in order to flourish and have a competitive advantage over competitors in the ever-dynamic and highly competitive business environments (Kuratko, Morris, & Covin, 2011; Kuratko, 2009). Generally, business environments have become highly hostile, unpredictable, and heterogenic (Kuratko, Ireland, & Hornsby, 2004); it poses a lot of challenges to business organizations and managers. The business environments have become even more challenging

57 considering the developments in the technological world today, particularly advancements in ICT. Advancements in  
58 technology have expanded the scope of competition among business organizations beyond their immediate territories. In  
59 order to cope with these challenges, business organizations need to become entrepreneurial and innovative in their  
60 activities, processes, and practices. Thus, it is either they behave entrepreneurially or they become outmoded (Kuratko,  
61 2009). Entrepreneurial activities refresh and revitalize existing business organizations (Kuratko et al., 2004).

62 The relationship between entrepreneurial orientation and organizational performance has been studied  
63 considerably. Contrary to the proposition that entrepreneurial activities within existing organizations contribute to  
64 improved organizational performance, extant empirical findings show that the relationship between entrepreneurial  
65 orientation and organizational performance is unclear and inconclusive (Rauch, Wiklund, Lumpkin, & Frese, 2009). Some  
66 researchers confirmed a positive relationship between entrepreneurial orientation and organizational performance (Arief,  
67 Thoyib, Sudiro, & Rohman, 2013; Jia, Wang, Zhao, & Yu, 2014; Karacaoglu, Bayrakdaroglu, & San, 2012; Mahmood &  
68 Wahid, 2012; Mokaya, 2012; Sharma & Dave, 2011; Zhang & Zhang, 2012). Others found a negative entrepreneurial  
69 orientation-performance relationship (Covin, Slevin, & Schultz, 1994; George, Wood JR, & Khan, 2001; Shamsuddin,  
70 Othman, & Shahadan, 2012; Slater & Narver, 2000).

71 Furthermore, some other researchers have argued that entrepreneurial orientation-performance relationship is not  
72 direct but depends on certain organizational and environmental variables like organizational culture, organizational  
73 structure, availability of organizational resources, competitive and dynamic environments, and top management support  
74 (Covin & Slevin, 1991; Kuratko et al., 2004; Lumpkin & Dess, 1996; Mohamad, Ramayah, & Puspowersito, 2011;  
75 Rutherford & Holt, 2007; Wang, 2008; Wiklund & Shepherd, 2005). Still, others have posited that entrepreneurial  
76 orientation needs to be combined with other business orientations such as market orientation, learning orientation, and  
77 employee orientation for organizations to achieve optimum performance (Grinstein, 2008; Idar & Mahmood, 2011; Kwak,  
78 Jaju, Puzakova, & Rocereto, 2013; Wang, 2008). Additionally, it is also argued that high entrepreneurial orientation does  
79 not guarantee continued improvement in organizational performance, especially in emerging economies for lack of  
80 institutional support, organizational formalization, and experienced managers (Tang, Tang, Marino, Zhang, & Li, 2008;  
81 Tang & Tang, 2010).

82 Considering the inconclusiveness and varied arguments about EO-performance relationship as discussed above, it  
83 can therefore be concluded that the relationship between entrepreneurial orientation and organizational performance is  
84 rather complex and needs to be examined by considering all possible related variables or factors that interact with  
85 organizational performance (Rauch et al., 2009). It is on this premise that teamwork is introduced in this study to play a  
86 mediating role in the relationship between entrepreneurial orientation and organizational performance. Contingency  
87 theorists posit that there must be congruence among important variables for an organization to achieve optimum  
88 performance (Lumpkin & Dess, 1996; Rauch et al., 2009). While a lot of past studies have investigated both direct and  
89 indirect relationship between entrepreneurial orientation and organizational performance, there is no specific study, to the  
90 knowledge of the authors that has examined the mediating effect of teamwork on the relationship between  
91 entrepreneurial orientation and organizational performance – a gap this study fills. In this study, we put forward that  
92 entrepreneurial orientation passes through teamwork to affect organizational performance. By this, we mean that the  
93 more employees work cooperatively as a team, the more entrepreneurial an organization behaves. Besides,  
94 entrepreneurial and innovative ideas come from the employees (intrapreneurs), and the more these employees work  
95 together the better for the organization. An organization cannot be entrepreneurial without the employees behaving  
96 entrepreneurially and working collaboratively as a team (Ireland, Kuratko, & Morris, 2006). Thus, we argue that the higher  
97 the team orientation among employees, the higher the entrepreneurial orientation and the more impact entrepreneurial  
98 orientation will have on organizational performance.

99 In view of the inconclusiveness regarding the relationship between entrepreneurial orientation and organizational  
100 performance as highlighted in the preceding paragraphs, the EO-performance relationship needs to be further studied.  
101 Thus, this study was set out to achieve the following objectives:

- 102 1) To determine whether entrepreneurial orientation is significantly related to organizational performance; and
- 103 2) To determine whether teamwork mediates the relationship between entrepreneurial orientation and  
104 organizational performance.

105 In order to achieve these objectives, the remainder of this paper is organized as follows. First, we review related  
106 literature on entrepreneurial orientation, teamwork, and organizational performance. Second, we discuss the methods  
107 adopted in carrying this study. Third, we present data analysis results. And lastly, we discuss the findings of this study  
108 and highlight the implications of the findings.

## 2. Literature Review and Hypotheses Development

### 2.1 Entrepreneurial Orientation (EO) and Organizational Performance

Theoretically and empirically, entrepreneurial orientation is one of the constructs that has received a lot of attention over the years (Rauch et al., 2009). EO is a construct that captures corporate entrepreneurship or organizational-level entrepreneurship of existing organizations (Lumpkin & Dess, 1996). It measures the entrepreneurial behaviour of an organization. Entrepreneurial orientation is a driving force that explains how entrepreneurial an organization behaves (Covin & Wales, 2012). Entrepreneurial orientation is defined as the entrepreneurial behaviours of an organization as reflected in organizational activities, strategies, and processes (Lumpkin & Dess, 1996). Miller (1983) defines entrepreneurial firm as one that takes risks, innovates, and is proactive. EO is also defined as one of the strategic orientations of an organization that describes the extent of entrepreneurial activities that is undertaken by the organization (Covin & Wales, 2012). According to Pearce, Fritz, and Davis (2010), EO is defined as a set of behaviours that have the qualities of risk-taking, innovativeness, proactiveness, autonomy, and competitive aggressiveness (Covin & Wales, 2012). It is also defined as a strategic orientation that an organization uses to adapt to changing business environment and have a sustainable competitive edge over rivals in the marketplace (Karacaoğlu et al., 2012).

Entrepreneurial orientation is conceptualized and operationalized as a unidimensional as well as a multidimensional construct (Covin & Wales, 2012). On the one hand, Miller (1983)/Covin and Slevin (1989) conceptualized and operationalized entrepreneurial orientation as a unidimensional construct with three dimensions: risk-taking, innovativeness, and proactiveness. They argued that the three dimensions covary, which implies that an increase in one dimension leads to an increase in the other dimensions and vice versa. On the other hand, Lumpkin and Dess (1996) added two additional dimensions, namely autonomy and competitive aggressiveness, thereby bringing the dimensions of EO to five. Contrary to the position of Miller/Covin and Slevin that the dimensions of EO covary, Lumpkin and Dess argued that the dimensions of EO do not covary and that no dimension is stronger than the other. They concluded that the dimensions of EO independently vary with organizational performance, depending on how supportive environmental and organizational factors or variables are in their interactions with organizational performance (Covin & Wales, 2012). The five dimensions of EO are briefly explained as follows.

- a) *Innovativeness*: Innovativeness is the number one characteristic of an entrepreneurial organization (Kuratko et al., 2011). It is an act that sees creative ideas through, resulting in new products or processes. Schumpeter refers to innovation as the process of creatively destructing an "old order" in order to create a "new order" as a result of new combinations (Barringer & Bluedorn, 1999; Lumpkin & Dess, 1996). Innovative organizations see things the way others see them but do things differently. It is the ability to translate creative ideas into something concrete, unique, or novel. Innovation could be product-market innovation or technological innovation. Innovation could also be making strategic renewals or improvements to existing products, processes, or systems (Lassen, Gertsen, & Riis, 2006). According to Schumpeter, innovative acts result in new products, markets, processes, sources of raw materials, and organizations (Kuratko, 2009; Lassen et al., 2006).
- b) *Risk-taking*: It is the willingness and readiness to commit resources (own or borrowed) to pursue identified market opportunities that have a reasonable possibility of losses. Risk-taking, as an important feature of entrepreneurship, is not about taking extreme or uncontrollable risks, but it is about taking moderate and calculated risks. Risk-taking and innovativeness are related. This is because innovation involves risk-taking, and the higher an organization innovates, the more risks it takes (Kuratko et al., 2011).
- c) *Proactiveness*: It is concerned with the ability of an organization to identify or anticipate market opportunities and marshal out resources to exploit identified opportunities before other competitors notice the presence of such opportunities. It is about being the first or among the first organizations to spot the presence of market opportunities and exploit them. A proactive organization has the ability to see opportunities where others see none. An organization can be proactive by anticipating potential market needs and taking actions, in the form of delivering quality products, to meet the market needs. According to Miller (1987), proactive firms *act on* rather than *react* to their environments.
- d) *Autonomy*: It is about giving a free hand to employees to explore and exploit identified market opportunities. Since creative and innovative ideas emanate from the people (the employees) (Ireland et al., 2006; Kuratko et al., 2011; Kuratko, 2009), therefore they should be allowed to experiment their creative and innovative ideas and bring them to fruition without being obstructed by the bureaucracies of the organization.
- e) *Competitive aggressiveness*: It refers to different tactics or strategies that an organization uses to compete



165 and outsmart competitors in the marketplace (Lumpkin & Dess, 1996). It entails massive deployment of  
166 resources and vigorously pursuing market opportunities with a view to outshining rivals (Venkatraman, 1989).

167 Theoretically, entrepreneurship scholars have argued that entrepreneurial activities within existing business  
168 organizations are a source of rejuvenation that gives organizations competitive edges over rivals, which, in turn,  
169 contributes to enhanced organizational performance (Kuratko et al., 2004). Also, extant literature acknowledges that  
170 organizational-level entrepreneurship is related to profitability, growth, strategic renewal, market share, wealth creation,  
171 and overall performance (Antoncic & Hisrich, 2004; Kuratko et al., 2004; Mohamad et al., 2011). As stated at the  
172 Introduction section, several empirical studies have examined the impact of entrepreneurial orientation (as a  
173 unidimensional and as a multidimensional construct) on organizational performance. However, available empirical  
174 findings regarding EO-performance relationship are mixed. Some studies found a positive EO-performance relationship  
175 (Arief et al., 2013) while others confirmed a negative EO-performance relationship (Slater & Narver, 2000). Given the  
176 inconclusiveness and divergent arguments about EO-performance relationship, the EO-performance relationship needs  
177 to be further examined. Thus, the following hypothesis is developed.

178 H1 Entrepreneurial orientation is significantly related to organizational performance.

179

## 180 2.2 Teamwork and Organizational Performance

181

182 Synergistically, when people work together as a team the results they will achieve will be greater than the results they  
183 would have achieved if they had worked individually (Loyd, 2005; Xyrichis & Ream, 2008). This is because team  
184 members share their knowledge and skills with one another, thereby resulting in efficient utilization of available resources  
185 and achievement of optimum results (Loyd, 2005). The importance of teamwork is mostly stressed in healthcare systems  
186 (Bitter, van Veen-Berkx, Gooszen, & van Amelsvoort, 2013). It is also important in other organizations, especially  
187 organizations that deal with safety and high-risk environments (Bitter et al., 2013). Teamwork is so important that  
188 organizations are advised to organize around teams (Carlos, 2000). Teamwork is acknowledged as the characteristic of  
189 successful organizations today (Sohmen, 2013). Teamwork refers to behaviours displayed by a group of people working  
190 cooperatively to accomplish common goals (Loyd, 2005). It is the working together of a group of individuals in order to  
191 achieve common goals. Teamwork means that a group of people are working interdependently to accomplish common  
192 goals (Eldon, 2010). It is the ability of a group of individuals to work together to achieve a common vision. In business  
193 organizations, there might be no clearly defined teams; however, an atmosphere for teamwork among employees should  
194 be created, since all organizational members work towards the achievement of common organizational goals. An  
195 atmosphere for teamwork requires a common goal, shared commitment to organizational goals, results-oriented  
196 organizational structure, and collaborative climate.

197 A review of existing literature reveals that there is a dearth of empirical evidence of the positive relationship  
198 between teamwork and organizational performance measures such as profitability, market share, growth, and overall  
199 performance. However, there are evidences of a positive relationship between teamwork and other variables such as  
200 leadership, motivation, empowerment, and workers' productivity (Chen, 2010; Mattick & Miller, 2006; Sewell, 2005;  
201 Sohmen, 2013). By implication, if teamwork is positively related to leadership, motivation, empowerment, and workers'  
202 productivity; and leadership, motivation, and workers' productivity are positively related to organizational performance  
203 measures such as profitability, market share, growth, and overall performance (Elena, 2010; Sokro, 2012; Yang, 2006);  
204 therefore, it can be concluded that teamwork is presumably related to organizational performance. In view of the  
205 significant role teamwork plays in the organization, its relationships with organizational performance and other  
206 organizational variables such as entrepreneurial orientation need to be empirically investigated. Therefore, the following  
207 hypothesis is formulated.

208 H2 Teamwork mediates the relationship between entrepreneurial orientation and organizational performance.

209

## 210 3. Methods

211

### 212 3.1 Sample, data collection, and data analysis

213

214 The sample of this study consisted of commercial banks in Nigeria and bank managers were chosen as key informants  
215 for their respective banks. The commercial banks seem to be firmly rooted and well organized compared to other  
216 categories of banks like the microfinance banks. To collect data for this study, a questionnaire was designed based on  
217 operationalization of latent variables examined. Thereafter, 1,000 copies of the questionnaire were mailed to the  
218 respondents (bank managers). In all, we received 322 questionnaires, accounting for approximately 32% response rate.

219 A 30% response rate from a mailing system of administering questionnaire is acceptable (Sekaran & Bougie, 2013). From  
220 the 322 questionnaires received, 297 usable questionnaires were selected for analysis. SPSS version 19 was used to  
221 test for non-response bias and normality of data. Results showed that there was no threat of non-response bias. Also, the  
222 normality test results showed that the data were normal as the z kurtosis and z skewness values were less than the  
223 recommended threshold of  $\pm 2.58$  (.01 level of significance (Hair, Black, Babin, & Anderson, 2010). SmartPLS-SEM was  
224 used to analyse data and test the hypotheses formulated.

## 225 3.2 Measurement of Latent Variables

### 227 3.2.1 Entrepreneurial Orientation

230 In measuring entrepreneurial orientation of commercial banks in Nigeria, the position of Miller (1983)/Covin and Slevin  
231 (1989) was adopted. They operationalized EO as a unidimensional construct with three dimensions: risk-taking,  
232 innovativeness, and proactiveness. In all, nine reflective items were used to measure EO of Nigerian commercial banks  
233 as used by Mahmood and Wahid (2012).

### 235 3.2.2 Teamwork

236 To measure teamwork, we captured the perceived team orientation of employees of the banks. Five items were used to  
237 measure team orientation as a unidimensional latent variable and were adapted from Denison (1990) (Denison & Neale,  
238 1999). Note that both entrepreneurial orientation and teamwork were measured on a 5-point Likert scale, where "1" =  
239 "strongly disagree", "2" = "disagree", "3" = "undecided", "4" = "agree", and "5" = "strongly agree".

### 242 3.2.3 Organizational Performance

244 Organizational performance was measured subjectively with three items as a unidimensional latent variable. The three  
245 items were profitability, return on assets (ROA), and market share. Organizational performance measures were adapted  
246 from (Antoncic & Hisrich, 2004). Note that the composite score of the three items were taken to represent organizational  
247 performance. Respondents (bank managers) were asked to assess the performance of their banks on average in the last  
248 three years on a 5-point Likert scale, where 1 = "very low", "2" = "low", "3" = "moderate", "4" = "high", and "5" = "very high".

## 250 4. Results

### 252 4.1 Results of the Measurement Models

254 Table 1 presents results of reflective measurement models evaluation. In all, the results of the measurement models  
255 showed that all the criteria or standards for assessing measurement models were met. The Cronbach's Alphas for all the  
256 latent variables were more than the recommended threshold of .70 (Hair, Hult, Ringle, & Sarstedt, 2014; Hair, Black,  
257 Babin, & Anderson, 2010). In addition, all the latent variables had composite reliability values greater than the  
258 recommended value of .70 (Fornell & Larcker, 1981; Hair et al., 2014). This revealed that the indicators measuring the  
259 latent variables were highly internally consistent. Equally, the average variance extracted values for all the latent  
260 variables were greater than the recommended value of .50 (Hair et al., 2014). This showed the unidimensionality and  
261 convergent validity of all the latent variables. Furthermore, all the latent variables passed the discriminant validity test  
262 (refer to Table 2). Also, the indicator loadings for all the items measuring each of the latent variables were greater than  
263 the recommended indicator loading of .70 (Hair et al., 2014).

265 **Table 1.** Results summary for the measurement models

Latent Variable	Indicators	Loadings	Indicator Reliability	Cronbach's Alpha	Composite Reliability	AVE	Discriminant Validity?
EntOrientation	Entori1	.795	.637	.754	.844	.576	Yes
	Entori2	.773	.598				
	Entori5	.725	.526				
	Entori9	.787	.619				
Teamwork	Team2	.761	.597	.766	.865	.681	Yes

	Team3	.899	.808				
	Team4	.813	.661				
Performance	Perf1	.860	.740	.765	.864	.682	Yes
	Perf2	.856	.733				
	Perf3	.755	.570				

EntOrientation = entrepreneurial orientation

#### 4.2 Discriminant Validity and Square Roots of AVE

Discriminant validity may be defined as the extent to which a latent variable is different from other latent variables (Hair, Hult, Ringle, & Sarstedt, 2014; Hair, Black, Babin, & Anderson, 2010). Discriminant validity shows that a latent variable is unique and measures some phenomena other latent variables do not capture. The average variance extracted (AVE) of a latent variable should be more than the highest correlation that the latent variable has with other latent variables for a discriminant validity test to be passed (Fornell & Larcker, 1981). An assessment of the average variance extracted for all the latent variables and the correlations between the latent variables showed that all the latent variables passed the discriminant validity test. The average variance extracted for each of the latent variables was greater than the highest correlation that the latent variable has with other latent variables. Table 2 shows results of the discriminant validity test performed.

**Table 2.** Discriminant validity and square roots of average variance extracted

latent variables	Entrepreneurial orientation	Performance	Teamwork
Entrepreneurial orientation	<b>0.759</b>		
Performance	0.203	<b>0.825</b>	
Teamwork	0.372	0.252	<b>0.826</b>

Note. Numbers shown diagonally (in bold) are square roots of AVE and the remaining values are correlations between latent variables.

#### 4.3 Results of the Structural Model and Hypotheses Testing

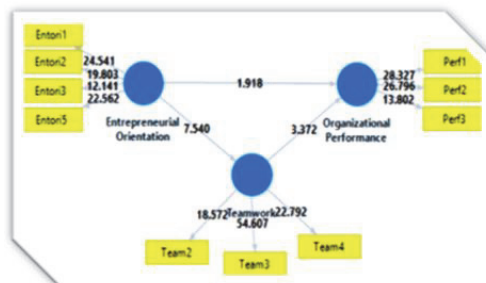
Table 3 presents results of the structural model. The table indicates the path coefficients (beta values) for all structural relationships tested in the models. Also, Figure 1 shows results of bootstrapping of the structural model.

**Table 3.** Path coefficients and hypotheses testing

Structural relationships	Path Coefficient	Std Errors	T values	P values
EntOrientation→Performance***	.209	.053	3.973	.000*
EntOrientation→Performance****	.127	.066	1.918	.055
EntOrientation→Teamwork	.372	.049	7.540	.000*
Teamwork→Performance	.205	.061	3.372	.001**

Note: \*significant at < .001 (two-tailed); \*\*significant at < .05 (two-tailed); EntOrientation = entrepreneurial orientation; \*\*\*without mediator variable; \*\*\*\*with mediator variable

**Figure 1.** Structural model showing the mediating effect of teamwork on the relationship between entrepreneurial orientation and performance



The results of the structural model indicated a positive and significant relationship between entrepreneurial orientation and organizational performance,  $b = .209$ ,  $t$  value = 3.973,  $p$  value < .001. Further analysis of the structural model showed a positive and significant relationship between teamwork and organizational performance,  $b = .205$ ,  $t$  value = 3.372,  $p$  value = .001. The results also revealed that entrepreneurial orientation and teamwork were positively and significantly related,  $b = .372$ ,  $t$  value = 7.540,  $p$  value < .001.

To assess the mediating effect of teamwork on the relationship between entrepreneurial orientation and performance, the following steps were followed. First, the relationship between entrepreneurial orientation and performance was examined without the mediator variable (teamwork) in the model. The result was significant,  $b = .209$ ,  $t$  value = 3.973,  $p$  value = .000. Second, the mediator variable was added to the model and the results were assessed. From the results, the relationship between entrepreneurial orientation and performance became non-significant,  $b = .127$ ,  $t$  value = 1.918,  $p$  value = .055. This showed that teamwork fully mediated EO-performance relationship. For a full mediation to occur, the relationship between the independent variable and the dependent variable should not be significant with the presence of the mediator variable (Baron & Kenny, 1986; Hair et al., 2010; Wu & Zumbo, 2007). To further ascertain the significance of the mediating effect, a Sobel test was carried out. To perform a Sobel test, the beta values (path coefficients) together with their standard errors for the relationship between entrepreneurial orientation and teamwork,  $b = .372$ , standard error = .049 and for the relationship between teamwork and organizational performance,  $b = .205$ , standard error = .061 were used. The results of the test showed that the mediating effect was significant,  $t$  value = 3.0510,  $p$  value = .0012 (one-tailed),  $p$  value = .0025 (two-tailed).

## 5. Discussions and Implications

This study investigated the relationship between entrepreneurial orientation and performance of commercial banks in Nigeria and the mediating effect of teamwork on the relationship. As predicted, the results of the structural model revealed that entrepreneurial orientation and organizational performance were positively and significantly related. This finding is consistent with the findings of previous studies that examined the relationship between entrepreneurial orientation and organizational performance (Mahmood & Wahid, 2012; Sharma & Dave, 2011; Zhang & Zhang, 2012). It means that the higher the entrepreneurial orientation, the greater the organizational performance. It also implies that entrepreneurial orientation is a predictor of organizational performance. Furthermore, as hypothesized, further assessment of the structural model indicated that teamwork fully mediated the relationship between entrepreneurial orientation and performance. Teamwork was positively and significantly related to entrepreneurial orientation and organizational performance. It means that the higher the team orientation, the higher the entrepreneurial orientation, and by extension, the greater the performance. The result of the analysis means that teamwork is an antecedent to both entrepreneurial orientation and organizational performance. It means that teamwork predicts both entrepreneurial orientation and organizational performance. More importantly, it means that teamwork has the ability to transfer the impact of entrepreneurial activities to organizational performance.

The findings of this study have some important managerial implications. First, the findings of this study underscore the importance of entrepreneurial activities within existing organizations. It implies that organizations must be entrepreneurial in their activities, processes, and operations. The findings suggest that organizations must behave entrepreneurially for them to achieve competitive edge over rivals and accomplish improved organizational performance. Second, the findings of this study confirm the key role that teamwork plays in organizations. The results of this study suggest that teamwork helps to explain the impact of entrepreneurial orientation on organizational performance. It has an insightful implication for organizations and managers. It implies that teamwork should be encouraged in organizations, as that is one of the significant ways to achieve optimal organizational performance. The implication is that the more team-oriented employees are, the more entrepreneurial the organization behaves. Entrepreneurial ideas emanate from the employees (intrapreneurs). Therefore, their creativity and innovativeness should be properly harnessed by creating the atmosphere for teamwork to thrive. Team spirit should be encouraged among employees.

Additionally, the findings also have some theoretical implications. To the knowledge of the authors, this study is the first to investigate the mediating role of teamwork in the relationship between entrepreneurial orientation and organizational performance. By providing empirical evidence of the mediating role played by teamwork in entrepreneurial orientation-performance relationship, this study adds to the existing knowledge on the field of corporate entrepreneurship. It provides a clearer understanding of the relationship between corporate entrepreneurship and organizational performance. Overall, the findings confirm the applicability and generalizability of contingency and resource-based view theories. Based on the findings of this study, it was concluded that while entrepreneurial orientation may be positively related to organizational performance, its impact on organizational performance will be greater if employees work

collaboratively as a team.

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# The Development of the Associative Movement in Morocco: Challenges and Constraints

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## Abstract

The present article has for aim to address the disequilibrium and fragmentation from which Moroccan associations suffer as well as to direct the attention towards the different challenges and constraints which the associative movement in Morocco has confronted and which have contributed in this latter's evolution regardless of the encountered difficulties. First and for most, this article will review the main historic periods tracing the existence of associative movements in Morocco while focusing on the significant challenges and constraints having been confronted by these latter. Second, while the main purpose of this articles is to analyze and explain these challenges and constraints and at the same time looking into the role which they have played in establishing the situation, this paper will also address the many interrelated factors which have led to this disequilibrium and the promotion of chaos in the network of associations most of which are considered related to human behavior, that is, the behavior of actors in the network of associations, while others are related to non-human actors. Finally, the article will conclude that the socio-economic and political evolution of the country agrees with adopting an associative approach even though it is a slow and laborious process.

**Keywords:** Morocco, Associative Movement, Challenge, Constraint, Civil Society.

## 1. Introduction

Over the recent years, the non-profit institutions' sector (NPIs), commonly known as 'civil society' or 'associative movement', has developed considerably. Through its proximity to the population and its commitment to the needs and interests of the citizens in various fields (economic, educational, social, cultural, infrastructure, religious, etc.), the associative movement has become an essential component of the economic and social life of the country. The synergies which it develops with public authorities and the private sector through partnership agreements have further strengthened its role and contributed to its development.

Morocco is also witnessing a new form of an international civil society to which the profit is not the main objective. It is rather in this context that new forms of economy and solidarity emerge allowing us to speak of a solidarity economy<sup>1</sup>. In this context, the role of an ideal civil society would be to make three sectors cooperate together: the State, the private sector, and the nonprofit sector with a social vocation.

Given this inescapable fact, the investigation which we undertake, to date, has as its foundation the finding that the associative movement in Morocco is facing enormous challenges and constraints due to the level of the human resource competence at the level of socially- motivated institutions and the near absence of appropriate materials made available to these latter.

## 2. Objectives and Methodology of the Study

### 2.1 Objectives of the Study

The purpose of the present study is to provide a theoretical overview on the evolution of the Moroccan associative movement as well as the various constraints and challenges it confronts. First, the paper aims to define the different steps through which the associative movement has gone, the manifestations of its development as well as its

<sup>1</sup> "The solidarity economy can be defined as the set of activities which contribute to the democratization of the economy through the contribution of citizens. Far from substituting the State's actions, Solidarity economy seeks a joint with it, a re-investment in the economy as a social and cultural integration project" (Laville, 2001: 21). The concepts of "solidarity economy" and "solidarity axes associations" lead us to draw a parallel with the concept of "the gift" as it was proposed by Mauss (1989) and compare it with the concept of "the gift" (and of the "anti-economic") in Arab-Muslim societies (Benabdelali, 1999).

51 controversial relationship with the State. Another objective of this article is to underline the challenges and constraints to  
52 its development.

53  
54 **2.2 Methodology**

55  
56 To achieve the above objectives, a thorough review of the existent literature is used as a technique to explore the  
57 challenges and constraints linked to the development of the Moroccan Civil Society. This literature review is a technical  
58 assessment of the existing research on the subject of the study. The main objective of the review is to provide, evaluate,  
59 analyze and synthesize knowledge and ideas shared by other studies on the problem, the purpose of which is to have the  
60 necessary foundations to complete our research with the qualitative study (i.e. the questionnaire) which will be the subject  
61 of our next article.

62  
63 **3. Genesis of the Moroccan Associative Action**

64  
65 The associative action, in the modern sense of the term, is a recent phenomenon in Morocco. It has been introduced with  
66 the protectorate at the beginning of last century. Certainly, we cannot deny<sup>2</sup> that Morocco, through its history, has,  
67 beforehand, experienced other institutional forms<sup>3</sup>, from its traditions which were, one way or another, of associative  
68 aspects such as the guild<sup>4</sup>. However, it would be absurd, if not an exaggeration to say that the youth of the associative  
69 movement constituted a focus for these traditional institutions. On the contrary, it turns out that the young found  
70 difficulties to access these social institutions.

71 The associative work in Morocco, in its regulatory and institutional form, dates back to the early years of the  
72 installation of the French protectorate. It is in the areas of youth, sports, charitable and pious sectors that the first  
73 associations are structured. Their common feature actually met the characteristics of this period of the protectorate,  
74 namely the assertion of their Moroccanity, the attachment to their identity and the implementation of the Moroccan  
75 heritage.

76 In 1932, an association called "Union Sportive de Rabat-Salé" (henceforth USRS) was created (Mernissi, 2008). It  
77 constituted the real launch of a Moroccan youth associative movement.

78 Upon the country's independence and particularly after the promulgation of the Dahir of 1958 on civil liberties,  
79 associative action began to assert itself.

80 We usually talk about four generations of associations which correspond to four major periods in the history of  
81 Morocco. These have all begun after independence, although the years under French and Spanish protectorate  
82 witnessed the creation of several associations working in the fields of culture, education, scouting, sports and social  
83 action.

84 The first period, which extends approximately from 1956 to 1975, is characterized by the creation of associations  
85 specifically Moroccan in a climate of relative freedom. Thus, several associations specialized in the field of children, youth  
86 and sports were created over the years.

87 At that time, young people became more aware of the role they should play in their liberated country. Their role  
88 had materialized in several economic and social projects: reforestation, school operation, and fight against illiteracy,  
89 which are examples of responsibility and involvement of young people in the construction and implementation of the  
90 development of the country, such as the participation of 12 000 young people in 1957 in the construction of the Road of  
91 Unity (Al Wahda).

92 The second period, between 1975 and 1984, saw the largest mobilization of Moroccan youth under the Green  
93 March (1975). 75% of the marchers were under 25 years old (Ikken, 1999). Thus, a clear regression of the exercise of  
94 freedom of association was linked to the limitation of freedoms in general. Despite this, the associations have played an  
95 important role in social, culture and sport activities in the country. It was at this time that the first associations of human  
96 rights, women's groups and child protection associations were created; the Moroccan Association for Human Rights  
97 (AMDH)<sup>5</sup> was created in 1975, the Moroccan Organization for Human Rights (OMDH)<sup>6</sup> in 1978, and the Moroccan

<sup>2</sup> For more details on the lack of the associative culture in Morocco, see Denoeux & Gateau, (1995)

<sup>3</sup> Before the Protectorate, socio-economic relations were organized as an association, whenever it was a question of combining the joint effort of individuals from homogeneous social groups to overcome the difficulties of all kinds of community life (Ameur & Filali Belhaj, 1997: 5).

<sup>4</sup> The guild is the name given to a "regulatory" grouping of artisans, at the head of each business grouping is a leader named 'Lamine'.

<sup>5</sup> Association Marocaine des Droits de l'Homme

<sup>6</sup> Organisation Marocaine des Droits de l'Homme



98 League for Human Rights (LMDH)<sup>7</sup> in 1979 (Faouzi, 2007).

99 But during this period, with the exception of those working in the field of human rights, existing associations were  
100 neither seen as an expression of the aspirations of the civil society nor as spaces of the participation and maturation of  
101 citizens being able to be involved in the process of political, economic, cultural, sporting, and social democratization.

102 The third period extends from 1985 to 1994. It took until the late 80s to attend a new direction in the development  
103 of the Moroccan associations. Under the impact of the international context ( Morocco entered into a deficit phase due to  
104 the application of the Structural Adjustment Program (PAS<sup>8</sup>) (Maroc Possible, 2006)) and the changes which have  
105 occurred at the internal level, the associations began to be perceived as essential partners in the redevelopment process  
106 of economic and social balance of the country. Henceforth, we are witnessing an expansion of associations and the  
107 establishment of new associative vocations which do not seek to provide services but rather to mobilize citizens as  
108 partners of the government in the selection and implementation of development.

109 Meanwhile, the current period began in the mid 90s and corresponds to an effective assertion of Moroccan  
110 associations. Thus, from 1995 appeared a new type of association, such as Afak, Alternative, and Maroc 2020. Also, the  
111 first environmental protection associations have emerged side by side with the complexity of the social fabric by the  
112 emergence of several professional associations , Health, STD / AIDS, neighborhood consumption, users, foundations  
113 (Mohammed V Foundation for Solidarity, Mohammed VI Foundation for the reintegration of prisoners). This type of  
114 associations seeks to promote the values of civic responsibility and constructive citizenship for a modern society. Their  
115 actions were intended for a wide distribution to the public and the media were widely used to convey their messages.

116 Nowadays, Moroccan associations have experienced a dramatic boost. In 2014, the number of actually active  
117 associations is estimated at more than 60,000 organizations, namely 185 per 100,000 against 17,000 associations in  
118 1997. Nonetheless, it remains below the average; for example, 1749 in France in 2005, and 508 in Canada in 2003.  
119 Many of these associations are active in a local frame at a locality or a neighborhood levels.

#### 121 4. Challenges of Associative Work

122 Despite its young age, the Moroccan NGO sector plays an important role in strengthening the Moroccan civil society, the  
123 establishment of the rule of law and the effective participation in the process of local development. Indeed, if, for some  
124 analysts, the opening on the issues of human rights, citizenship and good governance is largely due to the positive  
125 effects of new international circumstances, it is recognized that it is as much the substantive work of the association  
126 members as that of the emergence of an inconvenient but still growing civil society which was at the basis for this  
127 change. All in all, it remains bearer of change and hope as not only citizens but also the government show interest in it.

128 Moreover, several aspects and decisive factors make that the effective operational capacity of civil society remains  
129 below the potential it holds because of several inconsistencies ranging from the loss of identity to the total confusion of  
130 roles it plays.

##### 133 4.1 A young NGO sector in a consolidation phase requiring an unconditional support to enable the building of a strong 134 civil society (in particular):

135 The number of local associations which continues to grow every year, therefore, requires a great effort for their  
136 supervision. For instance, more than 3,000 local associations are operating in the North of Morocco. Thus, despite the  
137 efforts made during the last four years, the NORTHERN NGOs Forum has been able to support only a hundred  
138 associations; which is an indicator of the coaching needs of local associations. The establishment of local associative  
139 dynamics undoubtedly meets the expectations of these associations.

##### 142 4.2 The weakness in the institutional and organizational capacity of associations:

143 Most associations have a simplistic yet limited view of their role in the process of local development. Their reduced  
144 competences, both human and financial, do neither allow these associations to ensure strategic planning of their  
145 intervention nor to be assertive as major operators of economic and social development. Hence, there is a lack of  
146 organizations which can insure the defense of the most vulnerable groups including women's organizations and those  
147 dealing with the problems of the disabled, children, etc.

148 <sup>7</sup> Ligue Marocaine des Droits de l'Homme

<sup>8</sup> Programme d'Ajustement Structurel

149 4.3 *An unfavorable partnership environment to the development of associative work:*

150

151 Despite the very diverse partnership relations developed by Moroccan associations in the recent years, reports to the  
152 authorities remain very informal because of the difficulties in institutionalizing entrepreneurial relationships with  
153 communities and local governments.

154

155 Indeed, one of the directions which NGOs are trying to develop has to do with the strengthening of partnership  
156 policies and the exchange inter NGOs towards a better capitalization of resources, an increased valorization of the know-  
157 how and an optimization of a consultation and coordination to guarantee an efficient contribution of the associations as  
158 key players in the local development. The goal is to foster a sustainable development policy in which the associations  
have the required authority to occupy the spaces which belong to these latter and which stakeholders will grant them.

159

160 In this context, the establishment of the local consultation and coordination structures will have a key role to play in  
161 order to participate in the promotion of the local governance and occupy the spaces of influence which can strengthen  
162 associative representativeness and its legitimacy which is recognized as a key player in the inescapable management of  
public affairs in Morocco.

163

164

164 4.4 *The role of civil society below the local populations' expectations*

165

166 In Morocco, in the opinion of many experts, the favorable conditions for an active participation in the emergence of good  
167 governance are not yet acquired. The social dimensions are lacking in most development programs advocated by the  
168 government. This manifests itself, increasingly, through systematic questioning of the structures, the processes and the  
169 institutions around which society organizes and decides the criteria of power management, the allocation of public  
170 resources, and the arbitration between different individual and group interests.

171

172

172 4.5 *Volunteering and professionalism in associations*

173

174 Inspired by the intent of the 1901 Act with respect to associations in France, the Moroccan Parliament states "the  
175 association is the convention by which two or more persons pool, permanently, their knowledge and activities for a  
176 purpose other than profit sharing".<sup>9</sup>

177

178 This definition implies mutual recognition of rights and duties for all partners, the pursuit of a common goal  
(Professional, scientific, cultural, socio-economic, legal and humanitarian, sports ...), the joint implementation of the  
179 knowledge and the means, as well as a no-search for profit or gain. Therefore, acts of membership in an association are  
180 a legal, sovereign and responsible act.

181

182 Adhering means active and responsible participation in the work and activities of the association in view of the  
183 fulfillment of a given object: targeted operations, installation of a program of action, opening of training sites or  
workshops, etc.

184

185 The effectiveness of the work in association presupposes the establishment of communication between all  
186 stakeholders -decision makers and project managers-, an equal treatment to information and decision-making. It  
187 depends, too, on the ability of each member to engage in an activity in which they could implement their skills and even  
188 thrive. The distribution of competences, from this angle, is a necessary thing, because it affects the rest of the project,  
according to the rule which puts "the right man at the right place".

189

190 Also, the roles which the associate partners have to play presuppose they have a clear and consistent vision of the  
191 responsibilities, tasks and activities. It is imperative, thereby, to separate the overall strategy (design and orientation) of  
192 the act of ensuing decision and implementation tasks. The strategy and the decision shall be performed by a  
193 management structure, while the initiation of programs and actions is provided by volunteers or employees, working  
194 under the direct responsibility of an executive manager, project or operation manager. This latter may be part of the  
195 management structure as he can be appealed from the outside and be remunerated accordingly. In this case, in use in  
196 structured associations, he does not enjoy any elective responsibility within the association. His powers and his relations  
197 with the elected leaders must be stipulated in writing, either in the rules of procedure or in a separate but attached  
document.

198

199 These are some signs which should govern the proper functioning of an association, aspiring to efficiency and  
200 professional standing. The aspirant, although legitimate, raises the issue of professionalism of the service, with its  
immediate corollaries, relevance volunteer, internal democracy and resource empowerment.

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<sup>9</sup> Article 1 of the Royal Decree of 15 November 1958 regulating the right of associations in Morocco.

201 Surely, if Moroccan associations have operated hitherto in a random fashion, under the cover of volunteering and  
202 volunteerism, the limitations of such an approach are apparent since many projects could not succeed and that actions  
203 taken, even if they are successful, do not guarantee the sustainability of the associative structure, which is the instigator  
204 of such actions. The associations which were able to maintain and consolidate their gains are those which benefited from  
205 the logistical and financial support of national and international organizations. This partnership has allowed, in addition,  
206 these associations to create basic structures to better manage themselves and further refine internal mechanisms in  
207 respect of the delegation of responsibilities and program monitoring.

208 The exercise of volunteering, whether it is desirable in the short term, in the case of the associations which start or  
209 address a niche for which they are not equipped, is detrimental to the medium and long terms. Volunteering creates the  
210 problem of the availability of volunteer actor: it is obvious that we cannot ignore the work and family commitments of this  
211 latter and which at the risk may hinder activities monitoring since it is difficult to demand accountability from a volunteer  
212 who has not completed his/her task well. In addition, voluntary or charitable work creates the problem of the formation of  
213 candidates and the desired skills. Participants in associative work must master the techniques and acquire the required  
214 capacities to exercise their new responsibilities. This mastery can be achieved, however, by the ongoing work on the field  
215 and through appropriate training sessions.

216 In addition, international institutions specialized in the financing prefer to negotiate with the associations which are  
217 endowed with adequate structures at both the managerial and functional levels, that is to say, which have a powerful  
218 permanent structure to guarantee the smooth running of finalization and project implementation. Also, should projects  
219 funding parameters depend on the institutional and professional capacity of the applicant association; because,  
220 ultimately, the equation, without being simple, is of an unwavering rigor: the financing of a project presupposes the  
221 existence of reliable skills involving ipso facto a professionalizing process which can achieve the desired objectives. This  
222 innovative approach is not without causing critical questions about the future of many associations.

223 In this context, the issue of professionalism is acute. It appears that in the current state of the associative  
224 experience the notion of professionalism is formulated closely with project funding. Instead of being designed and thought  
225 as a serious alternative to the ambient amateurism, professionalism is perceived by the associative partners as a  
226 precondition demanded by international donors.

227 In fact, the development of the voluntary sector depends, to a large extent, on its ability to become more  
228 professional at all stages of its operation and its approach, despite the financial constraint<sup>10</sup>. Associations must, at first,  
229 form a network, horizontally (spatial clustering at the level of the municipality, prefecture, province and region), vertically  
230 (grouped by specialty or area of activity) and transversely (networking around a multi-thematic pole or around  
231 international agencies, donors). Once established, these networks - as is the case of Associative Space - can exert  
232 lobbying on public authorities to close judicial loopholes which hinder associative action and ensure technical support of  
233 specialist services of the state. At this domestic level, this time, the scale of involved structures will push partners to pave  
234 the way for a professional start in terms of managerial management, marketing, internal democracy, financing, relations  
235 with the various components of the associative structure (dyads officials / permanent, permanent / volunteers, founders /  
236 active members ...), relationships, partnering or conflicting, with competing associations, etc.

237 Therefore, it is imperative for the sector to develop a clear design, and strategically powerful, professional  
238 associations, which exclude in any way the inspired spirit of volunteering, provided they are supervised by professionals  
239 and oriented to the execution of targeted tasks. Volunteering constitutes, above all, the first and undeniable basis of  
240 associative action. In this perspective, organizing regular training sessions for executives, permanent and non-permanent  
241 in the area of the development, management and completion of projects, can only contribute to a better understanding  
242 between the players, able to promote the desired synergies and planned interactions, for, in the end, a good structure is a  
243 structure which works well, without failure, and whose members are permanently part of the action they initiate,  
244 convinced of its relevance and viability means which are mobilized in it.

245 To conclude on this point, it is certain that the associative action can only develop sustainably by professionalizing  
246 and regrouping. This professionalization goes, first, through the efficient management of volunteering, resource  
247 management (human and material), then necessary technicality for the design, conduct and completion of projects.

## 249 5. The Constraints Linked to the Development of the Associative Movement

250 Despite the existence of a large number of associations in Morocco and their significant potential to mobilize civil society,  
251

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<sup>10</sup> In France, the number of associations is estimated at more than 700,000 and the number of adherent at 20 million. There would be 1,250,000 employees; 800,000 full-time employees equivalent to 120,000 associations.

252 the actual associations active in the field of local development are few. The absence of a legal framework conducive to  
253 the involvement of associations in the social development process, the lack of structure and materials and human  
254 resources are obstacles impeding associative work.

255  
256 5.1 *The legal constraints*

257  
258 In Morocco, the immobility of association law has condemned the associations to operate within limits particularly in terms  
259 of ownership and administration of property and voluntary heritage.

260  
261 5.1.1 *Legal personality*

262  
263 Legal personality available to Moroccan associations is very limited. The recognition of the public interest is reflected in  
264 the strengthening of the legal capacity of associations of public utility so-called "of great personalities" by allowing them to  
265 benefit from additional resources to finance their activities, which is not the case for declared associations, say "of small  
266 personalities", only benefiting from enumerated and limited subsidies by the legal text.

267 Better yet, this personality is even more limited due to the absence of a case law interpreting the general terms of  
268 the law to provide the Moroccan associations necessary attributes to the modern concept of the association enterprise.

269  
270 5.1.2 *Legal capacity*

271  
272 In Morocco, contrary to what happens in other countries, the courts do not participate in the expansion of the legal  
273 capacity of associations by a favorable interpretation of the texts. In France, for example, case law allows associations to  
274 engage in trade and to be self-financing by means other than those prescribed by law as any other enterprise.

275  
276 5.1.3 *Patrimonial right*

277  
278 Legally, unreported public utility associations do not have the heritage capacity. Again, this is an obstacle to the  
279 development of associations which require significant material resources. These associations can only own the buildings  
280 strictly necessary to the exercise of their activities and to the achievement of their objectives, which is not the case for  
281 associations with the public interest to which the law grants more expanded movable and immovable property rights.

282  
283 *"This is how more than half of the associations have no room to operate. For the rest, 29.6% are hosted for free (mainly*  
284 *by public or private institutions in 58% of the cases or in the home of one of the members in 29% of cases), 11% are*  
285 *tenants and 8.4 % own their premises" (HCP, 2011).*

286  
287 Finally, we can say that the financial and asset limits from which Moroccan associations suffer further constrain  
288 their scope and, consequently, negatively impact their ambitions.

289 Many obstacles make associative work difficult as well as every possibility of developing a financial autonomy.  
290 What about institutional deficits?

291  
292 5.2 *The institutional constraints*

293  
294 In addition to the legal limits, other constraints make associative work in Morocco difficult. It is question of organizational  
295 obstacles relating to association management and the structuring of associations, not to mention the low practice of  
296 partnership either between associations themselves or between them and the State.

297  
298 5.2.1 *Deficit in terms of partnership*

299  
300 5.2.1.1 *Between associations and public authorities*

301  
302 So that the mobilization potential of civil society acts as a regulator lever, it is required that the government apparatus and  
303 local communities open up to a culture of partnership with associations.

304 It is true that the government declaration of April 1998 erected the associations as potential partners could play an  
305 important role in regional and local development, but it is a lure to legitimize and validate policies without considering the

306 issued opinions of the associations.

307 Generally, municipalities remain very septic against particular associations which, unlike the State, come to  
308 approach very closely the most vulnerable and marginalized layers. Urban or rural local officials do not want competing  
309 actors and consequently, systematically oppose any attempt to open on social actors despite their dynamism and vigor.

310 Contrary to what is the partnership between municipalities and associations, working with NGOs is less confrontational in  
311 that they provide knowledge and often significant material resources to enhance the action of the concerned local  
312 communities.

313  
314 *5.2.1.2 Lack of communication network between associations*  
315

316 Networking is a quite recent practice. Sectors which have known it are mainly the economic and financial fields, while the  
317 cultural and social fields are minimally affected by the movement. Indeed, several networking attempts have been  
318 considered but so far this has been much more formal than operational. Associations continue to work in a dispersed  
319 manner: each association cares very little about the actions taken by others. Only 7.9% of the associations have  
320 established partnerships with the State or public establishments, 2.7% with local communities and only 1.5% have  
321 worked in a partnership framework with Foreign Countries. (HCP, 2011)

322 The networking of the associations has for aim to strengthen the work of associations and the network without this  
323 one substitutes for its components. It is also a framework for coordination, guidance and information.

324 The legal text governing the networks is the same as the one governing associations. However, the risk is a  
325 reproduction of the same logic of the wait, the hierarchy and the leadership.

326  
327 *5.2.2 Deficit at the organizational level*  
328

329 *5.2.2.1 The status of social workers*  
330

331 The Moroccan NGO sector does not benefit from a social security cover for lack of funds. Although it is a generator of  
332 wealth for the country, its social workers are not recognized in terms of social security.

333  
334 *5.2.2.2 The absence of strategy and clear mission*  
335

336 The associative action suffers from an absence of global vision in the medium and long term and from a development  
337 policy. Thus, the definition of a clear orientation, of priorities and their translation into goals, mobilization of human and  
338 material resources and their management are obstacles for the majority of Moroccan associations.

339 All of these factors lead to a problem of identity, mission and values. In wanting to respond to all requests,  
340 associations operate in a dispersed manner or even inefficiently.

341  
342 *5.2.2.3 Association management and lack of professionalism*  
343

344 Volunteering, although it is an asset, is an obstacle to development for the organization and the management of an  
345 association. This being said, the volunteers are not the best equipped to manage the projects of the association; they  
346 have neither the competence nor the availability to ensure the smooth running of an association. In addition, the  
347 insufficiency of the executives' professionalization is likely to limit the ability of these latter to properly diagnose problems,  
348 formulate plans and implement them.

349 Also, the founders of associations, personalizing power, sometimes tend to use the association for commercial or  
350 personal use purposes. In most cases, they are part of departments which want to incorporate within their associations  
351 the bureaucratic and hierarchical "Ministry Culture", which is completely incompatible with the local approach on which  
352 any association should be based. Thus, a reflection should be conducted in this direction when thinking the organization  
353 of the voluntary sector.

354  
355 **6. Conclusion**  
356

357 If everyone agrees on the fact that economic and social development cannot be contemplated without the active  
358 participation of civil society, and that the role of the association is now the backbone of any reform, it will be necessary to  
359 admit the existence of a disability of associations to remain in line with the general guidelines of the State and be at the

360 level of social challenge.

361 Internally, organizations face the same fragmentation which affects the political class. They act in a disorganized  
362 fashion and have a hard time encouraging a dynamic grouping or networking, only able to enhance their work and the  
363 expected impact.

364 Functionally, the associations are characterized by a structural deficit in management, marketing, communication  
365 and partnership.

366 Only associations sustainably supported by international NGOs are beginning to restructure correctly. The access  
367 to information technology and the progressive and irreversible opening of Morocco on the outside as well as the political  
368 will which aims to improve the social action (national initiative for social development) will favorably influence the  
369 associations.

370 The country's political and socio-economic development goes in the consolidation of an associative approach. It is  
371 question of a slow but laborious process.

372

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# An Investigation of the Relationship between EQ and Decision-making Style of Investors in Stock Exchange Market (Case Study: Esfahan)

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## Abstract

The present study aimed to determine the relationship between EQ (mostly known by its quotient (EQ)) and decision-making styles of stock exchange market investors. The present study is a descriptive survey. Statistical population of the research included all investors in Esfahan stock exchange market using Cochran formula of unknown population, the sample size is determined to be 96 individuals. In this study, EQ questionnaire of Henry Wezinger (1998) and the questionnaire of Scott and Bruce (1995) were applied to assess the investors' EQ and decision-making style, respectively. Data analysis in two levels of descriptive and inferential statistics using univariate t-test and variance analysis (ANOVA) is conducted by applying spss software. The results show that from the perspective of investors, there is a relationship between rational and intuitive decision-making style and emotional intelligence. The results of the research indicated that there is a positive significant relationship between EQ and rational and intuitive decision making. No significant relationship was found between EQ and dependent, impulsive and avoidant decision making. While among the five decision-making styles, rational decision-making style the highest rank and spontaneous decision-making style the lowest rank have had among the styles.

**Keywords:** Emotional Intelligence (EQ), Decision-making Styles (Rational, Intuitive, Dependent, Impulsive, Avoidant), Esfahan Stock Exchange Market.

## 1. Introduction

EQ represents the ability of an individual to solve daily issues and challenges and helps the individual with prediction for success in life, including professional success and personal life success (Bar – on, 2000). EQ is a recent achievement in psychology which includes recognition and understanding of emotions and feelings of individuals; the recognition and understanding is applied to make proper decisions of daily life. Decision-making style represents the habitual pattern which is used while decision making. In other words, decision-making style of an individual is his/her personality approach to understand and react towards the decision-making task (Thunholm, 2004). Emotion is a precious source of information and helps us make decisions. Decision making occurs frequently in stock exchange market. Decision making is what the investors do in different levels of the organization and move constantly in its space; depending on the situation where they are placed, the investors require certain information or structure to make them able to play their best roles. While decision making, investors deal with several circumstances; in addition, the decisions made are of different natures. Further, changing information available to the investor makes the decision making circumstances different. In cases of sufficient experience and information, decision is certainly made; however, in case of little information and experience, decision must be cautiously made (Sadeqi,2011). Decision making as the main essence of investors' activities is of an important role in all their tasks. Investors choose their decision-making style according to different economical, political and social factors. Investors can get help of the information on their feelings for an efficient decision making. Regarding the new subject of EQ in investment area, the necessity of finding out a relationship between the concept and decision-making style of investors, with no research history in Iran, is the main aim of the present study.

## 2. Theoretical Framework and Literature Review

Intelligence has several definitions; one of the closest ones considers intelligence as “a series of cognitive capabilities which allows knowledge acquisition, learning and problem solution”. Excitement is a self-conscious emotion in which some concepts such as happiness, sorrow, fear, hatred and love are experienced. Excitement is different from cognitive and voluntary modes; in other words, excitement is related to pleasant and unpleasant aspects of mental process (Aqayar, Sharifie Daramadi, 2006).

Emotional Intelligence means having some skills to know who you are and what your thoughts, feelings and consistent behaviors is. In another definition, EQ means recognition of your and other's emotions for behaviors based on ethics and social conscience. Goleman define EQ as the abilities of an individual to maintain the motivation and resist against problems, control themselves in critical circumstances and impulsivity, postpone prosperity, empathize and be hopeful (Aqayar, Sharifie Daramadi, 2008).

According to Goleman, the components of EQ are as follows:

1. **Self-awareness:** recognition of the emotions you feel and know the reason.
2. **Self-management (autonomy):** emotional balance is called self-management and is a fundamental capability which plays an important role to control emotional behaviors.
3. **Motivation:** it means to be productive, effective and creative. Motivation is the ability to energize the others and guide their behavior in spite of weak morale. Motivation applies emotions as a means to achieve the goals.
4. **Social awareness (empathy):** it is the ability to empathize with the feelings of others and recognizing their viewpoint. Empathy means looking at the world from the viewpoint of the others and entrance to their emotional privacy; it requires understanding, recognition and respond to the others' emotions.
5. **Relationship management (communication or social skills):** it is the ability to recognize and empathize, effective communication, profound listening and collaboration; this aspect is a complex of the four above-mentioned aspects, which helps the individual communicate positively and constantly (Aqayar, Sharifie Daramadi, 2007).

EQ predicts the success of individuals and the way they effectively deal with stresses. Growth and development of emotional intelligent is of major importance. The followings can be mentioned as the importance of EQ:

- Development of responsibility
- Development of happy and lively life
- Dealing with dangerous situation
- Development of cooperative and helpful spirit

Decision making is defined as selection of a way among several others; this definition respects merely one aspect of decision-making process. As the definition implies, the main task of decision maker is receiving possible ways and their subsequent results and then, making the best choice among them (Golman, 2003).

Investors constantly face conditions which demand the necessity of decision making. It indicates the influence and major role of decision making in all tasks of investors and organizational processes. Decisions are our response to environmental events and phenomena; and they include three aspects:

1. There must be more than one solution to respond to the phenomenon. In other words, if there is just one solution to a problem or taking advantage of an opportunity, decision making will be pointless.
2. Decision makers make their predictions of future events on the basis of some probabilities and with a certain reliability degree.
3. Implications of each solution must be assessed in the frame of personal values and goals realization (Alvani, 2008).

Decision making as the main essence of investors' activities is of an important role in all their tasks. Investors choose their decision-making style according to different economical, political and social factors (Rezaeian, 2007).

Decision making is the fundamental and essential component of investment. Investors take their actions by relying on financial information. Therefore, understanding the relationship between decision-making process and EQ plays an important role. The role of EQ in decision-making process is to provide information for the investors to make decision. All the investors need the information related to their decisions. Subsequently, in addition to influential environmental and organizational factors on decision-making style of investors, various personality traits also cause the investors to behave differently towards decision-making opportunities; thus, their decision-making styles are different. Various decision-making styles include rational, intuitive, dependent, impulsive, avoidant (Singh, Jeffry, 2004).



**Rational decision-making style:** this style indicates the tendency of the decision maker to identify all possible solutions, evaluate the results of every solution through different aspects and eventually select the optimum desirable solution when they face decision-making circumstances (Rezaeian, 2007).

**Intuitive decision-making style:** it is an autonomous process which is obtained in light of deduced experiences (Robbins, 2002). Those with this style of decision making do not completely decline rational analysis, but intuition plays an important role to make an appropriate decision in particular circumstances including facing a crisis, uncertainty and facing huge unprocessed information and also when, due to complicated nature of the problem and critical condition, data collection on the subject and precise and systematic investigation of the data is impossible.

**Dependent decision-making style:** this style indicates lack of intellectual and practical independency and also reliance on supports and guidance of the others while decision making (Parker, 2007). Investors with this decision-making style need someone by their side to act on their ideas, when they face a problem or opportunity. Rather than consulting and making the final decision on their own, these types of people totally rely and depend on the viewpoints of the others.

**Impulsive decision-making style:** it indicates the sense of urgency and the tendency of decision makers to make the final decision as fast as possible. In other words, the investors with this style immediately make their decision when they face a decision-making circumstance.

**Avoidant decision-making style:** those with this style postpone their decision-making task as late as possible and avoid any kind of reaction to the problem. Therefore, avoidant decision-making style can be defined as the effort and tendency to avoid any decision making task and stay away from decision-making opportunities.

## 2.1 Role of EQ in Decision-making Process of Investors

The studies indicated that the distinction between the characteristics of outstanding investors and ordinary ones depends on their EQ. Emotions are a precious source of information and help us make decisions. The studies indicated that when emotion is not connected to the brain, an individual is not able to make decisions, as they do not know how they may feel about their decision. Everyday investors have to make some decisions with successful or unsuccessful consequences. Wrong decisions or being incapable of decision making might turn to chaos and result in credibility decline and depreciation of capital. The outcomes of such process inhibit the investors to achieve the goals and meet the expectations (Aqayar, Sharifie Daramadi, 2007).

Investors' decision making is a major component of their behavior; although their decision-making style and the quality of their final decision is to a great extent influenced by their perception. Investors can get help of the information on their feelings for an efficient decision making. To make more unplanned decisions, an individual needs more judgments and the judgments are based on some non-specific ways through experience, insight and perception. In fact, investors are able to make a reasonable decision only when they take advantage of the information and control their emotion; and this is what we call EQ which determines how they can control their behavior and come up with social problems and make the decisions with positive outcome (Sadeqi, 2011).

## 2.2 Literature Review

Little research has been conducted on this subject, i.e. the relationship between EQ and decision-making styles; however, an enormous body of research is dedicated to similar subjects so that recently, EQ is the subject of many domestic and overseas studies. Nevertheless, more research is required on this subject. Here, some research on this subject or similar studies will be discussed.

Naghizadeh et al. (2010) conducted a research entitled the relationship between EQ and occupational stress of managers and staff of educational hospitals of the University of Medical Science and health services in Tabriz and concluded that having the components of EQ results in the reduction of occupational stress.

Investigation decision-making styles and five factors of personal traits based on the interest styles among 567 students of different faculties in Selkuk University, Deniz (2006) found out that interest styles of students significantly predicts self-determination, decision-making styles and personality traits.

Ebsorn (2010) investigated the relationship between goal orientation, public confidence and decision-making style of managers among 210 Americans who attended a job interview to get a management position in Toluse Market Company. The findings indicated that there was a significant negative relationship between the goal orientation scores of managers and avoidant decision-making style scores. There was no significant relationship between the public trust score and goal orientation score of managers. In addition, the results indicated that goal orientation score can be a distinction index of managers with rational decision-making style and managers with other decision-making styles

165 (intuitive, dependent, avoidant). Furthermore, this study provided more documents on inappropriateness of avoidant style  
166 for effective decision making. Managers who avoid decision making or postpone it, expose their organization to risk.

167 To study the effect of control locus on decision-making style of middle-level managers, Thompson (2010)  
168 investigated 237 middle-level managers of different industries in the U.S.A.

169 He found out that there was no relationship between control locus and decision-making styles.

170 However, both age and gender have statistically significant relationship with the structure of decision-making style  
171 and control locus.

172

173 **3. Population and Sample**

174

175 All investors in stock exchange market in June, 2014. Regarding the population size, the sample size was evaluated by  
176 Cochran formula for unknown population to be 96 individuals. Simple random sampling was used to choose the sample  
177 members and 130 investors were selected and were handed the questionnaire in person. 105 investors responded the  
178 questions among all.

179

Equation 1: Cochran formula for the unknown  $n = \frac{z^2 pq}{d^2}$

180

n = sample size

181

z = percent confidence acceptable standard error

182

p = proportion of the population with a certain attribute

183

q = proportion of the population lacks certain features

184

d = degree of certainty

185

In this study for measuring investors' emotional intelligence from Henry Weisinger (1998) emotional intelligence  
186 questionnaire and for measuring the decision-making styles from Scott & Bruce (1995) questionnaire, and to respond to  
187 each of the questions as well as Likert spectrum have been used.

188

189

3.1 *Research Hypotheses*

190

191 Regarding the new subject of EQ in investment area, the necessity of finding out a relationship between the concept and  
192 decision-making style of investors, with no research history in Iran, is the main aim of the present study. On this basis, the  
193 research hypotheses are as follows:

194

1. There is a relationship between EQ and rational decision-making style.

195

2. There is a relationship between EQ and intuitive decision-making style.

196

3. There is a relationship between EQ and dependent decision-making style.

197

4. There is a relationship between EQ and impulsive decision-making style.

198

5. There is a relationship between EQ and avoidant decision-making style.

199

Data were analyzed by the statistical software, SPSS19, on two descriptive and inferential statistics level.  
200 Statistical factors including percentage, frequency, mean and standard deviation were applied for descriptive statistics;  
201 and univariant t-test, independent t-test and multivariant analysis of variance are used for inferential statistics.

202

203

3.2 *Research Findings*

204

205 The total 105 subjects consisted of 77 males and 28 females. The mean age of the subjects was lower than 30 and had  
206 invested in stock exchange market for less than 2 years. Most investors of statistical sample (52 subjects) were educated  
207 in bachelor degrees and their education fields were non-financial (70 subjects).

208

209

**Table 1.** Mean and Standard Deviation of EQ and Decision-making Styles

standard deviation	mean	statistical indices
		Sub scale
0/42693	3/4946	EQ
0/48900	3/6857	RATIONAL DMS
0/56144	3/6305	Intuitive DmS
0/70434	2/9924	Dependent DmS
0/73154	2/5752	Impulsive DmS
0/72135	2/5943	Avoidant DmS

210

**Source:** the results of the study

211 As Table 1 suggests, the mean EQ of 105 selected respondents was 3.4946. The mean of rational decision-making style  
212 was calculated to be 3.6857 which was the highest, and the lowest was obtained to be 2.5752 for impulsive decision-  
213 making style.

214  
215 **4. Results of the Study**

216  
217 **Table 2.** Pearson correlation coefficient calculation for research hypothes

Pearson correlation test			Results of Research Hypotheses
significance level	correlation coefficient	sample size	
0/000	0/459	105	first hypothesis
0/000	0/433	105	second hypothesis
0/724	0/035	105	third hypothesis
0/281	0/106	105	fourth hypothesis
0/904	-0/012	105	fifth hypothesis

219  
220 **Source:** the results of the study

221  
222 On the first hypothesis, regarding the above-mentioned table, as the significance value of the test (0.000) is lower than  
223 acceptable level of significance, it can be concluded that there is a significant relationship between emotional intelligence  
224 and rational decision-making style of investors in stock exchange market. Since the correlation coefficient of the test is  
225 positive (0.459), there is a direct relationship between EQ and rational decision-making style.

226 Regarding the results of investigating the relationship between EQ and intuitive decision-making style of the  
227 investors on Table 2, as the significance value of the test (0.000) is lower than acceptable level of significance (0.05),  
228 there is a significant relationship between EQ and decision-making style of the investors in stock exchange market. Since  
229 the correlation coefficient of the test is positive (0.433), there is a direct relationship between EQ and intuitive decision-  
230 making style.

231 Regarding larger value of significance value of the third hypothesis test (0.724) than acceptable level of  
232 significance (0.05), it can be concluded that there is no significant relationship between EQ and dependent decision-  
233 making style of the subjects.

234 The results of correlation test between EQ and impulsive decision-making style of investors in the statistical  
235 sample indicate that the test level of significance (0.281) is larger than acceptable level of significance (0.05); thus, there  
236 is no significant relationship between EQ and impulsive decision-making style of the subjects.

237 According to the results of the fifth hypothesis investigation, since test value of significance (0.904) is larger than  
238 acceptable level of significance (0.05), there is no significant relationship between EQ and avoidant decision-making style  
239 of the investors in stock exchange market.

240  
241 **5. Conclusion**

242  
243 According to the results obtained by investigating the research hypotheses, the first finding indicates a direct relationship  
244 between EQ and rational decision-making style of investors in stock exchange market. High EQ means having high levels  
245 of self-awareness and self-motivation; and other main factors of EQ allows investors and decision-makers to take  
246 advantage of their high EQ and cognition to make the best decision in the situation, instead of following rational style  
247 which might not be the best choice and might not provide the best solution in changing conditions and emergency  
248 situation. However, the investors with lower EQ are less able to get to know their own and the others' internal feelings  
249 and emotions and in many cases, they fail to control their emotion and establishment of an effective social relationship;  
250 thus, such investors, completely relying on rational, tend to behave based on rational principles in all decision-making  
251 circumstances; and investigating all dimensions and available solutions, they might choose the best choice.

252 The second finding of the research indicates a positive relationship between emotional intelligence and intuitive  
253 decision-making style. However, it must be noted that the investors with intuitive style do not totally reject wise analysis,  
254 but they believe that in many circumstances (such as complicated and dynamic environments), it is not possible to follow  
255 rational pattern and the solutions must be selected which recognize and confirm their intuition, it is even possible that  
256 there is no rational reason for justness of a selected solution. The ability to understand your own and the others' emotion  
257 causes the decision makers to balance internal feelings and emotions through their cognition and apply them to

258 facilitate decision-making process; and recognizing internal emotion of the staff and those who are influenced by the  
259 consequences of the decisions made and the ability to establish effective social relations to facilitate the process of  
260 putting the decision into action, they eventually choose the suitable solution.

261 Another finding of the research indicates an indirect relationship between EQ and avoidant decision-making style  
262 of the investors. Those with lower EQ, due to lack of ability to understand their own and others' internal emotion,  
263 weakness to control emotions and establish effective social relationship and recognize the unknown circumstances of  
264 decision-making, are imposed by stress and high pressure while decision making. An increase in stress may cause the  
265 individual to avoid any stressful situation by escaping the decision-making situation and a delay in any type of decision  
266 making as long as possible, and it may result in coming into conclusion that the best choice is to ignore the problems and  
267 avoid decision making.

268 Therefore, if we admit that high self-confidence and inner peace are major features of organizational decision  
269 makers, so that investors with higher levels of EQ are more capable of reacting to organizational threats and  
270 opportunities without escaping decision-making situations and without any passive approach.

## 272 6. Practical Suggestion

- 274 • As the present study indicated a positive significant relationship between EQ of the investors and rational and  
275 intuitive decision-making style, it is recommended to investors to make more effective decisions by increasing  
276 their EQ skills.
- 277 • Decision making is one of the concerns of most investors and the investors appear more successful that are  
278 able to make correct and logical decisions; and since the investors with higher EQ make more effective  
279 decisions, it is possible to promote the decision-making power of investors through EQ skills training.
- 280 • It is recommended that investors make decisions most on basis of logic and reason not on feelings and instant  
281 emotion.

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## Factors Affecting Purchase Intention of Customers to Shop at Hypermarkets

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### Abstract

Customers' purchase intention represents their desire to buy products from a particular shop. Product quality, brand image, socioeconomic condition and social influence have been considered in this study as the key factors affecting purchase intention of customers to shop at hypermarkets. The study aims at investigating how much differential impact these factors have on the purchase intention of customers to shop at hyper markets. Primary data were collected through survey with structured questionnaire from 150 customers in Kedah and Perlis states in Malaysia. Correlations and multiple regression analyses were employed to estimate relationships between independent and dependent variables. The results showed that brand image had the highest impact on purchase intention of customers followed by the quality of products sold at the stores and social influence. So marketers should give importance on these factors to influence customers to shop at hypermarkets.

**Keywords:** Purchase intention, hypermarket, social influence, socioeconomic, brand image and product quality.

### 1. Introduction

Customers' purchase intention represents their desire to buy products from a particular shop. Sometimes purchase intention is used to describe customer loyalty (Juhl et.al. 2002). And this purchase intention depends on a complex set of factors such as quality, value, and satisfaction, which can directly influence behavioral intention (Joseph et.al. 2000). Stores try to influence the buying decision process by representing their offerings in an appealing manner. In this process, there exists intense competition among grocery stores, supermarkets, discount stores, department stores, catalog showrooms; they are competing for the same customers (Kotler and Keller, 2006). Though these traditional superstores are making huge business, hypermarkets have appeared as a threat for them. These hypermarkets are gaining popularity very rapidly due to lower price and large assortments. These stores are providing more values to the customers with the use of advanced information technology, excellent logistic systems and powerful bargains (Kotler and Keller, 2006). In addition, traditional retailers are being coerced by modern stores since modern retail stores play in both the top (luxury offering) and the bottom (discount pricing) markets. Modern retailers have changed not only the structure of the retail industry, but also the pattern of consumer behavior. Nowadays, customers are facing difficulty in making their decision to select from many types of stores such as grocery stores, supermarkets, discount stores, large mega stores, and hypermarkets (Popkowski, et.al, 2004). Conventionally, customers give importance on product quality, price, responsiveness and location of the stores while making any purchasing decisions (Manish Madan and Sima Kumari, 2012, Ram, 2013). However, there are some other factors like the brand image, socioeconomic factors and social influence that have a profound influence in customers' choice (Davis, 1999). These factors are playing a significant role in the decision making process of buyers. But very few research works found where these factors have been used as the determinants of purchase intention. Only in theory, it is cited that customers' mind filter comprises of these factors. So the present study aims at investigating how much differential impact these factors have on the purchase intention of

57 customers to shop at hyper markets other than the traditional determinants like, pricing policy, responsiveness, location  
58 and store environment.

## 60 2. Literature Review

61  
62 Consumers have more options now in terms of products selection in supermarkets. For this reason, today's consumers  
63 are very much demanding and their purchasing behavior is changing over time (Besharat, 2010). They can choose from  
64 available branded products and supermarket's private brands. In advanced countries, some consumers choose to  
65 purchase supermarket's own brand due to price (Oh, 2003). In developed countries, supermarkets always try to promote  
66 their own brands along with selling others branded products (Liljander et al., 2009). In Malaysia, the consumptions of own  
67 brand have also shown significantly increasing since 2009 (Ganesah, 2010). Based on past studies on branded products,  
68 the factors of perceived price (Veale & Quester, 2009), quality (Banovic et al., 2010), confidence (Anchor & Kourilova,  
69 2009), social influence (Kulviwat et al., 2009), and brand image (Chowdhury & Andaleeh, 2007) are proven predictors for  
70 purchase intention. Responsiveness is also an important factor affecting purchase intention of customers. Customers  
71 expect the stores to understand their needs and address them in a timely manner with the availability of necessary items  
72 all the time. It is found to be a significant determinant of customer satisfaction of retail stores. (Conway and  
73 Andalib, 2006). The pricing policy of retail chain stores can also greatly influence customers because price has the  
74 capability of attracting or repelling them (Monroe, K.B. Grewal, D., and Krishnan, R, 1989), especially since price  
75 functions as an indicator of quality (Lewis and Shoemaker, 1997). If the price is high, customers are likely to expect high  
76 quality, or it can induce a sense of being "ripped off, (Conway & Andaleeb, 2006)". Pricing plays an important role in  
77 forming consumers' perception regarding products and services. (Ramirez & Goldsmith, 2009). According to Veale et al.  
78 (2009), information and details about the product cost, transaction cost and its accessibility through mass media influence  
79 consumers' evaluations and reactions to price. Most experts think that price is an indication of quality. (Chandrasekaran &  
80 Grewal, 2006, Roberta & Quester, 2009). As there are many studies on the traditional factors that affect customers'  
81 buying decisions, the present study only focuses on brand image, social influence, socioeconomic and the quality of  
82 products sold at hypermarkets. These factors have been chosen on this study as the factors are mostly unaddressed in  
83 hypermarkets situation. In this study, we proceed to explore using these factors to elicit purchase intention of customers  
84 of hypermarkets. So a brief description of these factors have been given below.

### 85 2.1 Product Quality

86  
87 An important factor constituting customer satisfaction is the quality of goods and services sold at the stores. Quality is the  
88 capacity of a product to satisfy some specific wants of the customers. Perceived quality refers to consumer's evaluation  
89 of products or brands that meet an individual's expectations. Such evaluation by individuals is their experience between  
90 two firms' brands products. According to Chowdhury & Andaleen (2007), product quality enhances competitive  
91 advantage. In comparison between national and private brands, consumers tend to favor national brands because they  
92 are more familiar, reputable and better coverage on media (Besharat, 2010; Chen et al., 2007). Quality of products is  
93 normally measured by product features, benefits and ability to satisfy required needs and so on. It is considered to be one  
94 of the important determinants of purchase intention of customers (Gillmore, 1974). So it can be hypothesized that;

95 H1: Product quality positively and significantly influences purchase intention of customers to shop at hypermarkets.

### 96 2.2 Brand Image

97  
98 The brand image means the way people view a given company or product. Hsieh & Liljander (2009) defined brand image  
99 as the mental perception based on its associations toward a brand. Organizations try to create a strong brand that people  
100 recognize with a given product. In addition to desiring to create brand recognition in general, most companies also want  
101 their product or company to have a specific image or to be looked upon in a certain way. So brand image is the overall  
102 impression in consumers' mind that is formed from all forms of interactions with the organization. This brand image can  
103 outline how they release a product, the type of product they released, the type of advertising they do, and the type of  
104 customers they serve. The origin of product such as country produced and manufacturer affect consumers' brand image  
105 perception (Koubaa, 2007). This suggests that the process of recalling is prior experience on the company, brand  
106 reputation and product attributes that may exert some influences on consumers' reaction and purchasing behavior  
107 (Chowdhury & Andaleeh, 2007). Positive brand image exceeds customers' expectations. Positive brand image increases  
108 the goodwill and brand value of an organization (MSG, 2014). So, we can hypothesize that  
109  
110

H3: There is a positive and significant relationship between brand image and purchase intention of customers of hypermarkets.

### 2.3 Socioeconomics

Socioeconomic condition is a vital issue for the customers to make any purchase decision. One of the important factors of socioeconomics is the income of individuals; it divides people into social standing by estimating their amount and source of revenue (Schiffman, and Kanuk, 2000). Poor customers tend to purchase from low price stores and buy little from supermarkets because of their limited resources (Figuié, and P. Moustier, 2009). Customers make decisions based on their personal characteristics such as age, occupation and economic circumstances. Such factors have a direct impact on customer behavior (Kotler and Keller, 2006). This socioeconomic condition of buyers influences their purchase decisions to a great extent. For this reason, marketers consider the socioeconomic factors while designing products and promotional campaign. So we can hypothesize that

H4: There is a positive and significant relationship between socioeconomic condition and purchase intention of customers to shop at hypermarkets.

### 2.4 Social Influence

Social influence refers to actions, feelings, thoughts, attitudes or behaviors of individual change through interaction with other individuals or groups. It can be seen in socialization, peer and family pressures. In social psychology, it is often related to the impact of social norms toward the changing of individual behavior and attitudes (White et al., 2009). Buying decision is related to having social values that derived from a need to be respected and to acquire desirable social status (Delre et al., 2008). It is found in some observations that most consumers do not shop alone. Peers, family members and other groups exert strong influence on the buying decision of individuals. These reference groups do the word of mouth marketing. They can play an active role in influencing the opinions of others. That influential impact sometimes goes against or in favor of the interest of a particular organization. For this reason, we hypothesized that:

H2: There is a significant relationship between social influence and purchase intention of customers to shop at hypermarkets.

## 3. Methodology

For conducting the research, data were collected from both primary and secondary sources. The primary data were collected through a structured questionnaire with a likert type 5 point scale from 150 respondents who are the present customers of hypermarkets and convenience sampling was used for choosing the respondents. The secondary data were collected from publication manuals, academic journals, books and finally the current and available information from online sources. Out of the factors that influence the purchase intention of customers, the following have been taken into consideration for the present study: quality of products sold at the stores, socioeconomic condition of buyers, social influence and brand image. Survey area included two states of Malaysia which are Perlis and Kedah. Collected data were computed and analyzed by the researchers using Statistical Package for Social Sciences software. Multiple regression model was used to find out which factors significantly contributed to the purchase intention of customers to shop at hypermarkets.

## 4. Demography of the Respondents

Out of the 150 respondents, 47% were male and 53% were female. 23% were below age 30 years, 59% were between 30-40 years and 18% were above 41 years. Among all the respondents, 65% were service holders, 23% were involved in business and remaining 12% were students and housewives.

## 5. Findings Analysis

### 5.1 Reliability test of data

The reliability of the collected data was tested using Cronbach alpha value. According to Nunally, (1978), the minimum acceptable value of Cronbach alpha is 0.7 and above. Table 1 shows that the Cronbach alpha values of all variables are

165 above 0.7 that indicates good reliability of data.

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**Table 1:** Cronbach Alpha values of all variables.

Variable	Cronbach Alpha	No. of Items
Product Quality	.887	5
Brand Image	.858	5
Socioeconomic	.888	5
Social Influence	.865	5
Purchase Intention	.879	5

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**Table 2:** Correlation Analysis Findings

Variable	Mean	St. Deviation	Product Quality	Brand Image	Socioeconomic	Social Influence	Purchase Intention
Product Quality	3.4667	.7702	1				
Brand Image	3.5711	.7408	.557**	1			
Socioeconomic	3.5556	.7816	.642**	.795**	1		
Social Influence	3.5289	.7733	.598**	.785**	.754**	1	
Purchase Intention	3.5444	.7743	.624**	.750**	.706**	.737**	1

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Correlation analysis was conducted to determine the degree and direction of relatedness between constructs used in the present study. As shown in the table, the degree of relatedness between independent and dependent variables are all good. It is clear from the table that the product quality, brand image, socioeconomic and social influence are positively related to purchase intention. In terms of relationship all the variables are significant.

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### 5.2 Regression Analysis

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Multiple-regression analysis was used with the four factors as independent variables to test the model for purchase intention (see Table 3). SPSS output shows that the independent variables such as product quality, brand image and social influence are statistically significant with positive beta values. The other independent variable, socioeconomic, was not statistically significant

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The findings show that product quality is positively and significantly related to purchase intention at 5% level of significance. So hypothesis (1) is accepted. The socioeconomic condition of customers positively influences their purchase intention though it is not statistically significant at 5% level of significance. Based on the SPSS output it is found that the brand image is statistically significant at 1% significance level (Sig t = .004) with a positive beta. It means that brand image has significant positive effect on purchase intention. So hypothesis (2) is accepted.

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**Table 3:** Regression Analysis Findings

Independent Variables	Beta	t value	Significant
Product Quality	.212	2.476	.014
Brand Image	.349	2.964	.004
Socioeconomic	.089	.752	.454
Social Influence	.268	2.398	.019

R-square = .651  
Adj R-square = .635  
Significant F = 0.000  
Durbin-Watson = 2.281  
Condition Index= 40.191

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Social influence is also statistically significant at 5% significance level (Sig t = .019) with a positive beta. It means that social influence has significant positive effect on purchase intention. So hypothesis (4) is accepted.

The R<sup>2</sup> was 65.6 percent meaning that the regression model used for this study can explain 65.6 percent variations on purchase intention. This indicates that there are other factors that explain the remaining 34.4 percent variations of purchase intention. The F value was adequate and significant at 1 percent significance level. This signifies that there was



an adequate model. The Durbin-Watson value falls within the acceptable range which means that there was no auto correlation problem in the data. The VIF, tolerance and condition index all fall within the acceptable range and therefore there was no multicollinearity problem in the model. Normal P-P plot shows that data were linear. The histogram shows that data were normally distributed. The results suggest that model explains purchase intention of customers to shop at hypermarkets reasonably well.

## 6. Conclusion

The present study revealed insights into the factors influencing the purchase intention of customers of hypermarkets. This research gave emphasis on some factors that are overlooked in consumer researches. The research findings indicate that customers not only consider the conventional criteria like, price, product quality, location and others while taking purchase decision. The influence of their reference group and the brand image are also important to the customers for taking purchase decisions. The identification of the significant influence of product quality, social influence and brand image has confirmed the casual relationship between these factors and purchase intention proposed by Schiffman and Kanuk (2000). The study findings suggest that hypermarkets focus on product quality, brand image and social influence. The present study showed that brand image had the highest impact on purchase intention of customers followed by the quality of products sold at the stores and social influence. In spite of having some value of this research, there are some limitations of his study like data were collected from only two states of Malaysia and a small sample of 150 respondents participated in the survey that ultimately affects the representativeness of data. However, the findings have some practical implications for people involved in superstores or hypermarket business also for them who want to enter in this market. It can also provide some directions for future researches.

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# Economic Development through Prime Minister Employment Generation Programme in India: An Analysis

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## Abstract

Gandhiji often said that village economics is different from industrial economics and the nation can progress only, when the villages are self reliant. That is why more concentration is given towards the rural sector of the Indian economy. The Govt. of India is giving great importance to the Khadi and Village Industries programmes which are the backbone for the development of rural economy of our country. In this paper we investigate the performance of Prime Minister Employment Generation Programme in the economy of India as well as Jharkhand State in the 11th FivePlan (2007 -2012) in terms of numbers of project started, production, sales, employment and earnings. An explorative as well as descriptive research methodology is used to get the data related to the production and employment generated by village industries in India which is well segregated into six zones by the commission (East, West, North, South, Central and North East). The correlation analysis shows a very strong relationship between the selected variables in India. But in case of Jharkhand there is a strong correlation between Number of Village Industries started and Production from those village industries, and the product produced and the sales of those product, but the correlation between the project started and employment generated from those industries and employment generation and the earnings from those employment is very weak, which shows that although the number of industries increased under the PMEGP scheme but still lot have to be done to promote village industries in the economy.

**Keywords:** PMEGP(Prime Minister Employment Generation Programme), Khadi and Village Industries, Micro Small Medium Enterprises, Jharkhand, India

## 1. Introduction to Village Industries

As per the KVIC Act., 1956(No.61 of 1956 and amended in 2006), Village Industry means any industry located in a rural area which produces any goods or renders any service with or without the use of power and in which the fixed capital investment per head of an artisan or a worker does not exceed [one lakh rupees] or such other sum as may, by notification in the official gazette, be specified from time to time by the Central Government;

Provided that any industry specified in the scheduled and located in an area other than a rural area and organized as a village industry in any time before the commencement of the Khadi and Village Industries Commission (Amendment) Act, 1987 shall, notwithstanding anything contained in the sub-clause, continue to be a village industry under this Act;

Provided further that in the case of any industry located in a hilly area, the provisions of this sub-clause shall have effect as if for the words "one lakh rupees", the words "one lakh and fifty thousand rupees" had been substituted.

....any other non-manufacturing unit established for the sole purpose of promoting, maintaining, assisting, servicing (including mother units) or managing any village industry. (Directorate of Economic Research, 2011 - 2012)

Village Industries attracted the Father of Nation, Mahatma Gandhi's attention in 1935. This resulted in the formation of All India Village Industries Association (AIVIA). Thus, the village industries, as a group, came under systematic development process in 1935. At that point of time, there was no specific definition given to the village industries. The industries in rural areas, processing local raw material for local markets with simple techniques and equipments were categorized under "Village Industries". Traditional village industries like GhaniOil, Pottery, Leather, Beekeeping, Carpentry, and Blacksmithy, Soap, Agarbatti, Papad, Pickles, etc. were thriving in rural India, since time immemorial.

The Village Industries in the country worked on self-supporting basis, with an underlying theme of taking advantage of the local raw materials and local skills to achieve production locally and also to provide employment opportunities for local people. Every village had its share of potters, cobblers/tanners, carpenters and blacksmiths. Bee-keepers, oil-crushers etc., working with traditional skills and bringing out exclusive products not only for the consumption of local population but also sending to urban markets.

Because of the declining trend in the additional employment generation opportunities in the agricultural sector, village industries in the non farm sector, is playing an important role in bridging the demand-supply gap in rural employment. With the enlarged scope of micro finance, village industries capability to provide livelihood to rural unemployed people are enhancing. With comparatively low per capita investment and adoption of appropriate skills and technology, Village Industries have been definitely playing a commendable role as an employment provider in the rural areas.

### 1.1 Built-in-Strength of Village Industries:

In India village industries are a major source of rural employment. In large and medium industries per capita investment is very high, therefore, only a small portion of the labour force could be accommodated. Agriculture alone cannot provide employment to the rest, thus village industries are especially important for all developing economies. The scope of village industries is changing fast and today it does not include only the traditional village industries but any industry with or without the use of power which can be established in the villages, with appropriate technology, can be taken as village industries.

The rural industries provide immediate large scale employment and they also offer a method of ensuring a more suitable distribution of the national income. Rural industries facilitate an effective mobilization of resources, capital, and skill which might otherwise remain unutilized.

Some of the problem that unplanned industrialisation tends to create will be avoided by the establishment of small centres of industrial production all over the country. The development of small scale industry is seen as a way of serving the following objectives.

- Employment Generation.
- An equitable distribution of income.
- Mobilisation of capital.
- Entrepreneurial skill.
- Regional Industrial Dispersal.

### 1.2 Historical Perspectives of Village Industries in India

Initially KVIC was responsible for planning, organizing, and implementing of village industries, within due course of time 96 industries were eligible for assistance under the commission's development programme.

In this context we may quote Prof. P.C. Mohalnobis, according to Prof. Mohalnobis, there is no possibility in the short run for creating much employment through the factory-industry i.e. the large industries. On the other hand, the household or cottage industries require very little capital with any given investment, employment possibilities, would be ten or fifteen or even twenty times greater or comparison with corresponding factory industries .

Like other developing nations, in India, next to agriculture, cottage and village Industries were the main-stay of the villages since pre-historic times. Agriculture can't provide employment to everyone and since in large and medium industries, the per capita investment is very high, only very small portion of the total labour force could be accommodated.

In a developing country, small scale industries and village industries are generally of two distinct type:

- i) Modern small industries
- ii) Traditional Cottage industries

Modern small industries are mostly in town and cities, but with the tendency to scatter in interior areas for various reasons like the tax reduction in backward area, availability of cheaper land and labour, availability of local raw material, ready market, special raw material, special climate favourable to the industry or the existence of a clustered localization of a particular industry in that area for availability of special skill.

On the other hand, the traditional cottage industries, using simple tools and requiring less capital, operates both in urban cottages and in villages. The village industries, in rural areas, catered to the staple needs of the villagers, mostly or

110 exchange basis.

111 In India, traditional small industries include khadi textiles and handloom textile, village industries, handicrafts,  
112 sericulture etc. to add the national wealth of a developing country, it is necessary to help the small industries and village  
113 industries, which provides an outlet for the creative faculties and resourcefulness of the people. Village industries can  
114 provide jobs to the large number of unemployed people to earn an honest living.

## 115 2. Prime Minister's Employment Generation Programme 116 117

118 The Prime Minister's Employment Generation Programme (PMEGP), came into existence during the year 2008-2009  
119 (September, 2008), by merging the erstwhile, Rural Employment Generation Programme (REGP), implemented by KVIC  
120 and Pradhan Mantri Rojgar Yojna (PMRY) implemented by DICs. This is a 'credit linked subsidy programme' for  
121 generation of employment opportunities through establishment of micro enterprises in the rural as well as urban areas.  
122 KVIC is the Nodal agency at the National level for implementation of the programme (Directorate of Economic Research,  
123 2011 - 2012).

### 124 2.1 Implementing agencies 125 126

127 The Ministry of MSME, Government of India has nominated KVIC as 'National Nodal Agency to implement the scheme  
128 with the active participation of Banks, State Khadi & Village Industries Boards and DICs of the State Governments

129 The scheme is being implemented by KVIC(Khadi Village Industries Commission), State KVIBs (i.e. State Khadi &  
130 Village Industries Boards) and DICs (District Industries Centres) in rural areas, while in urban areas, by DICs only.  
131 Maximum cost of the project under the scheme in manufacturing sector is Rs.25.00 lakhs and in service sector Rs.10.00  
132 lakhs.

### 133 2.2 Industries under PMEGP 134 135

136 Any industry, including coir based projects (except those mentioned in the negative list), which produces goods or  
137 renders any service with or without the use of power and in which the fixed capital investment per head of a full time  
138 artisans or worker i.e. Capital Expenditure on workshop/work-shed, machinery and furniture of the project does not  
139 exceed Rs.1.00 lakh in plain areas and Rs.1.50 lakh in hilly areas.

#### 140 2.2.1 Segments under village industry (PMEGP scheme) 141 142

- 143 • Mineral based industries
- 144 • Forest based industry
- 145 • Agro based and food industry
- 146 • Polymer and chemical based industry
- 147 • Engineering and conventional energy
- 148 • Textile industry(excluding khadi)
- 149 • Service industry

#### 150 2.2.2 Negative list of activities: 151 152

153 Any industry/business connected with Meat (slaughtered) i.e. processing, canning and/or serving items made of it as  
154 food, production/manufacturing or sales of intoxicant items like Beedi/Pan/Cigar/Cigarette etc., any hotel or dhaba with  
155 sales outlet serving liquor, preparation/producing tobacco as raw materials, tapping of toddy for sale.

156 Any industry/business connected with cultivation of crops/plantation like Tea, Coffee, Rubber, Sericulture (Cocoon  
157 rearing), Horticulture, Floriculture, Animal Husbandry like Pisciculture, Piggery, Poultry, Harvester machines etc.

158 Manufacturing of Polythene carry bags of less than 20 microns thickness and manufacture of carry bags or  
159 containers made of recycled plastic for storing, carrying, dispensing or packaging of food stuff and any other item, which  
160 causes environment problems.

161 Industries such as processing of Pashmina Wool and such other products like hand spinning and hand weaving,  
162 taking advantage of Khadi programme.

163 Rural Transport (except Auto Rickshaw in Andaman & Nicobar Island; House Boat, Shikara & Tourist Boats in J&K  
164 and Cycle Rickshaw).

165 Business activities like opening of grocery and stationary shops etc. involving no manufacturing process and value  
166 addition.

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### 168 2.2.3 Area of operation

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170 **Rural area** as defined under KVIC Act, 2006:

171 Any area classified as village as per the revenue record of the State/U.T., irrespective of population.

172 It will also include any area even if classified as town, provided its population does not exceed 20,000 persons.  
173 Scheme is being implemented by KVIC, KVIBs and DICs.

174 **Urban area** means those areas not covered under Rural Area. Scheme is being implemented by DICs only.

175

## 176 3. Objective and Methodology

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178 The objective of this paper is to examine and critically analyze the existing structure of village industries with emphasis  
179 upon number of village industries established, production, sales, employment generation and earnings by the village  
180 industries as defined by Khadi and Village Industries Commission and to find out the existing relationship between  
181 various variables

182 In order to achieve the objective the present study require secondary data from published and unpublished work on  
183 the related topic(economic survey, journals, etc.), government organizations(Directorate of Industries, Directorate of KVIC  
184 Ranchi, Directorate of Economics and Statistics).

185 An explorative as well as descriptive research methodology is used to get the data related to the production and  
186 employment generated by village industries in India which is well segregated into six zones by the commission (East,  
187 West, North, South, Central and North East).

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## 189 4. Literature Review

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191 Small scale sector holds an important place in agro – industrial economy of India. A number of researchers and subject  
192 experts have done a commendable job by providing their feedback in the form of experience and inferences from data  
193 analysis. This certainly needs to be studied for a better understanding of the small – scale sector in agro – industrial  
194 economy its present status and implications.

195 Village Industries is one of the means of providing gainful employment opportunities to a number of people in the  
196 countryside, due to various inherent limitations of the growth of the organised industry sector and insufficient potentialities  
197 of agricultural development and migration of rural people to urban areas where opportunities are too limited, village  
198 industries play a significant role (Dubashi, 1984), although the removal of poverty is a very difficult task but Khadi and  
199 Village Industries can contribute its share to remove poverty (Thomas, 1984),through rural industrialisation as a poverty  
200 alleviation programme (George, 1984),although substantial income and income generating opportunities could be created  
201 through agriculture and allied programmes but village industries can diversify the poor rural masses towards gainful  
202 employment and promoting rural industrialisation (Bhanujan, 1984), because rural development programmes has to  
203 address both the open employment and disguised employment and Khadi and Village Industries provide an important  
204 means for rural industrialisation through which poverty can be reduced by means of industrial employment (Adiserhiah,  
205 1992),rural industrialisation should be encouraged to provide suitable employment to the rural household without  
206 involving any dislocation and migration (Prema, 1998) Khadi and Village Industries programme had registered an  
207 impressive growth during 1987 – 88. The production of these industries had attained a level of Rs. 1488.39 crores during  
208 1987 – 88 registering an increase of 13% over the production level of Rs.1316.72 crore during 1986 – 87, it also provide  
209 employment (full time as well as part time) to 41.80 lakhs person whose earnings amounted to Rs. 468.98 crore (Jain,  
210 1989) in 1990 – 91 Khadi products worth Rs. 2780.02 crore were produced in the country, in 1993 – 94 the production  
211 increased to Rs. 3233.86 crore. The earnings went up from Rs.784.05 crore in 1990 – 91 to Rs.1140.65 crore in 1993 –  
212 94. This sector provided employment to 53.28 lakhs person during this period against 48.57 lakhs in 1990 -91. During  
213 1993 – 94, over 8000 artisans were trained under village industries which included over 900 women, about 450  
214 scheduled caste and 280 scheduled tribe candidates were also trained during the period (Arunachalam, 1995) Khadi and  
215 Village Industries provide crucial non – farm opportunities to the rural population, small scale sector employs over 15  
216 million workers and account for over 40% of Indian manufacturing output and 35% of its export (Gangal, 1996).

217 Indian population faced the problem of unemployment and underemployment which is more grave in rural sector.  
218 The unemployment of rural youth is the new dimension of the problem. This hassled to the problem of migration to urban  
219 areas abandoning the village, which in turn has generated many problems in urban areas like development of slums,  
220 unemployment proliferation of antisocial elements. In such a condition rural industries and village industries through  
221 massive rural industrialisation is the only measure to cure the problem and accelerate the development of rural India,  
222 large scale industries could not contribute in solving the gigantic national problem of unemployment and poverty , Khadi  
223 and Village Industries in rural areas would expand work opportunities, raises incomes and standards of living and bring  
224 more balanced and integrated rural economy (Khatri & Bhandari, 1998) ; (Sahaya, 1999) Khadi and Village Industries  
225 helps to generate non – farm employment opportunities and restrict migration of rural population to urban centres for  
226 employment and livelihood (Tripathy, 1998); (Bhargava, 1998), Agro based Industries also contribute to the development  
227 of economy, they would achieve economic growth, reduce dependency of rural population on government and other  
228 agencies and would also lead to industrialisation, they utilise local tools and materials provide employment opportunities  
229 and raises the income level of rural people and to help eradicate growing poverty (Sahaya R. ..., 1998) but a backward  
230 and forward linkages should be ensured in respect of agro – based industries that maximum growth impulses are  
231 generated (Sundaram, 2002) Khadi and Village Industries sector will be part and parcel of economic system of India by  
232 providing sustainable employment (Meenakshisundaram, 2000) these industries can effectively bring about rural  
233 economic development with relatively less financial resources (Gupta, Singh, & Pruthi, 1998) Khadi and Village Industries  
234 provide entrepreneurial opportunities to ideal rural women workforce and contribute for accelerating economic growth  
235 (Hanamashetti, 1999). To solve the problem of unemployment and underemployment a well designed integrated  
236 approach towards rural employment has to be prepared (Dwarkanath, 1999). The problem of unemployment has to be  
237 brought into the sharpest focus while planning and implementing the programme of the economic growth of the nation  
238 (Sharma, 1999) in the terminal year of Eighth five year plan only 58.17 lakhs person employed in Khadi and Village  
239 Industries in other words only half – percent of rural population engaged themselves in Khadi and Village Industries  
240 (Bhardwaj, 1998).

241 Development goals must be defined in terms of progressive reduction and eventual elimination, diseases, illiteracy  
242 squalor, unemployment and inequalities (Haq, 1971). If the poverty, unemployment and inequalities declined from higher,  
243 then beyond doubt this has become period of development for the country concerned, if one or two of the central problem  
244 have been growing worse, especially if all three have it would be strange to call the result 'development' even if per capita  
245 income doubled (Seers, 1969), village industries have a unique role to play in the economic development of the poor rural  
246 people in India (Patel, 1970), it was observed that agro industries have played an important role in the economy of  
247 developing countries, the economic prosperity of a developing country like India is dependent on integration of its  
248 agriculture with industry (Baig & Iqbal, 1981).

249 Khadi and Village Industries Sector plays an important role in the economic development of rural areas from the  
250 angel of exploitation of local resources and skills and generation of employment and income of rural people (Bhusan,  
251 1995) these industries provide immediate large scale employment offer a method of ensuring a more equitable  
252 distribution of national income and facilitate an effective mobilisation of resources which might otherwise remain  
253 unutilised (Balasubramanya, 1999) small scale and household enterprises is an important component of an employment  
254 oriented strategy of industrialisation. The employment output ratio is the lowest in the small scale sector while that  
255 employment generation capacity is eight times higher than that of large sectors (Datt & Sundaram, 1979) the large  
256 volume of unutilised labour possessed by less developed countries has a productive potential , capable of creating capital  
257 and increasing production by labour intensive technique (Myrdal, 1968) in this sense, Khadi and Village Industries should  
258 be developed and promoted especially in an economy where capital is scarce (Lewis, 1954) as there is a positive  
259 relationship among productivity of labour, output and employment (Keynes, 1936).

260 Village Industries are labour intensive industries with a short gestation period which results in higher growth rate  
261 both in terms of employment and output and most important labour intensive pattern of industrialisation can avoid the  
262 pitfall of concentration of industries in few industrial areas (Jamal, 1999), village industries would play an important role in  
263 the rural areas whereas modern small units are likely to be more concentrated in the urban areas because of the  
264 sophistication in the product, rural development is a basic necessity and economic imperative and there is a need for  
265 evolving proper policies and measures to promote small scale industries and village industries in rural areas with a view  
266 to raising the incomes, increasing employment opportunities encouraging participations in the development process and  
267 adding to the quality of life. Achievement of these would contribute to the correlating of industrial growth and reducing  
268 migration (Singaravelu, Ali, & Kanakaiah, 2000).

269 Khadi and Village Industries now be considered as a second freedom struggle i.e., freedom from want and poverty  
270 (Panditrao Y. ..., 1999) village industries have the potential to play a very major role in bringing about rural industrialisation

(Raghavrao, 1999). In the process of rural industrialisation there is a development of rural markets, roads, transport, employment and quality of life of the rural masses shall improve in the natural courses which are the basic needs of rural development (Singh, 2000); (Siddiqui, 2002).

The pace of technological development in rural cottage and village industries including Khadi sector in India has been extremely slow, for centuries the technology has almost stagnant, an integrated approach is needed to remove the blockage for the development and transfer of the technology in village industry so that it leads to increasing work opportunities and ensuring reasonable income and banish poverty from the land (Panditrao Y. A., 1998) ; (Seerangarajan, 1998).

The promotion of Small Scale Industries have been widely recognised as one of the most appropriate means of developing industries in developing countries, which are facing mounting pressure of population, and acute shortage is in investable capital fund and lack of entrepreneurial and managerial abilities (Bharti, 1978) small scale industry can act as a integral part of country's economic structure as a whole (Prasad L. , 1983)

If small scale industries are properly developed they can provide a large volume of employment, can raise income and standard of living of the people in lower income group and can bring about more prosperity and balanced economic development.

## 5. Performance of Prime Minister Employment Generation Programme in India

Table 1: Number of Projects (In Nos.)

S.No	YEAR	NORTH	EAST	NORTH-EAST	SOUTH	WEST	CENTRAL	INDIA
1	2008-09	2596.00	12204.00	2246.00	4040.00	2138.00	4384.00	27608.00
2	2009-10	5195(100.11)	10465(-14.24)	3720(65.62)	9327(130.86)	4216(97.19)	6579(50.06)	39502(43.08)
3	2010-11	7102(36.70)	11359(8.54)	6847(84.05)	8839(-5.23)	6821(61.78)	8851(34.53)	49819(26.11)
4	2011-12	6722(-5.35)	15528(36.70)	9781(42.85)	8465(-4.23)	4723(-30.70)	9916(12.03)	55135(10.67)

Source:- Statistical Statement, KVIC, Mumbai

Table 2: Production (Rs. In lakhs)

S.No	YEAR	NORTH	EAST	NORTH-EAST	SOUTH	WEST	CENTRAL	INDIA
1	2008-09	34251.92	120765.78	29474.71	53520.40	28297.65	48128.84	314439.30
2	2009-10	47723.35(39.33)	55301.85(-54.20)	11933.45(-59.51)	88412.95(65.19)	27138.97(-4.09)	87045.90(80.86)	317556.47(0.99)
3	2010-11	52346.89(9.68)	74471.03(34.66)	29689.65(148.79)	94353.79(6.71)	45274.02(66.82)	120683.59(38.64)	416818.97(31.25)
4	2011-12	45500.01(13.07)	102617.57(37.79)	44985.98(51.52)	93927.62(-0.45)	39819.01(-12.04)	146765.21(21.61)	473615.40(13.62)

Source: Statistical Statement, KVIC, Mumbai

Table 3: Sales(Rs. In Lakhs)

S.No	YEAR	NORTH	EAST	NORTH-EAST	SOUTH	WEST	CENTRAL	INDIA
1	2008-09	52789.06	194959.95	45426.43	82485.64	43612.33	74176.17	493449.58
2	2009-10	55764.55(5.63)	97720.55(-49.87)	23967.35(-47.23)	135686.43(64.49)	44560.55(2.17)	126763.55(70.89)	484462.98(-1.82)
3	2010-11	65433.63(17.33)	93088.80(-4.73)	37112.09(54.84)	117942.25(13.07)	56592.53(27.00)	150854.49(19.00)	521023.79(7.54)
4	2011-12	56875.15(-13.07)	128272.04(37.79)	56232.57(51.52)	117409.58(-0.45)	49773.81(-12.04)	183456.57(21.61)	592019.72(13.62)

Source: Statistical Statement, KVIC, Mumbai

Table 4: Employment (In Numbers)

S.No	YEAR	NORTH	EAST	NORTH-EAST	SOUTH	WEST	CENTRAL	INDIA
1	2008-09	43372.00	130003.00	72823.00	60452.00	31668.00	59882.00	398200.00
2	2009-10	46977.00(8.31)	95641.00(-26.43)	23920.00(-67.15)	152612.00(152.45)	31262.00(-1.28)	69585.00(16.20)	419997.00(5.47)
3	2010-11	64506.00(37.31)	106723.00(11.58)	51656.00(115.95)	112035.00(-26.58)	56973.00(82.24)	90131.00(29.52)	482024.00(14.76)
4	2011-12	47653.00(-26.12)	124858.00(-16.99)	78417.00(51.80)	105361.00(-5.95)	45790.00(-19.62)	93444.00(3.67)	495523.00(2.80)

Source: Statistical Statement, KVIC, Mumbai



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**Table 5: Earnings(Rs. In Lakhs)**

S.No	YEAR	NORTH	EAST	NORTH-EAST	SOUTH	WEST	CENTRAL	INDIA
1	2008-09	15636.00	59401.12	13455.21	24432.06	12917.88	21970.82	147813.09
2	2009-10	22447.10(43.56)	33901.10(-42.92)	8197.05(-39.07)	49606.10(103.06)	14918.45(15.48)	55511.35(152.65)	184581.15(24.87)
3	2010-11	34761.52(54.85)	49803.88(46.90)	22261.97(171.58)	58298.96(17.52)	30584.49(105.01)	72170.15(30.00)	267880.97(45.12)
4	2011-12	31279.07(-10.01)	67714.28(35.96)	34109.59(53.21)	58805.86(0.86)	29886.29(-2.98)	87914.35(21.81)	309709.44(15.61)

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**Source:** Statistical Statement, KVIC, Mumbai

### 5.1 Performance of Prime Minister Employment Generation Programme in Jharkhand

**Table 6: Projects (In Nos), Production (Rs. in Lakhs), Sales (Rs.in Lakhs), Employment (In Nos), Earning (In Nos)**

S.No	YEAR	PROJECT	PRODUCTION	SALES	EMPLOYMENT	EARNING
1	2008-09	538.00	7133.88	10994.74	7705.00	3256.62
2	2009-10	353(-34.38)	2954.60(-58.58)	5114.05(-53.48)	3250.00(-57.81)	2250.10(-30.90)
3	2010-11	1545(337.67)	10917.98(269.52)	13647.47(166.86)	15450.00(375.38)	6896.60(206.50)
4	2011-12	2372(53.52)	14514.23(32.93)	18142.80(32.93)	7116.00(-53.94)	9939.53(44.12)

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**Source:** Statistical Statement, KVIC, Mumbai

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## 6. Demography of Jharkhand

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Jharkhand is primarily an agricultural state. Out of the total population of 2.69 crore, the rural population is 2.09 crore and urban population is 59.85 lakh. In this way nearly 77.75% of the people live in rural areas. Most of them are dependent on agricultural activities. The total agricultural land of the state is 38lakhs hectare out of the total area of 79,714 square kilometers. Only forty percent of the land is fertile and assured irrigation is available in 2 Lakh hectare. The total geographical area of the state is 79.71ha. An area of 23.22 lakh ha (29.13%) is under forests, 5.66 lakh ha(7.10%) is barren land, 7.24 lakh ha(9.08%) is under non- agricultural, 0.90lakh ha(1.13%) is under pastures and other grazing lands, 3.07 lakh ha(3.85%) is under cultivable waste land, 1.18 lakh ha(1.48%) is under miscellaneous trees and groves, 12.04 lakh ha(15.10%) is current fallows, 8.45 lakhs ha(10.60%) is other fallows and 17.95 lakh ha(22.53%) is the sown area. These figures indicate that an area of 24.4 lakh ha is under agricultural wasteland and must be usefully utilized.

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### 6.1 Naxalism in Jharkhand

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Naxalism is a movement which originated in the north Bengal country side near Naxalbari thana in early 1967. The uprising was not a disorganized outburst of peasant anger but the result of political agitation by a group of communist organizer. Secondly the uprising was not a sharp, short event, soon ignited and soon put down, but a lingering and fairly long drawn out struggle between the forces organized by revolutionaries and the groups opposed them.

335

The naxalites ideology is against India in its present form They believe that india is still to acquire freedom from the hunger and deprivation and that the rich classes – landlords, industrialists, traders, etc – control the means of production. Their final aim is to overthrow of the present system, hence they targeting the politician, police officer, forest contractor etc.

336

More recently there has been a spurt in the naxal violence especially against the police in many district such as Ranchi, Palamu, Khunti, Latehar, Giridih, and Bokaro. They are important in the sense that the maoist have proved that they can penetrate even the capital town. They mobilized civilian in their struggle areas for the first time and tested their mobile warfare. Such developments are real causes of concern to the state authorities.

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The MCC maintains close relationship with the maoist insurgents in Nepal. On July 1, 2001, nine naxal outfits of India, Nepal, Bangladesh, and Sri Lanka joined hands to form an umbrella organization, the Coordination Committee of Maoist Parties and Organisations (CCOMPOSA) with a purpose to unify and coordinate the activities of the Maoist Parties and Organisations in South Asia.

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353 6.2 Factors Behind Naxalism  
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355 The origin and growth of Naxalities movements can be attributed to a combination of economic, social, and political  
356 factor. It has been estimated that 54 percent of the Jharkhand's population still lives Below the Poverty Line(BPL). It  
357 implies that a large mass of Jharkhand population leads a miserable life despite six decades of development effort. It can  
358 largely been attributed to the imbalance between the growth of population and the growth of Economy. The government  
359 triedto tackle the problem of poverty but the result were offset by the population explosion.

360 The employment front is also perplexing. Employment opportunities have not expanded enough to reduce poverty.  
361 The backlog of employment is rising steadily. Some of the salient features of unemployment in rural areas, under –  
362 employment among women and higher incidence of unemployment among the educated.

363 There are various theories of extremism. The most popular theory is the “grievance – frustration” concept. Some  
364 analyst attribute insurgency as “deviant social behavior” , while other ascribe it to the break – up of traditional societies  
365 and the process of modernization.

366  
367 6.3 Khadi and Village Industries in Jharkhand  
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369 Jharkhand being a mineral rich state primarily focuses on iron ore and coal reserves. Majority of reform process have  
370 been considered as MOU for development of large scale private players eyeing for the natural mineral resource of the  
371 state. However the state is still waiting for the new industrial policy to come into force which was formulated in 2003. The  
372 Jharkhand economic survey have revealed the fact of the under utilization of arable land. Although the policy makers  
373 have stated the importance of Village Industries in terms of art and craft, tussar, handloom, Lacs, cosmetics, processed  
374 foods etc. However there need to be exhaustive and critical study of Khadi and Village Industries prospects in Jharkhand  
375 state. This is much needed to overcome the problem of underdeveloped rural economy which is forcing extreme poverty,  
376 naxalism and mal nutrition. Over and above the central government policy of MNERGA have not benefited the rural  
377 economy due to multi crore corruption.  
378

379 7. Village Industries under Prime Minister Employment Generation Programme in 11<sup>th</sup> Five Year Plan(2007 –  
380 2012) – A Correlation Analysis  
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382 The correlation analysis indicates mutual dependence of two variables. It shows the relationship between two such  
383 variables in which the value of one variable changes due to the change in the other variable.

384 A bivariate Correlation analysis was undertaken between number of projects started under PMEGP scheme and  
385 product produced in Indian Rs.(In Lakhs), number of project started under PMEGP scheme and employment generated  
386 (In Nos), Employment Generated (In Nos) and Earnings in Indian Rs.(In Lakhs) and product produced in Indian Rs.(In  
387 Lakhs) and Sales of the product produced by Village Industries in Indian Rs.( In Lakhs) under PMEGP scheme in the  
388 country between 2008 – 2012, result of the correlation is (  $r = .918$ ), (  $r = .973$ ), (  $r = .993$ ) and (  $r = .939$ ) respectively in the  
389 entire country.

390 Another bivariate Correlation analysis was under taken between of projects started under PMEGP scheme and  
391 product produced in Indian Rs.(In Lakhs), number of project started under PMEGP scheme and employment generated  
392 (In Nos), Employment Generated (In Nos) and Earnings in Indian Rs.(In Lakhs) and product produced in Indian Rs.(In  
393 Lakhs) and Sales of the product produced by Village Industries in Indian Rs.( In Lakhs) under PMEGP scheme in the  
394 Jharkhand State between 2008 – 2012, result of the correlation is (  $r = .963$ ), (  $r = .399$ ), (  $r = .416$ ) and (  $r = .993$ )  
395 respectively.  
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397 8. Interpretation  
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399 8.1 Interpretation of Prime Minister Employment Generation Programme in entire India  
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401 The project sanctioned under PMEGP scheme has revealed a fluctuating trends during the period under study. The  
402 project sanctioned was recorded to the tune of 27608 and 55135 respectively during the first year of PMEGP(2008-09)  
403 and last year of 11<sup>th</sup> five year plan (2011-2012). It is found that the maximum increase in project was noted during 2009-  
404 10 revealing a hike of 43.08 percent and minimum in 2011-2012, 10.67 % respectively. The average growth rate is 26.62  
405 %.

406 The production by industries under PMEGP has revealed a fluctuating trend during the period under study. The

407 production was recorded to Rs. 314439.30 and Rs. 473615.40 in 2008-09 and 2011-2012 respectively. It is found that the  
408 maximum increase in production was noted 31.25% in 2011 and minimum increase in production was noted 0.99% in  
409 2009-2010. The average growth rate is 15.28 % .

410 The revenue from the sale of products constitute the source of income to the KVI sector. Sales of Village Industries  
411 product under PMEGP scheme was registered to Rs.493449.58 lakhs in the year of 2008-09 which was further gone up  
412 to Rs 592019.72 in 2011-2012. It is found that maximum increase in sales was recorded during the 2011-2012 revealing  
413 a hike of 13.62% and a negative growth of (-) 1.82% in 2009-2010. The average growth rate is 6.44% in India.

414 The employment generated by industries under PMEGP has showing fluctuating trends. During the first year of  
415 implementation PMEGP provided employment to 398200 persons and it raised to 495523 persons in 2011-2012. The  
416 maximum increase in employment generated is noted in PMEGP at 14.76 % in 2010-2011 and minimum growth is 2.80  
417 % in 2011-2012. The average growth is 7.67 %.

418 The earnings generated by industries under PMEGP has showing fluctuating trends. The earning by the PMEGP  
419 industries were registered to Rs. 147813.09 lakhs in 2008-09 when reached to Rs. 309709.44 lakhs in 2011-12. It is  
420 found that the maximum increase in earnings in 2010-2011 was recorded 45.12 percent. The average growth rate is  
421 28.53%.

## 422 8.2 Interpretation of Prime Minister Employment Generation Programme in entire Jharkhand

423 The project sanctioned under PMEGPscheme has revealed a fluctuating trends during the period under study. The  
424 project sanctioned was recorded to the tune of 538 and 2372 respectively during the first year of PMEGP(2008-09) and  
425 last year of 11<sup>th</sup> five year plan (2011-2012). It is found that the maximum increase in project was noted during 2010-11  
426 revealing a hike of 337.67 percent and minimum in 2009-2010, (-) 34.38 % respectively. The average growth rate is  
427 118.93 %.

428 The production by industries under PMEGP has revealed a growing trend during the period under study. The  
429 production was recorded to Rs. 7133.88 in lakhs and Rs. 14514.23 in lakhs during 2008-09 and 2011-2012 respectively. It  
430 is found that the maximum increase in production was noted 269.52% in 2010-2011 and negative growth in production  
431 was noted (-) 58.58% in 2009-2010. The average growth rate is 80.99 % .

432 The revenue from the sale of products constitute the source of income to the KVI sector. Sales of Village Industries  
433 product under PMEGP scheme was registered to Rs.10994.74 lakhs in the year of 2008-09 which was further gone up to  
434 Rs 18142.80 in lakhs during 2011-2012. It is found that maximum increase in sales was recorded during the 2010-2011  
435 revealing a hike of 166.86% and a negative growth of (-) 53.48% in 2009-2010. The average growth rate is 48.77% .

436 The employment generated by industries under PMEGP has showing fluctuating trends. During the first year of  
437 implementation PMEGP provided employment to 7705 persons and it raised to 15450 persons in 2010-2011. The  
438 maximum increase in employment generated is noted in PMEGP at 375.38 % in 2010-2011 and negative growth of (-)  
439 )57.81 % in 2009-2010. The average growth is 87.87 %.

440 The earnings generated by industries under PMEGP has showing fluctuating trends. The earning by the PMEGP  
441 industries were registered to Rs. 3256.62 lakhs in 2008-09 and reached to Rs. 9939.53 lakhs in 2011-12. It is found that  
442 the maximum increase in earnings in 2010-2011 was recorded 206.50 % . The average growth rate is 73.24%.

443 The correlation analysis shows a positive strong correlation between the variables; number of projects started  
444 under PMEGP scheme and product produced in Indian Rs.(In Lakhs) is  $r = .918$  , number of project started under  
445 PMEGP scheme and employment generated (In Nos) is  $r = .973$  , Employment Generated (In Nos) and Earnings in Indian  
446 Rs.(In Lakhs) is  $r = .993$  and product produced in Indian Rs.(In Lakhs) and the Sales of the product produced by Village  
447 Industries in Indian Rs.( In Lakhs) is  $r = .939$  under PMEGP scheme in the country between 2008 – 2012.

448 In case of Jharkhand a strong correlation was observed between number of projects started under PMEGP  
449 scheme and product produced in Indian Rs.(In Lakhs) is  $r = .963$  , product produced in Indian Rs.(In Lakhs) and the Sales  
450 of the product produced by Village Industries in Indian Rs.( In Lakhs) is  $r = .993$  , but a weak relation was observed  
451 between number of project started under PMEGP scheme and employment generated (In Nos) is  $r = .399$  , Employment  
452 Generated (In Nos) and Earnings in Indian Rs.(In Lakhs) is  $r = .416$  under PMEGP scheme between 2008 – 2012.

## 453 9. Conclusion

454 One of the flagship programmes undertaken by the Govt. of India for creating employment opportunities for the rural as  
455 well as urban masses during the year 2008 – 09 is the PMEGP. The result of the study shows a mix trend in case of  
456 growth rate of number of village industries/projects established, goods produced from those industries, sales of goods  
457

461 produced from those industries, employment generated by those industries, and the earning generated by those  
462 industries in Jharkhand state as well in India.

463 The correlation analysis shows a very strong relationship between the selected variables in India. But in case of  
464 Jharkhand there is a strong correlation between Number of Village Industries started and Production from those village  
465 industries, and the product produced and the sales of those product, but the correlation between the project started and  
466 employment generated from those industries and employment generation and the earnings from those employment is  
467 very week, which shows that although the number of industries increased under the PMEGP scheme but still lot have to  
468 be done to promote village industries in the economy.

469 Collecting our result provide the holistic scenario of PMEGP in India and Jharkhand, the study shows the  
470 importance of village industries in the economic growth and economic development of the region as well as country  
471 suffering from regional imbalance, extremist problem and unemployment.

472 Ganhijee stated that "production by masses rather than mass production"

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# Governmental Support of Innovative and Industrial Development of the Economy

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## Abstract

The article studies peculiarities of implementation of governmental support of industrial and innovative development of the economy; theoretical aspects of the incentive function of the state and main forms and methods of supporting the innovation sphere. It provides analysis of the experience of Kazakhstan, identifies typical attributes of governmental support of industrial and innovation activities, formulates main problems of participation of the state in innovative projects, and development of the algorithm of assessment of governmental support of innovative small business.

**Keywords:** innovations, state, development, Kazakhstan, support, small businesses, assessment.

## 1. Problem Definition

Presently, the social progress is based on development of the industrial and innovation activities. Taking this into account, many countries treat implementation of industrial and innovation development as one of strategic directions of state regulation of the economy. The industrial and innovation development targets stable development of the country through mastering production of conceptually new types of products and technologies, expansion of native goods' markets based on it. It is to be noted that the process of reframing the necessity to move to the new type of economic systems' development in different institutions of different countries is carried out without coordination either of time or of the concept. And in such countries as Russia, Ukraine, Kazakhstan and other CIS countries, this process is at the initial stage currently, which is clearly evidenced by Figure 1.

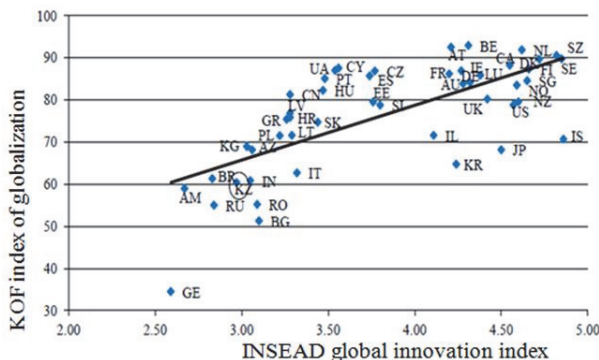


Figure 1. Globalization and innovations [INSEAD, Switzerland School of Economics, www.worldbank.org/reference, 2013]

44 Kazakhstan is especially interesting in this context, as it gradually develops innovative economy and, for example, moved  
45 up by 8 points for the period 1995-2009 by the knowledge economic index (KEI) , and up from 84<sup>th</sup> position in 2011 to  
46 83<sup>rd</sup> position in 2012 with regard to the global innovation index. This progress was facilitated by the fact that industrial and  
47 innovation development is one of priorities of the national strategy and policy of Kazakhstan. All main elements of the  
48 modern innovation system have already been formed and function in the country. However, prospects of further  
49 development and its acceleration depend greatly on how efficiently governmental support of industrial and innovation  
50 development of the economy will be provided; and whether mechanisms of focusing state and business resources on  
51 development of prioritized innovative sectors of the economy will be efficient, and whether usage of advanced information  
52 systems of monitoring specific instruments of industrial and innovation policy implementation will manage to give effective  
53 output.

54 Thus, these circumstances confirm the vitality of the research subject and form its composition platform, goals and  
55 objectives.

## 56 **2. Analysis of Latest Researches and Publications**

57 Many fundamental researches are dedicated to issues of state regulation of industrial and innovation development of the  
58 economy (Volkova & Sakhno, 2005; Geets, 2007; Zyanko, 2008; Kolokolov, 2012; Mendaliyeva, 2010; Yulenkova, 2012)  
59 and other authors can be included in this list.

## 60 **3. Unresolved Parts of the Problem**

61 Despite significant number of works, most of them are dedicated to peculiarities of governmental support in developed  
62 countries. It is obvious that clearly formulated recommendations are not always acceptable for countries with transitive  
63 economy. Besides, issues, related to mechanisms and instruments of governmental support have yet been studied  
64 tenuously as governments of developing countries pay for actions of specialists rather than for intellectual property. The  
65 problem of governmental support of innovations, which face absence of market demand, also requires to be analyzed  
66 further. As for Kazakhstan, the debating points are the issues of economic and organizational grounds of state  
67 encouragement of industrial and innovation activities in economy sectors of high priority.

68 The research objective is to study theoretical and key aspects of governmental support of industrial and innovation  
69 development of the economy, consideration of peculiarities and problems of the implementation of state incentives of  
70 innovation sphere in Kazakhstan.

## 71 **4. General Results of the Research**

72 The main objective of the governmental support of the industrial and innovation development of the economy is creation  
73 of social and economic, organizational and regulatory positions for efficient formation, development and application of  
74 scientific and technical potential of the country as well as implementation of advanced technologies of production and  
75 sale of new types of competitive products. Government intervention in the behavior of innovative processes is necessary  
76 for creating incentives for innovations that are not created by the market institutional environment.

77 In the world, there are two efficient models of government support of industrial and innovation development: the  
78 American and the Japan models. The American model assumes maximum autonomy of entrepreneurial activity, which is  
79 engaged in developing innovations. This model is based on the principles of free competition and orientation to  
80 technological development. Implementation of the supporting functions of the state is carried out by way of defining a  
81 sector of the highest priority. The Japan model assumes that the government ensures technological prerogatives through  
82 encouraging specific technologies, rather than single sectors (Grechko, 2012). At that, the government support can be  
83 rendered directly by granting money from the budget or by distribution of money through special non-budgetary funds or  
84 in the form of indirect influence, which assumes granting tax releases, privileges to subjects of innovative sphere. The  
85 authors believe that for developing countries, such direction of development must become dominant, which is based on  
86 application of the strategy of industrial and innovation potential building in prioritized directions of progress in science and  
87 technology as the government determines. In this context, developing innovative programs and establishing a legal base  
88 for the innovative activity seems to be most important.

89 The main instruments and mechanisms of encouraging and supporting the industrial and innovation development  
90 of the economy include:

- 91 • subsidizing companies in a competitive order by prioritized directions of their innovative activities:

- creating conditions for efficient operation of innovative financial and credit institutions and investment businesses;
- encouraging directly state sector companies as well as companies that operate in the natural monopoly sphere to form and implement industrial and innovation development programs;
- supporting science development at economic entities;
- using instruments of tax incentives of innovative activities of companies;
- ensuring formation and development of the direct investment and venture capital industry for attracting investments in international capital markets;
- developing innovation infrastructure;
- improving efficiency and transparency of mechanisms of the public and private partnership;
- improving the export system with regard to high technology goods and services and the import system with regard to standalone foreign technologies, which are very prospective for distribution in the economy;
- forming internal relations at state-owned companies, which would encourage creating various organizational forms of market-type economic activity and attraction of private investments including investments in the innovation sector.

The authors believe that particular attention in the process of formation of the mechanism of governmental support of industrial and innovation development of the economy must be paid to revealing interrelations between the forms and the methods as well as the expected results of such rendering governmental support to innovation companies and sectors, functions and instruments of such support.

1. As it has been noticed before, the industrial and innovation development of Kazakhstan, which is based on implementation of new ideas, scientific knowledge, technologies and types of products in various spheres of production and society management, is one of the most important factors of the Republic's economy development. General provisions of the Law of the Republic of Kazakhstan *On governmental support of industrial and innovation activities* (www.kz.government.kz/docs/z120000053420120109~2, 2013) and the *Program of innovative development of the Republic of Kazakhstan* target the expansion of the scopes of industrial and innovation activities in Kazakhstan. In 2010, the *Strategic plan of development of the Republic of Kazakhstan until 2020* was approved. Its main objective is ensuring qualitative growth of the economy through its modernization, development of human resources and improvement of the institutional base, which, in their turn, are to facilitate the accelerated industrial and innovation development of the country and the increase of the citizens' prosperity level (Grechko, 2012). The government program of accelerated industrial and innovation development of the Republic in 2010-2014 prescribes formation of favorable environment for investors who are ready to implement projects in the following prioritized sectors of the economy:

- oil refining and infrastructure of the oil and gas sector, the mining and smelting industry, nuclear and chemical industry with further upgrade of rough manufacturing to higher levels;
- mechanical engineering, building industry, pharmaceuticals industry;
- agricultural, consumer and travel industries;

2. information and communication technologies, biotechnology, alternative energetics, space industry (On Governmental Support of Industrial and Innovation Activities, www.kz.government.kz/docs/z120000053420120109~2, 2013).

The planned total value of the program is 60 billion tenges (approximately 400 million US Dollars), of which 36 billion tenges (approximately 240 million US Dollars) will be financed by the budget directly. Main objectives of the program are provided in Table 1.

**Table 1.** Main objectives of the Program of innovation development and facilitation of technological modernization in 2010-2014 (INSEAD, Switzerland School of Economics, www.worldbank.org/reference, 2013)

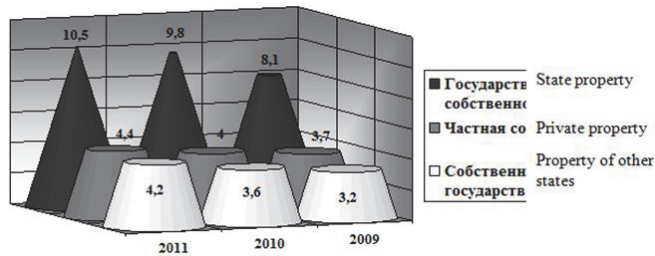
Targeted values	2011	2012	2013	2014
Innovative activities of companies in 2015, (%)	4.8	6.8	8.8	10
Government expenses for science and innovations in percentage of the GDP	0.4	0.6	0.8	1
The share of innovative products in the aggregate value of the GDP, (%)	0.6	0.7	0.85	1
Expenses for technology innovations in industry, million tenges.	45,000	60,000	75,000	98,000

The program is supposed to facilitate the increase of demand for innovations through tax releases, state purchasing and

146 technological agreements with national and foreign companies.

147 Analysis of the legislative grounds of the innovation sphere functioning in Kazakhstan allows to admit that  
148 legislative base for the formation, development and support of industrial and innovation development of the country has  
149 been created. And the work on improvement of the legislative base is permanently carried out. An indicative fact is that  
150 issues of the governmental support of the industrial and innovation development are managed by three main public  
151 regulatory authorities, namely: the Ministry of Economy and Trade, the Ministry of Education and Science, and the  
152 Ministry of Energy and Mineral Resources, and the majority of innovatively proactive businesses are owned by the  
153 government, which is evidenced by the statistics given in Figure 2.

154



155  
156

**Figure 2.** Innovative activeness of Kazakh companies in proportion to their forms of incorporation (%) (Strategic Plan of Development of the Republic of Kazakhstan until 2020, www.akorda.kz/kz/category/gos\_programmi\_razvitiya, 2013)

159

160 Despite the drastic growth rate and rapid development of the innovation sphere in Kazakhstan, it is to be noted that the  
161 progress of these processes is accompanied with certain difficulties, obstacles and contradictions. Improper operation of  
162 the governmental infrastructure of innovation support can be also considered as a problem of the governmental support  
163 of the industrial and innovation development of the economy of Kazakhstan. Main difficulties in this issue relate to the  
164 efficiency of the performance of these bodies, and they require a comprehensive approach to their solution. Every  
165 element of the innovation support infrastructure functions separately from the others and the incentive measures often do  
166 not facilitate rapid growth of innovative businesses.

167

168 Such certain difficulties relate to the support of small and medium entrepreneurship, which is the impelling force of  
169 the formation and development of the innovation market. It is also worth noting that entrepreneurship in Kazakhstan is  
170 mostly non-productive, and does not have the target to create and implement innovations. Its goal is only to earn profit by  
171 re-distribution of existing wealth. To balance these weak chains, it is necessary to elaborate a new state policy of  
172 supporting the small entrepreneurship based on innovations, which would target first of all development of its innovative  
173 side based on competition principles. The objective of the state policy of supporting the small entrepreneurship in the  
174 innovation sphere is multi-criteria optimization, which allows to form a comprehensive assessment of its strategic  
175 directions of development. The comprehensive assessment in aggregate must consider all objectives of the program.

176

Let us consider a detailed algorithm of assessing governmental support of the innovative small entrepreneurship.

$$K_t = (K_{1t}, \dots, K_{it}, \dots, K_{nt})$$

177

$$A_t = (A_{1t}, \dots, A_{it}, \dots, A_{nt})$$

178

179 where  $K_t$  and  $A_t$  are the vectors, which describe the state of the system (aggregate number of studied small  
180 businesses) at the  $t$  moment;

180

$K_{it}$  - basic capital of the  $i$  company at the  $t$  moment;

181

$A_{it}$  - productivity of capital for the  $i$  company at the  $t$  moment;

182

$n$  - total number of studied small businesses involved in innovation processes;

183

$t$  - time reference.

184

Now let us specify the list of directions of governmental support of small businesses:

185

- normalization of statutory regulation of entrepreneurship (A);

186

- financial and credit support; investment support (X);

187

- resources and information provision, infrastructure formation (Y);

188

189 Based on that the object of the research is the governmental support of innovative small businesses, it seems  
reasonable to include two more directions in the list:



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- formation of the virtual market (F);
- development of environmental entrepreneurship (Z);

Let us assume that the assessment of selected directions will be carried out through  $m$  number of criteria. Let us specify  $x_j$  as a value of  $j^{\text{th}}$  criterion of the direction. Then, the following convolution will be the form of representation of comprehensive assessment:

$$F = \sum_{j=1}^m \lambda_j x_j$$

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where  $\lambda_j$  is the weight of the  $j^{\text{th}}$  criterion, which is mainly determined as a consequence of the expert assessment;

According to the methodology of multi-criteria comprehensive optimization, where every variant differs at least by one criterion, it is necessary to select the efficient (Pareto optimal) variant, i.e. such variant, which is the only best one by all criteria.

200  
201

Let us set  $m=2$  in the convolution formula, and we will sequentially receive the following formula of assessment of each direction:

$$F = \lambda_1 x_1 + \lambda_2 x_2$$

202  
203  
204

where  $x_1$  is the value of efficiency of a certain direction by criterion 1;

$x_2$  are the values of efficiency of a certain direction by criterion 2.

205

The resulting values of the governmental support efficiency should be reasonably divided into 4 groups:

206  
207

- values of expenses (scopes and structure of the resources, which ensure implementation of the budget program);
- product values (scope of manufactured products or rendered services by small businesses during implementation of the budget program, number of consumers of goods (works, services), etc.);
- values of efficiency (resources spent for a product unit, i.e. economy; the ratio of maximum number of manufactured products (completed works, rendered services) to the scope of invested financial resources, i.e. productivity; achievement of certain results, i.e. effectiveness);
- values of quality (the aggregate properties characterizing the achieved quality results of the created product, which satisfy consumers in accordance with their purpose and which mirror the weakening of negative or strengthening of positive trends in rendering services to consumers at the expense of the budget program).

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Let us formalize some of the described criteria.

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217  
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Taking into account governmental support, productivity of small innovative businesses is determined by the system:

$$A_{it}^n = \begin{cases} (A_{it} + \Delta A_{it}) \cdot \theta_{it}^n = 1 \\ A_{it} \cdot \theta_{it}^n = 0 \end{cases}$$

219  
220

where  $\theta_{it}$  is the Boolean variable equal to zero (if investments in innovations do not cause changes of the capital productivity), or equal to one (if investing in innovations results in changes of the capital productivity).

221  
222

At the heart of such dependency, the critical (marginal) level of state investment is (Rkp):

223  
224

$$R_{it}^n < R_{kp} \Rightarrow \theta = 0$$

$$R_{it}^n < R_{kp} \Rightarrow \theta = 1$$

225  
226

Calculation of changes of small businesses' capital is made in the following way:

- profitability  $\pi_{it}$ :

227  
228

$$\pi_{it} = \frac{Z_{it}}{K_{it}}$$

- financial limits of granted state resources  $I_{it}^{\max}$ :

229  
230

$$I_{it}^{\max} = G(\tau_{it}, b) \cdot k_{it} = Z_{it}(1 - b),$$

231  
232

where  $G$  is the function, which determines the maximum of gross investments per a capital unit;

$b$  is the share of external financing in the economic profit.

232  
233

- calculation of expected investments in technology innovations. The expected investments depend on the market share ( $\mu_{it}$ ), ratio of capital to output ( $k_{it}$ ) and fixed capital depreciation ratio ( $\delta$ ) of small businesses:

234  
235

$$I_{it}^{\text{des}} = H(k_{it}, \mu_{it}, \delta) \cdot K_{it}$$

236

Expected investments of small businesses depend on the ratio of price of products in the current period to the cost unit of the next period ( $t+1$ ), taking into account the change of productivity; objective inflator, which is an increasing

237 function of the market share of small innovative businesses.

238 As the resulting values of operation efficiency and quality of small innovative businesses mirror the end results of  
 239 the state program implementation, it is reasonable to provide assessment of governmental support by complex criteria,  
 240 which would enable us to take into account various efficiency directions (economical, social, environmental, etc.) The  
 241 author believes that in this case the qualitative parameters must be determined by expertise through a scoring scale of  
 242 attributes of indicators and values of weight numbers (weights) of importance of these indicators.

243 An important indicator for determining the efficiency of invested government funds in innovative small businesses  
 244 is the elasticity of new innovative product manufacturing with respect to the scope of innovation costs as well as to the  
 245 number of active innovative businesses. This indicator points at the relative change of the resulting value by just 1%  
 246 change of the factor. The elasticity ratio is calculated in the following way:

$$\widehat{E}_k = \widehat{\beta}_k \cdot \frac{X_k}{y}$$

247

248 where  $\widehat{\beta}_k$  is a standardized parameter;

249  $\frac{X_k}{y}$  is the value of regressors and the regressand for such point of the regression function, for which the  
 250 elasticity ratio is calculated.

251 Upon finishing all calculations, the new state of small businesses, which use governmental support at the  $t+1$   
 252 moment, is formed.

253 The algorithm proposed by the author and the set of above mentioned models is evaluated with materials of  
 254 innovative small businesses of Russia, which are engaged in development of innovations in healthcare.

255 For the chosen five basic options of directions A, X, Y, F, and Z, the following assessments of values were  
 256 determined through an expert survey (the assessment was carried out by two comprehensive criteria –economic  
 257 feasibility and efficiency) (refer to Table 1) and their comparative efficiency was described with the following inequality:  
 258  $X > A > Y > F > Z$

259

260 **Table 1.** Expert assessment of options of governmental support of innovative small businesses in healthcare by  
 261 comprehensive criteria.

Criteria	Directions				
	A	X	Y	F	Z
Economic feasibility	3	6	5	2	1
Efficiency	5	1	4	7	8

262

263 It is obvious that the weights  $\lambda_1$  and  $\lambda_2$  must have such values, which would make the following inequalities true:

$$264 \quad 5 \cdot \lambda_1 + \lambda_2 > 3 \cdot \lambda_1 + 6 \cdot \lambda_2 > 4 \cdot \lambda_1 + 4 \cdot \lambda_2 > 2 \cdot \lambda_1 + 8 \cdot \lambda_2 > \lambda_1 + 9 \cdot \lambda_2$$

265 Let us solve the tasks of linear programming: let us define  $\lambda_1, \lambda_2$  and  $\varepsilon$ , which are equal to:

$$266 \quad \varepsilon \rightarrow \max;$$

$$267 \quad \lambda_1 + \lambda_2 = 1;$$

$$268 \quad 5 \cdot \lambda_1 + \lambda_2 \leq 3 \cdot \lambda_1 + 6 \cdot \lambda_2 + \varepsilon;$$

$$269 \quad 3 \cdot \lambda_1 + 6 \cdot \lambda_2 \leq 4 \cdot \lambda_1 + 4 \cdot \lambda_2 + \varepsilon;$$

$$270 \quad 4 \cdot \lambda_1 + 4 \cdot \lambda_2 \leq 2 \cdot \lambda_1 + 8 \cdot \lambda_2 + \varepsilon;$$

$$271 \quad 2 \cdot \lambda_1 + 8 \cdot \lambda_2 \leq \lambda_1 + 9 \cdot \lambda_2 + \varepsilon.$$

272 As a result, we receive the following values:  $\varepsilon = -0.1, \lambda_1 = 0.7, \lambda_2 = 0.3$

273 According to the received values of the weights, the comprehensive assessments of governmental support option  
 274 are as follows:  $F_A = 3.9; F_B = 3.8; F_C = 4; F_D = 3.5; F_E = 3.4$ . From the represented assessments, it is obvious that the  
 275 best option of governmental support of innovative entrepreneurship in medical care and technology is the Y option - the  
 276 resources and information provision, and the formation of infrastructure (refer to Table 2).

$$277 \quad Y \leq A, Y \leq X, Y \leq F, Y \leq Z$$

278

279 **Table 2.** Results of selecting the efficient prioritized direction of governmental support of innovative small businesses

Criteria	Directions				
	A	X	Y	F	Z
Economic feasibility	3	6	5	2	1
Efficiency	5	1	4	7	8

We need to draw your attention to the fact that direction of development of environmental entrepreneurship has the highest level according to expert assessments. However, taking into account the low value of the comprehensive efficiency assessment, it is reasonable to introduce a certain program on formation of resource and information coverage for implementation of environmental entrepreneurship in the Y direction, which is the resource and information provision.

Calculations given below allow to represent the extent and the changes of innovative development (productivity and profitability) of small healthcare businesses, i.e. their evolution after governmental support has been rendered to them, forecast prospects and maintaining their market share due to it.

**Table 3.** Development of innovative healthcare businesses participating in governmental support programs

2010			2012			2014			constant	Total governmental support in 2010-2014
Capital productivity (thousand rubles)	Innovation costs per capital unit, rubles	Profitability level, %	Capital productivity (thousand rubles)	Innovation costs per capital unit, rubles	Profitability level, %	Capital productivity (thousand rubles)	Innovation costs per capital unit, rubles	Profitability level, %		
4.536	0.736	42.9		0.832	43.8	5.432	0.965	45.9	0.030	44935.52
1.832	0.096	-24.7	2.16	0.54	-20.3	2.56	0.67	-15.4	0.018	38949.31
4.643	1.544	10.8	4.36	0.716	27.7	4.76	0.812	31.6	0.049	72437.87
4.392	2.04	41.7	3.972	0.82	43.7	4.123	1.024	51.7	0.060	113354.3
4.792	1.052	46.6	4.948	0.716	50.5	5.134	0.814	52.4	0.074	96148.15
3.932	1.916	1.9	3.344	0.572	24.9	3.678	0.532	25.8	0.040	58618.04
4.084	1.472	16.1	3.78	0.608	22.6	4.76	0.864	24.6	0.040	55771.32

As evidenced by the Table 3 data, participation in programs of governmental support incurs increase of capital profitability and productivity. The strategy of further support of analyzed businesses must continue in the same investment direction, i.e. investment of money in their business is reasonable, incurs increase of efficiency both of such companies' performance and performance of the whole sector they render their services to. There is no doubt that there are such representatives in the market, supporting which is inefficient, and the only result will be outflow of state funds without due return. As a result, such strategy becomes a strategy of disinvestment, i.e. unreasonable investment of resources, and the businesses, which receive the support, should leave the market.

## 5. Summary

Thus, summarizing the fulfilled research, we can emphasize the following:

Building an innovative society is possible only with proactive governmental support, offering long-term incentives of industrial and innovation development, and encouraging fundamental and corporate sciences. A vital objective of innovation market development is the improvement of the mechanism of selecting innovative projects by the government with further support of their commercialization and introduction in the market as an innovation. As practice evidences, efficient functioning of the innovation sphere self-regulation is not possible for developing countries. In this case, it is necessary to implement relevant adequate programs of governmental support of industrial and innovation development of the economy. And Kazakhstan is a successful example of elaboration and application of such programs. The government of this country directs considerable resources for supporting innovative activity, implements various forms and methods of encouraging industrial and innovation spheres of activity. Along with existing practices and achievements, Kazakhstan faces certain problems, which require reorganization of mechanisms and instruments of the governmental support of the industrial and innovation development of the economy. This article offers an efficiency assessment algorithm for the governmental support with respect to innovative small businesses. However, despite its efficiency, it is to be noted that each specific governmental program is unique, and, therefore, efficient strategic solutions on rendering support to certain innovative spheres must be based on a synthesis of results of modelling and comprehensive analysis of the economic, social and environmental components of such program implementation.

317 It is reasonable to focus further research on considering the most efficient ways and methods of supporting  
318 Kazakhstan innovative clusters' development through such measures as: development of a system of their financial and  
319 credit support, establishment of an efficient innovative infrastructure, implementation of an efficient technology transfer  
320 mechanism.

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## Types and Duration of Unemployment in Kosovo

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### Abstract

The unemployment rate remains one of the most important economic indicators of a country as the employed themselves are the most important part of any economy. In Kosovo, such a topic remains one of the most debated problems since the unemployment rate hits 30% (KAS, 2012), a rate much higher than in any OECD member. Making a clear distinction of the types of unemployment that a country faces is crucial since different ALMP's are required to target each of the types. Hence, we discuss the different types of unemployment that a country may face and we analyze if such types are suitable for describing the unemployment rate in Kosovo and if so, what policies are required to target them. We then return to the duration of unemployment and we discuss the reasons for the long-term unemployment in Europe. We then analyze if such reasons are suitable for describing the long-term unemployment in Kosovo.

**Keywords:** Unemployment, structural, long-term, causes, policies.

### 1. Introduction

Speaking about the consequences that it has, unemployment may not be an unknown problem. But when it comes to analyzing the types of unemployment, its causes, its natural rate and similar problems, it remains a challenging one.

This paper tries to explain how different types of unemployment affect the Kosovo's economy. Each economy faces different types of unemployment, consequently, different policies are required to deal with them. The wrong policy, not only will not solve the problem, but it may deepen the problem further. Therefore, the first important step in this field remains the identification of the causes of unemployment so that the governments can pick up the right policy that will make a difference. That is very important in Kosovo, where the unemployment rate goes up to 30% (KAS, 2013).

For such a purpose, the authors have used standard labor economics textbooks for the various technical definitions explained. Also, the data used in this paper were collected from official organisations such as Kosovo's Agency of Statistics (2012) which is by far the most comprehensive study of the labor market in Kosovo. Thus, the paper combines standard definitions and official data in order to explain the situation to a broader range of economists, politicians and the general public as well.

In the first part of this paper, we briefly discuss the rate of unemployment, the way of measuring it and its restrictions. We conclude that if the labor market situation is assessed solely by this indicator, we will have a distorted picture of it. Then we analyze the types of unemployment encountered in Kosovo and what policies are required to target them.

At the end, we return for the duration of unemployment in Kosovo, where we primarily give a conclusion of the international debate on the causes of long-term unemployment in Europe and then analyze the causes of this type of unemployment in Kosovo and eventually treat some of its consequences.

### 2. The Rate of Unemployment and the Labor Market in Kosovo

For objective reasons, there is a considerable gap between the usage of the work factor as an abstract concept and the unemployment rate as a statistic. This is so because a complete measurement of the phenomenon of unemployment is impossible. Thus, in most countries the unemployment rate is given as a proportion between the number of those actively

57 seeking a job and who cannot find one and the total number of the workforce, that consists of skilled persons aged 16-64  
58 years.

59 However, this measurement has some limitations that make it unsuitable for extracting decisive estimates and  
60 conclusions on the state of the labor market.

61 The first of these limitations is the exclusion of discouraged workers (Qiriçi, 2005). These include individuals who  
62 have given up on looking for a job for various reasons. In Kosovo, discouraged workers make up to 14.8% of the  
63 workforce (KAS, 2013). So there are approximately 176,100 people who have given up looking for work because they  
64 believe no jobs are available. This is very important because in a potential economic success, this force can be activated  
65 and serve as a resource of work.

66 Under this understanding, in Kosovo, the problem remains in the growing rate of inactivity. From 2009 to 2012 the  
67 unemployment rate dropped to 14.5%, but participation in the workforce has also fallen to 11.2%. A large proportion of  
68 inactive persons, 17.7% of them, are justified with household duties or several other similar reasons and can be activated  
69 in the labor market either with the opening of new jobs or with other specific policies.

70 Part-time work remains one of the other problems. In this case, workers may fail to reach their potential through  
71 their work. In Kosovo, it was reported that 11.1% of employees work part time while 66.7% of them work as such without  
72 their consent.

73 A controversial issue remains the 'hidden' unemployment in the public sector or public enterprises, partly inherited  
74 from the previous communist system. We say that a hidden unemployment exists when the removal of an employee from  
75 his job does not affect the overall performance of the organization. A doubt for such a situation in Kosovo arises from the  
76 fact that the public sector is responsible for 33% of (MLSW, 2012) the employments in the country and the performance  
77 of this sector is estimated to be poor.

78 As a conclusion, the unemployment rate does not fully reflect the problems that the society faces (Ehrenberg &  
79 Smith, 2012). These are some of the factors that should be considered when assessing the rate of unemployment in  
80 Kosovo. But generally speaking, the rate of unemployment, without being considered as an absolute indicator, represents  
81 an important indicator in the framework of labor market indicators.

### 82 83 84 **3. Types of Unemployment in Kosovo**

85 The unemployment rate in a country is not necessarily bad in itself. This depends greatly on the type of unemployment in  
86 that country. Societies are usually more concerned if a few individuals are unemployed for a long time than if many  
87 individuals move quickly from one job to another (Ehrenberg & Smith, 2012).

88 Types of unemployment that economists usually highlight are four:

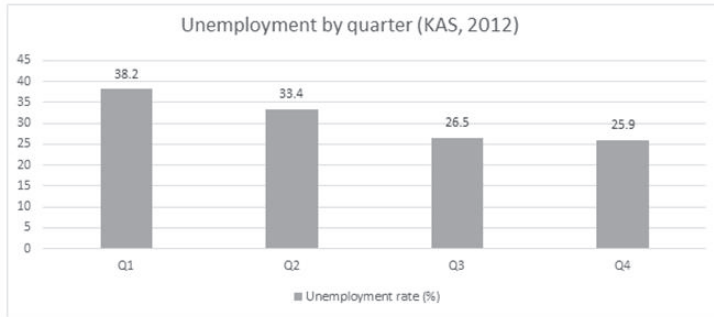
- 89 1) Frictional unemployment, which implies that some people are between jobs. Some leave a job to find a better  
90 one, others have just entered the labor market and didn't find a job yet and so forth. This type of  
91 unemployment occurs because of asymmetric information and as such firms and workers need time to adapt.  
92 In fact, if they would find one another immediately or if workers would stay in a job for life, this type of  
93 unemployment would not exist. That is why it is impossible. In reality, frictional unemployment is necessary  
94 and useful because job search makes more efficient allocation of resources. To reduce this type of  
95 unemployment, government can expand or modernize the employment offices to facilitate information  
96 exchange between workers and firms.
- 97 2) Structural unemployment is a result of the changes in the structure of the economy. Put in other words, in the  
98 economy, some sectors may be declining while others may be growing. For example, in developing countries  
99 the industrial sector is declining while the services sector is growing. This appears the problem of 'skills  
100 mismatch' or labor demand and supply mismatch, because workers need time to adapt to the new jobs.

101 In transition economies, the conversion from a centralist system to a market economy is accompanied by structural  
102 changes in the economy (Borjas, 2005). On the spur of the moment, the production is oriented from the heavy industry  
103 towards the light industry or the service sector. In Kosovo, with a predominantly young population, impacts of these and  
104 other shocks that occurred 10-20 years ago may have faded already.

105 An indicator to assess whether unemployment is structural is the probability of individuals with higher education to  
106 get a job (Hobijn, 2011). This is so because it is considered that if they have a problem to find a job, then the abilities of  
107 workers can't be the problem. Also, worth noting is the fact that in Kosovo many of the workers work in the manufacturing  
108 sector, trade and construction.

109 Given these indicators, we may reason out that unemployment in Kosovo is not purely of structural reasons, not  
110 denying the fact that this form of unemployment comes out in any normal economy.

- 111 3) Seasonal unemployment occurs when a job can't continue during the entire time period, usually a year, due to  
112 lack of demand for manufactured goods, weather conditions and so on. In Kosovo, due to the large number of  
113 employees in agriculture, trade and construction, differences in unemployment during the year are  
114 considerable.  
115



116 **Figure 1.** Seasonal unemployment in Kosovo (KAS: 2012).  
117

118 Such unemployment is somewhat predictable and probably not harmful, for employees who work seasonal jobs receive  
119 higher wages as a compensation. A study in the US found that seasonal workers in agriculture receive an average salary  
120 10% higher than those who work on farms throughout the year (Ehrenberg & Smith, 2012).  
121

- 122 4) Cyclical unemployment or the lack of demand for labor is the most problematic type of unemployment. In  
123 situations when the economy is in decline, firms' profits fall and while wages are rigid-downwards,  
124 unemployment results. In a full competition model, wages would fall and firms wouldn't start firing. Another  
125 scenario occurs when economic growth is likewise sluggish and as such does not allow for creating decent  
126 jobs. In both cases, there are individuals who are interested and have the ability to work, but the firms don't  
127 provide jobs for them.  
128

129 In the case of Kosovo, the second scenario is present. According to an estimate, since 2010, Kosovo needs an  
130 average economic growth of 10% per year to reach Albania after 10 years, assuming that it will grow by 5.5% per year  
131 until then (UNDP, 2012). Currently, economic growth is less than half of that. In a tough business environment with many  
132 administrative procedures, low security, high interest rates and a multitude of other problems, firms face many difficulties  
133 to offer stable jobs.  
134

#### 135 **4. Duration of Unemployment in Kosovo**

136 59.8% of the unemployed in Kosovo remain so for more than 12 months (KAS, 2013). We mentioned earlier that some of  
137 those who once were seeking a job are now counted as inactive since they have given up looking for work because they  
138 believe that they can't find one. These are certainly facing long periods of unemployment.  
139

##### 140 **4.1 The debate over the long-term unemployment**

141 One of the most challenging questions in economics remains that how some workers remain unemployed for a long time.  
142 Although not a single theory comes up with a convincing explanation of this problem, it seems that this problem is  
143 different in different countries or in different situations.  
144

145 Many factors can affect both the duration of unemployment as most of the research suggests (Krugman, 1994).  
146 For example, in Europe, unemployment benefits, the rules that impede firing/hiring, maximum hours and minimum wages  
147 are seen by many economists as the main causes of a rising long-term unemployment.  
148

149 The inquiry arises, in an economy like that of Kosovo's without benefits for the unemployed, with few labor market  
150 regulations accompanied by a high level of informality, which are the causes of long-term unemployment?  
151

152 Broadly understood, the long period of economic stagnation that pretty much started from the time of work-  
153 expulsion from the 90s, the destruction of industry, in particular of manufacturing during the war are associated with a  
period of uncertainty and transition that was not able to create enough places for work to improve the economy from the

shocks led to the enormous length of unemployment (RI 2003).

#### 4.2 The consequences of long-term unemployment

A stable unemployment rate as in Kosovo leaves many consequences for the economy. In addition to the opportunity costs of not using the human capital, the eventual violence and insecurity, as well as the problems encountered by an unemployed individual, it is worth to mention some other problems.

The foremost is the deprivation of a skilled work force. Former socialist countries were initially struck by the problem of the 'mismatch of skills' (Hoti, 2003), a problem which has risen as a result of the fact that many skills were then not necessary due to the shifting labor market - the transition from several sectors into others. This can bear an impact, especially in the older generations, because changes have occurred in their time. They (i.e. Aged approximately 45-60 years) also may have given up looking for work. On the other hand, 126,200 young people (16-24) who neither work nor go to any training program remains disturbing (KAS, 2013).

Secondly, studies indicate that there is an inverse relation between the level of wages and the rate of unemployment (Ehrenberg & Smith, 2012). When unemployment is low wages are high and vice versa. This connection is mapped by the wage curve.



Thus, long-term unemployment affects the unemployed by hindering their current hiring chances and by cutting their income. Both of these problems have macroeconomic impact on the level of income in the economy and in other indicators consequently.

#### 5. Conclusions

As we mentioned earlier the unemployment rate may not fully reflect the situation of the labor market in a country. The exclusion of discouraged workers and the growing rate of inactivity, then the inclusion of 'hidden' unemployment and that of part-time work are some of the main reasons for this. That said, the unemployment rate provides us with some useful insights about the labor market.

As for the types of unemployment in Kosovo, we make the argument that frictional unemployment is always to be found in an economy. Structural changes are not the main cause of unemployment, although Kosovo's economy passed through a severe transition. We make such a conclusion for several reasons, including the fact that the workers work primarily in sectors which don't have any "barriers of entry". Also, those who earn a degree have a much higher chance of employment than those who don't. Mentioning the fact that seasonal workers usually get higher compensation, seasonal unemployment is present due to the large number of employees in agriculture, trade and construction.

So finally, we associate the high rate of unemployment with the lack of economic growth during the last two decades. The unstable political situation made it unlikely for major investments in the economy. Also, the persistent high rate of unemployment may worsen itself by itself by hindering the hiring chances for the unemployed.



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# Internal and External Audit Attributes, Audit Committee Characteristics, Ownership Concentration and Earnings Quality: Evidence from Malaysia

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## Abstract

The objective of the study is to examine the association between internal and external audit attributes, audit committee characteristics, ownership concentration and discretionary accruals (as a proxy of earnings quality) based on the agency and resource dependence theories. The final sample of the study is 508 firms listed on the Malaysia Main Market from 2009 to 2012. Two measures of discretionary accruals are used, Modified Jones model by Dechow et al. (1995); and extended Modified Jones Model by Yoon et al. (2006). Results of the study suggest that outsourcing internal audit function, investment in internal audit function and external audit fees are related to higher earnings quality. However, large audit committee size, more frequent audit committee meetings, having a senior or former audit partner as audit committee chairman and ownership concentration are associated with lower earnings quality. This study extends the prior related literature by apply extended modified Jones model by Yoon, et al.'s (2006) of discretionary accruals to measure earnings quality in Malaysia Main Market listed companies and introduce new variables, namely audit committee chairman who is a senior or former audit partner in the audit firm.

**Keywords:** Audit committee, audit fees, internal audit function, ownership concentration, discretionary accruals, earnings quality, Malaysia.

## 1. Introduction

With the recent high-profile scandals in accounting, investors have become concerned with earnings management and have begun to demand for earnings quality for the purpose of enhancing financial statement quality (Bedard & Johnstone, 2004). Certain aspects, such as discretionary accruals, have received much attention as an important indicator of earnings quality. High earnings quality, financial reporting transparency and auditing are important to gain investors' and other stakeholders' confidence.

Earnings management is reflected in earnings quality, whereby greater earnings management results in lower earnings quality and vice versa. Management engages in earnings management for many reasons, among them being to reduce political costs (Warfield, Wild & Wild, 1995), to avoid default in debt covenant (Klein, 2002; Davidson, Goodwin-Stewart & Kent, 2005) and to increase manager's wealth (Radzi, Islam & Ibrahim, 2011).

The purpose of the study is to examine the influence of internal and external audit as governance monitoring mechanisms because they are responsible for evaluating the quality of financial reporting. The audit committee is considered as one of the pillars of accountability because it supports the boards' role to monitor the process of financial reporting while the function of internal and external audit supports the function of the audit committee through auditors' reports. Simunic (1984) argues that the provision of external non-audit services leads to high audit quality. Thus, companies that engage external auditors to carry out non-audit services will have less accounting risks than companies that do not engage such services.

This study extends the prior related literature by several ways. First, this study is the first study to apply Yoon, Miller and Jiraporn's (2006) model of discretionary accruals to measure earnings quality of companies listed on the Malaysian Main Market. Second, we introduce new variables, namely audit committee chairman who is a senior or former audit partner in the audit firm. Third, following the previous studies (Porta, Lopez-De-Silanes & Shleifer, 1999; Fan &

57 Wong, 2002; Yunos, Smith & Ismail, 2010; Kamardin & Haron, 2011; Abdullah & Nasir (2004); Abdul Rahman & Ali 2006)  
58 suggestions of the effect of ownership concentration on monitoring mechanisms, information asymmetry and its impact  
59 on earnings quality, we also examine ownership concentration (five largest shareholders) on earnings quality of  
60 companies listed on the Malaysian Main Market.

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## 2. Literature Review and Hypotheses Development

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65 The Malaysian government took certain measures as proposed by the regulatory bodies and accountancy professions to  
66 alleviate the occurrence of fraud and fraudulent financial reporting. This resulted in the implementation of the Malaysian  
67 Code on Corporate Governance in March 2000. This code covers four areas, i.e., board of directors, accountability,  
68 shareholders and remuneration of directors. The revision of the Code was done in 2007 (known as the MCCG 2007), to  
69 allow for greater internal monitoring control. The function of an internal auditor, who directly reports to the audit  
70 committee, is to recognise and manage risks (Hassan, Moyes, Mohd-Sanusi & Iskandar, 2010). In addition, the  
71 Malaysian Code on Corporate Governance (revised again in 2012 and known as MCCG 2012) pays greater attention to  
72 the composition and structure of the board, where the directors' role is recognized as active and responsible fiduciaries.  
73 Directors should ensure that the governance structure is effective in order to enable risk and internal control  
74 management.

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### 2.1 Audit Committee Size

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78 According to the resource dependence theory, a larger audit committee means the members can bring more resources to  
79 the firm, such as experience and expertise, which contribute to the audit committee's effectiveness in monitoring  
80 management, hence leading to high earnings quality. The Cadbury Report (1992) and the Smith Report (2003) stipulate  
81 the number of audit committee members must be at least three; the Sarbanes–Oxley Act (2002) also mandates a  
82 minimum of three members in the audit committee. Buchalter and Yokomoto (2003) recommend that audit committees  
83 should be composed of three to five members although it is generally based on the firm's size. The Malaysian Code on  
84 Corporate Governance recommends there should be at least three non-executive directors in the audit committee, a  
85 majority of whom should be independent.

86

87 Empirical studies provide evidence that audit committee size is related to high earnings quality (Garcia, Barbadillo  
88 & Perez, 2010; Lin, Li & Yang, 2006). Additional evidence from Malaysia by Ahmad-Zaluki and Wan-Hussin (2010); and  
89 Ismail, Adibah, Dunstan and Ziji (2009) find a significantly positive relationship between audit committee size and  
90 earnings quality. However, Abbott, Parker, Peters and Raghunandan (2003); Abbott, Parker and Peters (2004); Xie,  
91 Davidson and DaDalt (2003); Baxter and Cotter (2009); and Adiguzel (2013) find an insignificant association between  
92 audit committee size and earnings quality.

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94 Following the resource dependence theory, it is predicted that the appointment of many audit committee members  
95 contributes to efficient internal monitoring and better earnings quality. Thus, we hypothesize that:

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*H<sub>1</sub>: Audit committee size is negatively associated with discretionary accruals*

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### 2.2 Audit Committee Independence

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100 From the agency theory perspective, the effectiveness of audit committee is based on its characteristics (Ika & Ghazali,  
101 2012; Klein, 2002; Garcia, Barbadillo & Perez, 2012; Vafeas, 2005). For the audit committee to achieve its functions,  
102 its members should be independent from the management (Ismail *et al.*, 2009; Krishnamoorthy, 2002). Lin, Li and Yang  
(2006) argue that an audit committee with majority of independent members can effectively monitor the management and  
103 reduce the opportunity for fraudulent reporting because there is less interference from the management.

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105 Mustafa and Yusof (2010) argue that the independence of directors results in high financial reporting quality.  
106 Several empirical studies have shed light on the effectiveness of audit committee independence. Klein (2002) shows that  
107 audit committee independence is related to decreased abnormal accruals (proxy of earnings quality). Yang and Krishnan  
(2005); and Yunos (2011) find that audit committee independence is related to less discretionary accruals. Audit  
108 committee independence is also related to higher earnings quality (Bradbury, Mak & Tan, 2006; Garcia *et al.*, 2012) and  
109 quality financial reporting (Agrawal & Chadha, 2005; Bedard & Johnstone, 2004; Klein, 2002; Siagian & Tresnaningsih,  
110 2011). Some studies report an insignificant association between audit committee independence and earnings  
informativeness (Petra, 2007); discretionary accruals (Xie *et al.*, 2003; Garcia *et al.*, 2010; Adiguzel, 2013); and accrual

111 quality (Baxter & Cotter, 2009).

112 In relation to Malaysian studies, Saleh, Iskandar & Rahmat (2007); and Mansor, Ch-Ahmad, Ahmad-Zaluki and  
113 Osman (2013) report a negative relationship between audit committee independence and earnings management; while  
114 Ahmad Zaluki and Wan Hussin (2010) show a positive association. On the other hand, some studies find no significant  
115 association between the independence of audit committee and earnings quality (Abdul Rahman & Ali, 2006; Abdullah &  
116 Nasir, 2004; Ismail *et al.*, 2009). Based on the agency theory, we predict that an independent audit committee will be able  
117 to monitor management behaviour to manage earnings. Thus we hypothesize that:

118 *H<sub>2</sub>: Audit committee independence is negatively associated with discretionary accruals*

### 119 2.3 Audit Committee Meeting

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123 Bursa Malaysia emphasizes that the audit committee should meet at least four times annually. The frequency of audit  
124 committee meetings is a reflection of its effectiveness; the directors' experience and expertise can enhance internal  
125 monitoring functions (Zaman, Hudaib & Haniffa, 2011). In relation to earnings quality, Garcia *et al.* (2010) find evidence  
126 that frequency of audit committee meetings is related to high earnings quality. Xie *et al.* (2003); and Garcia, *et al.* (2010)  
127 find frequency of audit committee meetings decreases the level of discretionary accruals. Saleh *et al.* (2007); and Yusof  
128 (2010) reveal a negative association between earnings management and meeting frequency of audit committees in  
129 Malaysia. Another study in the U.S. by Goh (2009) reveals that audit committee meeting frequency relates positively to  
130 timelier remediation of material weaknesses. However, some studies find no relationship between frequency of audit  
131 committee meetings and earnings quality (Baxter & Cotter, 2009; Abdul Rahman & Ali, 2006; Mohamad, Rashid &  
132 Shawtari, 2012). Thus, we hypothesize that:

133 *H<sub>3</sub>: The frequent meeting of audit committee is negatively associated with discretionary accruals*

### 134 2.4 Audit Committee Financial Expertise

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138 Financial expertise is very important for audit committee effectiveness to enhance the integrity of financial reporting  
139 quality. The Malaysian Code on Corporate Governance recommends that at least one of the audit committee members  
140 must have financial expertise. Xie *et al.* (2003); Baxter and Cotter (2009); and Chen and Zhou (2007) find evidence that  
141 financial expertise in audit committees decreases discretionary accruals. With regards to Malaysian companies, Saleh *et al.*  
142 (2007); and Yusof (2010) find audit committee financial expertise leads to high earnings quality. On the other hand,  
143 Mohamad *et al.* (2012) find no relationship between audit committee financial expertise and earnings quality. Based on  
144 the agency and resource dependence theories, we argue that audit committee financial expertise reduces discretionary  
145 accruals and enhances earnings quality. Thus, we hypothesize that:

146 *H<sub>4</sub>: Audit committee financial expertise is negatively associated with discretionary accruals*

### 147 2.5 Audit Committee's Chairman Being Former Audit Partner

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151 The resource dependence theory proposes that a firm's directors who have knowledge and expertise bring important  
152 resources to the company which lead to increasing the firm's internal monitoring and enhancing financial reporting quality  
153 (Hillman & Dalziel, 2003). Likewise, a former audit partner in the audit committee can be an expert who can help to  
154 increase the audit committee's internal monitoring effectiveness because he or she has experience in auditing, internal  
155 control and financial statements (Naiker & Sharma, 2009). Naiker and Sharma (2009) examined the relationship between  
156 former audit partners on the audit committee and internal control deficiencies and find a negative relationship. However,  
157 another study by Menon and Williams (2004) finds that firms having a former audit partner as officers or directors are  
158 associated with larger accruals, thus suggesting a potential threat to audit independence. A study in Malaysia by Yusof  
159 (2010) finds former senior audit managers/partners are associated with larger discretionary accruals. Therefore, the  
160 chairman position could be the most influence factor. Accordingly, this study aims to provide empirical evidence about  
161 audit committees' chairman former audit partner which unexplored issue. Thus we hypothesize that:

162 *H<sub>5</sub>: Audit committee's chairman being former audit partner is negatively associated with discretionary accruals*

166 2.6 Investment in Internal Audit Function

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According to the agency theory, an increase in the internal control system could lead to an increase in the monitoring process of the company to reinforce and increase the financial information outcomes (Jensen & Meckling, 1976). Internal audit function has become a crucial internal monitoring mechanism in corporate governance (Al-Shetwi, Ramadili, Chowdury & Sori, 2011). Prawitt, Smith and Wood (2009) argue that internal audit function that is relatively well funded has a greater monitoring ability to detect and deter material misstatements. Increased resources enable the internal audit department to hire and retain more competent personnel.

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The MCCG 2007 supports the roles and responsibilities of the internal audit function. The board should set up an internal audit function, which is directly accountable to the audit committee, to recognise and manage risks. Investment in the internal audit function implies more competent internal audit function personnel can help management to establish stronger controls over financial reporting, thus reducing the existence of control problems (Lin, Pizzini, Vargus & Bardhan, 2011). Yasin and Nelson (2012) find a positive relationship between external audit quality and cost of internal audit function. Further, Prawitt *et al.* (2009) find a significant association between internal audit function and absolute abnormal accruals. Thus, we hypothesize that:

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*H<sub>5</sub>: Investment in internal audit function is negatively associated with discretionary accruals*

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2.7 Sourcing Arrangement of Internal Audit Function

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Internal audit function can be undertaken in-house by the internal audit department in the company or outsourced to other professional companies. Outsourced internal audit refers to internal audit services that are undertaken by independent accounting firms (Carcello, Hermanson & Raghunandan, 2005; Desai, Gerard & Tripathy, 2011). According to Bursa Malaysia, listed companies are required to disclose whether their internal audit function is performed in-house or is outsourced. Some studies have found the in-house internal audit function leads to greater internal monitoring and control over audit operations, thereby protecting proprietary information, providing better understanding of business processes and associated risks from outsiders and nonemployees as well as learning opportunities for the company's own employees compared to an outsourced internal audit function (Vecchio & Clinton, 2003; Rittenberg, 1999). The benefits of in-house audit function are due to in-depth knowledge, loyalty and role in handling crisis situations, such as those involving fraud (Spekle, Elten & Kruis, 2007).

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On the other hand, advocates of outsourced internal audit function argue that in-house internal auditors are less independent than outsourced internal auditors as it is difficult for an employee to be truly independent from the management (James, 2003; Ahlawat & Lowe, 2004). There are external auditors who consider internal auditors to be more objective and independent when the internal auditors are not employees of the company (Gramling & Hermanson, 2006). Johl, Johl, Subramaniam & Cooper (2013) find the internal audit function increases discretionary accruals when this function is outsourced, but the in-house internal audit function decreases the level of discretionary accruals. The above discussion leads to the hypothesis that:

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*H<sub>6</sub>: Sourcing arrangement of internal audit function is associated with discretionary accruals*

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2.8 Big4 Audit Firm

Big 4 audit firms are commonly used as proxy of audit quality which is considered as an external monitoring mechanism (Fan & Wong, 2005). Davidson *et al.* (2005) argue that Big4 audit firms affect earnings quality positively with respect to earnings management activity detection due to higher expertise and resources that Big4 audit firms have relative to their smaller counterparts. Thus, we hypothesize that:

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*H<sub>7</sub>: Companies which are audited by Big4 audit firms are negatively associated with discretionary accruals*

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2.9 Audit Fees

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An audit fees, as a proxy of audit quality, is an important external monitoring mechanism to mitigate earnings management (high earnings quality). Frank, Johnson and Nelson (2002) find that an audit fees is associated with smaller discretionary accruals. Also, Larcker and Richardson (2004) find that strong governance mitigates the negative relationship between audit fees and accruals. Gul, Chen & Tsui (2003) find positive relationship between audit fees and

221 discretionary accruals. Antle, Gordon, Narayanamoorthy & Zhou (2006) find audit fees leads to high abnormal accruals.  
222 Additionally, Hasnan, Rahman & Mahenthiran (2012) show evidence that audit fees is positively related to fraudulent  
223 financial reporting in Malaysia. Thus, we hypothesize that:

224  $H_8$ : Audit fees for external audit are negatively associated with discretionary accruals

### 2.10 Non-Audit Services Fees

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228 More investment in non-audit services could increase audit quality by increasing an auditor's ability to detect earnings  
229 management (Dechow & Schrand, 2010). Antle *et al.* (2006) find non-audit services fees decreases the level of abnormal  
230 accruals. While, Frankel *et al.* (2002) find that non-audit services fees is associated with higher discretionary accruals.  
231 Thus, we hypothesizes that:

232  $H_9$ : Non-audit services fees for external audit are negatively associated with discretionary accruals

### 2.11 Ownership Concentration

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234 Ownership concentration is said to be a source of agency problems because higher ownership concentration provides  
235 more power to a limited number of shareholders, who in turn might expropriate minority shareholders' interests (Porta, *et al.*,  
236 1999). Fan and Wong (2002) report that ownership concentration is related to low earnings quality. Yunos, *et al.*  
237 (2010) find ownership concentration is associated with lower accounting conservatism. Another study by Kamardin and  
238 Haron (2011) suggests effective monitoring mechanisms through concentrated ownership in Malaysian companies  
239 whereby there is interest alignment between the majority and minority shareholders. However, Abdullah and Nasir (2004);  
240 and Abdul Rahman and Ali (2006) provide evidence on the possible influence of concentrated ownership on board  
241 independence in relation to earnings management. Following the agency theory, this study hypothesizes that:

242  $H_{10}$ : Ownership concentration is positively associated with discretionary accruals

## 3. Research Method

243  
244 The population of the study is 822 firms in year 2012 listed on the Main Market of Bursa Malaysia. The period of study  
245 covers four years (from 2009 to 2012). The study includes the year 2009 because it is the first year full disclosure for the  
246 cost of investment in internal audit function is made as required by the Bursa Malaysia. We follow previous studies by  
247 excluding finance-related companies and unit trusts (Yatim, Kent & Clarkson, 2006; Yunos, *et al.*, 2010); firms with  
248 incomplete online annual reports for the period between 2009 and 2012; and firms which have missing data of study  
249 variables. The final sample of the study is 508 firms. Data were collected from Data Stream and annual reports available  
250 on the Bursa Malaysia website. Table 1 provides a breakdown of the sample by industries.

251  
252 **Table 1.** Sample of Study by Industries

Industries	Firms	Observations	Percentage
Construction	30	120	6
Consumer	83	332	16
Industrial products	163	652	32
Plantation	33	132	6
Property	49	196	10
Technology	23	92	5
Trading and Services	127	508	25
<b>Total</b>	<b>508</b>	<b>2,032</b>	<b>100</b>

### 3.1 Measurement of Discretionary Accruals

261  
262 Discretionary accruals are used as proxy for earnings quality. Two measurements of discretionary accruals are used in  
263 this study to see whether the results are consistent for all the models. The first measurement (DA1) follows the modified  
264 Jones model by Dechow, Sloan and Sweeney (1995) which has been widely used in previous studies. Ordinary-Least  
265  
266

267 Squares (OLS) cross-sectional regression for all study years and industries are used to estimate the fitted values  
268 (coefficients of  $a_1$ ,  $a_2$ , and  $a_3$ ). The equation to calculate total accruals is as follows:

$$269 \text{ACC}_t / \text{TA}_{t-1} = a_0 + a_1(1 / \text{TA}_{t-1}) + a_2(\Delta\text{REV} - \Delta\text{REC} / \text{TA}_{t-1}) + a_3 (\text{PPE} / \text{TA}_{t-1}) + e_t(1)$$

270 Where:

271  $\text{ACC}_t$  = total accruals measured by net income – cash flows from operations

272  $\text{TA}_{t-1}$  = prior total assets

273  $\Delta\text{REV}$  = change in sales/revenue

274  $\Delta\text{REC}$  = change in trade receivables

275  $\text{PPE}$  = property, plant and equipment

276  $e_t$  = error term.

277 Following Dechow *et al.* (1995), the change in accounts receivable is deducted from the change in revenues before  
278 estimation. Then, the industry- and year-specific is used to estimate the parameter estimates (coefficients  $a_0$ ,  $a_1$ ,  $a_2$ , and  
279  $a_3$ ) to infer non-discretionary accruals (NDA) as in equation (2):

$$280 \text{NDA}_t = a_0 + a_1 (1 / \text{TA}_{t-1}) + a_2 (\Delta\text{REV} - \Delta\text{REC} / \text{TA}_{t-1}) + a_3 (\text{PPE} / \text{TA}_{t-1})(2)$$

281 The difference between estimation (standardized residuals) in equation (2) and actual accruals represents the total  
282 discretionary accruals in the following equation:

$$283 \text{DA}_t = \text{ACC}_t - \text{NDA}_t \tag{3}$$

284 Where:

285  $\text{NDA}$  = non-discretionary accruals

286  $\text{DA}$  = discretionary accruals from the residual estimated from model 1

287 The second measurement of discretionary accruals ( $\text{DA}_2$ ) follows the modified Jones model by Yoon *et al.* (2006).  
288 Studies in Korea by Yoon *et al.* (2006); and in Bangladesh by Islam, Ali and Ahmed (2014) find that the modified Jones  
289 model by Dechow *et al.* (1995) does not robust for Asian companies. The model ( $\text{DA}_2$ ) is described in equation (4):

$$290 \text{TA}_t / \text{REV}_t = \beta_0 + \beta_1(\Delta\text{REV}_t - \Delta\text{REC}_t) / \text{REV}_t + \beta_2 (\Delta \text{EXP}_t - \Delta\text{PAY}_t) / \text{REV}_t + \beta_3(\text{DEP}_t + \text{RET}_t) / \text{REV}_t + e_t(4)$$

291 Where:

292  $\Delta\text{EXP}$  = change in sum of cost of goods sold and selling and general administrative expenses excluding non-cash  
293 expenses.

294  $\Delta\text{PAY}$  = change in accounts payable

295  $\text{DEP}$  = depreciation expenses

296  $\text{RET}$  = retirement benefits expenses

297 Yoon *et al.*'s (2006) model proposes that the total accruals are related to changes in the cash revenue/sales,  
298 change of cash expenses and non-cash expenses of depreciation expenses and the expenses of retirement benefits.  
299 Discretionary accruals are accruals minus non-discretionary accruals for each observation as follows:

$$300 \text{DA}_t = \text{TA}_t / \text{REV}_t - [\beta_0 + \beta_1(\Delta\text{REV}_t - \Delta\text{REC}_t) / \text{REV}_t + \beta_2 (\Delta \text{EXP}_t - \Delta\text{PAY}_t) / \text{REV}_t + \beta_3(\text{DEP}_t + \text{RET}_t) / \text{REV}_t] (5)$$

301 The absolute value of discretionary accruals  $|\text{DA}_t|$  represents earnings management because earnings  
302 management can be income-increasing or income-decreasing accruals. Bedard and Johnstone (2004); Klein (2002); and  
303 Abdul Rahman and Ali (2006) suggest that the absolute value of abnormal accruals is a good proxy for the combined  
304 effect of income-increasing and income-decreasing earnings management. Thus, the high absolute value of discretionary  
305 accruals indicates low earnings quality and vice versa.

306 Table 2 shows that the extended model of Yoon *et al.* (2006) is significant at the 1% level and it has an explanatory  
307 power of 47.54% which is more than Dechow *et al.*'s (1995) model of 0.81%. The  $R^2$  shows that the model by Yoon  
308 *et al.*(2006) has more explanatory power to capture the discretionary accruals of Malaysian Main Market listed companies.

309 **Table 2.** Multiple Regression Results of Discretionary Accruals  
310  
311

Variables	M-Jones by Dechow <i>et al.</i> (1995)		Extended M-Jones by Yoon <i>et al.</i> (2006)		
	Coef.	t-stat	Variables	Coef.	t-stat
_cons	-0.0110**	-2.31	_cons	0.0852	1.57
1 / TA	-485.35	-1.31	( $\Delta\text{REV} - \Delta\text{REC}$ ) / REV	-0.0924***	-19.91
( $\Delta\text{REV} - \Delta\text{REC}$ ) / TA	0.0112	1.06	( $\Delta \text{EXP} - \Delta\text{PAY}$ ) / REV	0.1321***	23.50
PPE / TA	-0.0346***	-3.78	( $\text{DEP} + \text{RET}$ ) / REV	-3.8545***	-29.95
F-value	5.25		613.74		
Sig	0		0		
R-squared	0.0081		0.4754		
N	2032		2032		

Hence, the model of Yoon *et al.* (2006) is used as (DA2) the second measurement of discretionary accruals (proxy of earnings quality) in this study.

### 3.2 Discretionary Accruals Model Specification

Specifically, this study attempts to examine the relationship between audit committee characteristics (size, independence, frequency of meetings, financial expertise and chairman being former audit partner), internal audit function, Big4 audit firm, audit and non-audit services fees, ownership concentration and earnings quality. In addition, following previous studies, we include firm size, return on assets, leverage, income loss and sales growth as control variables (Ismail *et al.*, 2009; Peasnell, Pope & Young, 2005; Abdul Rahman & Ali, 2006; Dechow, Richardson & Tuna, 2003). Additionally, we include years and industries as dummy variables to control business cycle effects and differences across industries (Datta, Iskandar-Datta & Singh, 2013). The model to achieve the objectives is listed below:

$$|DA| = \beta_1 ACSIZE + \beta_2 ACIND + \beta_3 ACMEET + \beta_4 ACEXPRT + \beta_5 ACPART + \beta_6 IAFINVE + \beta_7 IAFSOUR + \beta_8 BIG4 + \beta_9 AF + \beta_{10} NONAF + \beta_{11} OWCO + \beta_{12} ROA + \beta_{13} LEV + \beta_{14} FSIZE + \beta_{15} LOSS + \beta_{16} SGROWTH + e$$

Where:

|DA| = absolute value of discretionary accruals

ACSIZE = audit committee size

ACIND = audit committee independence

ACMEET = audit committee meeting

ACEXPRT = audit committee financial expertise

ACPART = audit committees' chairman former audit partner

IAFINVE = cost of internal audit function

IAFSOUR = internal audit function sourcing arrangement

BIG4 = big 4 audit firm

AF = external audit fees

NONAF = external non-audit services fees

OWCO5 = ownership concentration

ROA = return on assets

LEV = leverage

FSIZE = firm size

LOSS = net income loss

SGROWTH = sales growth

Table 3 provides a summary of measurements of variables used in the study.

**Table 3.** Summary of Measurement of Study Variables

Variables	Measurement
ACIND	Percentage of total number of independent non-executive directors divided by the total number of AC members (Abdul Rahman & Ali, 2006; Mohamad <i>et al.</i> , 2012).
ACSIZE	Total number of audit committee members (Saleh <i>et al.</i> , 2007).
ACEXPRT	The ratio of audit committee members with accounting and financial knowledge to total members of AC (Saleh <i>et al.</i> , 2007; Goh 2009; Zaman <i>et al.</i> , 2011).
ACPART	The chairman of audit committee who was previously a senior auditor in audit firm (senior manager or partner) (Yusof, 2010).
ACMEET	Frequency of audit committee meetings (Saleh <i>et al.</i> , 2007; Xie, <i>et al.</i> , 2003; Zaman <i>et al.</i> , 2011).
IAFINVE	The natural log of internal audit cost (Johl, <i>et al.</i> , 2013).
IAFSOUR	Equals "1", if IAF is established in-house and "0" otherwise (Johl, <i>et al.</i> , 2013).
BIG4	Equals "1" if the firm is audited by Big4 Auditors; and "0" otherwise (Abdul Rahman & Ali, 2006; Davidson <i>et al.</i> , 2005).
AF	The natural log of external audit fees (Frankel <i>et al.</i> , 2002; Antle <i>et al.</i> , 2006).
NONAF	The natural log of external non-audit services fees (Frankel <i>et al.</i> , 2002; Antle <i>et al.</i> , 2006).
OWCO	Ownership by largest five shareholders (Gedajlovic & Shapiro, 2002).
FSIZE	Natural log of total assets (Ismail <i>et al.</i> , 2009; Peasnell <i>et al.</i> , 2005; Abdul Rahman & Ali, 2006).
LEV	The ratio of total liabilities to total assets (Klein, 2002; Davidson <i>et al.</i> , 2005).
ROA	The annual net profit of individual firm before tax divided by total assets (Abdul Rahman & Ali, 2006; Ismail <i>et al.</i> , 2009).
LOSS	Dummy variable equal to "1" if the net income is less than zero and "0" otherwise (Dechow <i>et al.</i> , 2003).
SGROWTH	Sales growth, annual sales growth (current year sales – prior year's sales)/prior year's sales (Ahmed, Billings Morton & Stanford-Harris, 2002).



**4. Descriptive Statistics and Analysis**

Table 4 provides descriptive statistics of the continuous variables while Table 5 provides descriptive statistics of the dichotomous variables. Table 4 shows the average size of audit committee of Malaysian Main Market companies is three members. A total of 88% of the audit committee members are independent directors. An average (Mean) of 47.47% of the audit committee members have financial expertise. There is an increase in audit committee independence and audit financial expertise compared to findings in Yunos *et al.* (2010) of 70% and 37%, respectively, using data from 2001 to 2007. This increase in audit committee independence follows the recommendation of the MCCG that independent directors should dominate the audit committee. Furthermore, the minimum value of 67% for audit committee independence indicates that the audit committee is dominated by independent directors.

**Table 4.** Descriptive Statistics of Continuous Variables

Variable Name	Minimum	Maximum	Mean	S.Dev.	Skewness	Kurtosis
DA1	0.002	0.195	0.056	0.050	1.266	4.028
DA2	0.007	1.452	0.256	0.338	2.258	7.801
ACSIZE	3.000	5.000	3.237	0.473	1.815	5.456
ACIND	0.667	1.000	0.885	0.150	-0.581	1.423
ACMEET	4.000	10.000	4.992	1.082	2.000	8.468
ACEXPERT	0.200	1.000	0.475	0.202	0.910	3.013
IAFINV (log)	8.923	15.607	11.408	1.350	0.808	3.433
AF (log)	10.731	13.724	11.927	0.799	0.602	2.663
NONAF (log)	-9.210	12.763	6.009	8.051	-1.298	2.827
OWCO	17.850	85.730	54.241	15.735	-0.161	2.318
ROA	-0.599	0.337	0.033	0.093	-0.892	6.647
LEV	0.004	1.652	0.391	0.220	0.997	5.710
FSIZE (log)	10.402	17.453	12.897	1.440	0.863	3.692
SGROWTH	-0.593	1.581	0.071	0.337	1.818	9.254

The average number of meetings for the audit committee in the majority of companies is about 4.99 which is more than what is recommended by the MCCG, i.e., to meet at least four times annually. The average investment on internal audit function is 11.41 (RM370,658) with the minimum value being 8.92 (RM3,000) and the maximum value being 15.61 (RM39,000,000). These results indicate that there is a concerted effort towards investment in internal audit function to increase earnings quality and to enhance the quality of financial reporting in Malaysian Main Market listed companies. The average external audit fees is 11.93 (RM284,136) and the average non-audit services fees is 6.01 (RM97,310). An average of 54.24% of the firms' shares is concentrated among the largest five shareholders in Malaysia Main Market companies which means that majority of the shares is in the hands of a few shareholders (high ownership concentration).

In terms of the controlled variables, the size of companies varies with a minimum of 10.4 and a maximum of 17.45. The sample has an average leverage level of 39% and ROA of 3.3%. Some of the companies have losses. The average of sales growth is 7% and some have negative value which indicates revenue in current year is less than previous year.

**Table 5.** Descriptive Statistics of Dichotomous Variables

Variable Name	Observations	Frequency		Percentage	
		1	0	1	0
IAFSOUR	2032	937	1,095	46.10%	53.90%
ACPART	2032	655	1,377	32.20%	67.80%
BIG4	2032	1135	897	55.90%	44.10%
LOSS	2032	438	1,594	21.60%	78.40%

Table 5 indicates that 46.2% of Main Market listed companies in Malaysia have in-house internal audit function and 53.8% of the companies outsource their internal audit function. The finding also indicates that 32.3% of Malaysian companies have audit committee chairman who was an audit partner. A total of 1,135 companies or 55.7% are audited by Big4 audit firms while another 44.3% (901 companies) are audited by non-Big 4 audit firms. The statistics also indicate that 21.5% of the companies have net income loss.

Following previous studies (e.g., Saleh *et al.*, 2007; Yoon *et al.*, 2006; Ball & Shivakumar, 2005; Kraft, Lee &

Lopatta, 2014; Bonetti, Parbonetti & Magnan, 2013; Gaio, 2010; Kothari, Leone & Wasley, 2005; Prawitt *et al.*, 2009), winsorized distributions were conducted to eliminate possible outliers in all continuous variables at the top and bottom one percent of the data distribution to maintain the characteristics of original data. Robust standard errors were conducted to estimate the regression models to solve heteroskedasticity problem. Skewness and kurtosis were used to test the normality assumption; for skewness, Hair, Tatham, Anderson and Black (2006) suggest a higher threshold of  $\pm 3$ ; for kurtosis, Kline (1998) suggests a higher threshold of  $\pm 10$ . The results from this approach (see Table 4 and Table 5) led to the conclusion that the data set has no serious violation of the normality assumption. The correlation matrix between variables using Pearson correlation was conducted to test for multicollinearity issue. As presented in Table 6, no correlation exists of more than 0.80 (Hair *et al.*, 2006); thus multicollinearity is not an issue in this study.

**Table 6.** Correlations Matrix of Study Variables

		1	2	3	4	5	6	7	8	9	10	11	12
1	DA1	1											
2	DA2	0.25***	1										
3	ACSIZE	0.0145	0.0147	1									
4	ACIND	-0.0348	0.0310	-0.1431	1								
5	ACMEET	0.0037	0.0674	0.0981	0.0458	1							
6	ACEXPART	-0.0014	-0.0226	-0.14*	0.0508	0.0129	1						
7	ACPART	0.0289	0.0252	-0.0171	0.0054	0.0423	0.1244	1					
8	IAFSOU	-0.0711	-0.0440	0.17**	0.0716	0.0938	-0.0449	-0.0508	1				
9	IAFINV	-0.0948	-0.0887	0.27***	-0.0055	0.25***	-0.0572	-0.0406	0.64***	1			
10	BIG4	-0.1126	-0.0662	0.0948	-0.0390	0.0371	-0.0530	0.0406	0.17**	0.32***	1		
11	AF	-0.0940	-0.0699	0.23***	0.0412	0.24***	-0.0928	-0.0133	0.44***	0.71***	0.28***	1	
12	NAF	-0.0713	-0.0459	0.0775	-0.0059	0.0580	0.0235	0.0141	0.0596	0.23***	0.23***	0.19**	1
13	OWCO	0.0163	0.0316	0.1097	-0.1123	0.0248	0.0075	-0.0142	0.0687	0.1222	0.15*	-0.0010	0.0222
14	ROA	-0.18**	-0.19**	0.1047	0.0016	-0.0681	0.0095	0.0083	0.0868	0.16**	0.18**	0.1005	0.1294
15	LEV	0.1183	0.0114	0.0379	0.0230	0.1274	-0.0320	-0.0022	0.0362	0.1105	-0.1268	0.22***	-0.0779
16	FSIZE	-0.1254	-0.0485	0.25***	0.0338	0.23***	-0.1234	-0.0099	0.44***	0.76***	0.35***	0.79***	0.22***
17	LOSS	0.15*	0.16**	-0.0509	0.0412	0.0593	-0.0046	0.0072	-0.0936	-0.17**	-0.16**	-0.14*	-0.0814
18	SGROWTH	0.0398	-0.0825	0.0309	0.0449	0.0192	0.0105	-0.0235	0.0390	0.0320	0.0119	0.0606	0.0352
		13	14	15	16	17	18						
13	OWCO	1											
14	ROA	0.15*	1										
15	LEV	-0.14*	-0.32***	1									
16	FSIZE	0.1136	0.18**	0.18**	1								
17	LOSS	-0.1285	-0.66***	0.27***	-0.22***	1							
18	SGROWTH	-0.0009	0.19**	0.0375	0.0704	-0.17**	1						

Note: \*, \*\*, \*\*\*, significant level at 10%, 5% and 1%, respectively. DA1 = Discretionary accruals modified Jones model (Dechow *et al.*, 1995), DA2 = Extended of modified Jones model by (Yoon *et al.*, 2006), ACSIZE = AC size, ACIND = AC independence, ACMEET = AC meeting, ACEXPART = AC financial expertise, ACPART = AC chairman audit partner, IAFSOU = sourcing arrangements of internal audit function, IAFINV= investment in internal audit function, BIG4 = largest 4 audit firms, AF = external audit fees, NAF= external non-audit services fees, OWCO = Ownership Concentration, ROA = Return on assets, LEV = Leverage, FSIZE = Firm size, LOSS = Net Income Loss, SGROWTH = Sales Growth.

## 5. Results and Discussion

The OLS regression was used to analyse the data. For the first dependent variable (DA1), the model is fit and significant at 1% level (with F-value = 6.22,  $R^2 = 0.0792$ ); and for the second dependent variable (DA2), the model is also fit and significant at 1% level (with F-value = 18.13,  $R^2 = 0.2577$ ).

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**Table 7. Multiple Regression Results**

$$|DA| = \beta_1 ACSIZE + \beta_2 ACIND + \beta_3 ACMEET + \beta_4 ACEXPART + \beta_5 ACPART + \beta_6 IAFINVE + \beta_7 IAFSOUR + \beta_8 BIG4 + \beta_9 AF + \beta_{10} NONAF + \beta_{11} FSIZE + \beta_{12} ROA + \beta_{13} LEV + \beta_{14} OWCO + \beta_{15} LOSS + \beta_{16} SGROWTH + e$$

Variables	Predicted DA1			DA2	
	Sign	Coef.	t-stat.	Coef.	t-stat.
_cons	?	0.0838***	3.94	0.362***	2.82
ACSIZE	-	0.0046*	1.83	0.0186	1.22
ACIND	-	-0.0063	-0.86	0.0449	1.04
ACMEET	-	0.0002	0.21	0.0238***	3.64
ACEXPART	-	-0.0040	-0.73	-0.0374	-1.14
ACPART	-	0.00389*	1.66	0.0201	1.40
IAFSOUR	?	-0.0026	-0.90	0.0316*	1.73
IAFINVE	-	0.0010	0.64	-0.0294***	-2.88
BIG4	-	-0.0035	-1.44	-0.00758	-0.50
AF	-	-0.0021	-0.92	-0.0267*	-1.68
NONAF	-	-0.0001	-0.73	-0.00136	-1.50
OWCO	+	0.0002***	3.05	0.000123	0.28
ROA	-	-0.0696***	-2.71	-0.664***	-3.87
LEV	+	0.0176***	2.74	0.00675	0.17
FSIZE	-	-0.0030**	-2.02	0.0150	1.49
LOSS	+	0.0035	0.92	0.0451	1.64
SGROWTH	+	0.0108***	2.76	-0.0401	-1.58
Years Dummy	?	Include		Include	
Ind. Dummy	?	Include		Include	
F-value		6.22		18.13	
Sig		0.000		0.000	
R-squared		0.0792		0.2577	
N		2032		2032	

Note: \*, \*\*, \*\*\* significant at 10%, 5%, and 1% levels, respectively. DA1 = Discretionary accruals under modified Jones model by Dechow *et al.*, 1995, DA2 = Extended modified Jones model by Yoon *et al.*, 2006; ACSIZE = AC size, ACIND = AC independence, ACMEET = AC meeting, ACEXPART = AC financial expertise, ACPART = AC chairman former audit partner, IAFSOUR = sourcing arrangements of internal audit function, IAFINVE= investment in internal audit function, BIG4 = largest 4 audit firms, AF = external audit fees, NAF= external non-audit services fees, OWCO = Ownership Concentration, ROA = Return on assets, LEV = Leverage, FSIZE = Firm size, LOSS = Net Income Loss, SGROWTH = Sales Growth.

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Table 7 shows that ACSIZE is positively significant with DA1 ( $t = 1.83, p < 0.10$ ) but not significant with DA2. This result does not support the agency theory and resource dependence theory which suggests that larger audit committees would effectively monitor and bring more external resources to enhance financial reporting quality.

Audit committee meetings (ACMEET) is found to be significant with positive relationship with discretionary accruals (DA2) ( $t = 3.64, p < 0.01$ ), but not significant with DA1. This result contradicts  $H_3$  which proposes an increase in ACMEET decreases the level of discretionary accruals. Also, this result is in contrast with the arguments of the agency and resource dependence theories that an increase in the frequency of audit committee meetings can enhance internal monitoring and increase the transparency of financial reporting by exploiting directors' expertise during the meetings. The possible explanation might be due to the fact that high ownership concentration affects directors' independence and leads to ineffective audit committee meetings.

ACPART is found to be in a significantly positive relationship with DA1 but not with DA2. The significant relationship indicates that the discretionary accruals (DA1) is increasing in the companies which have audit committee chairman who is a senior or former audit partner. This finding contradicts the hypothesis.

The results also show insignificant association between sourcing arrangements (IAFSOUR) and DA1, but a significant and positive association with DA2. The explanation of this result could be the in-house internal audit function (IAF) leads to increased discretionary accruals. This result suggests that outsourced IAF is more expertise compared to in-house IAF. In addition, outsourced IAF is considered as more independent and able to fulfil the monitoring role better than the in-house IAF (Johl, *et al.*, 2013).

The cost of internal audit function (IAFINVE) is insignificant with DA1 but significant and negatively related to DA2 at the 1% level. This finding somehow indicates that increasing the cost of IAFINVE would increase internal monitoring by reducing the earnings management and lead to higher earnings quality. This result supports increasing investment in

432 internal audit function as a source to enhance internal monitoring.

433 The association between external audit fees (AF) and DA1 is not significant but it is negatively significant with DA2  
434 ( $t = 1.68, p < 0.10$ ). This supports the hypothesis that high audit fees can be a proxy of audit quality and subsequently,  
435 enhanced earnings quality. However, no significant relationship appears between external non-audit services fees  
436 (NONAF) with DA1 and DA2. In terms of ownership concentration (OWCO), the coefficient is significantly positive with  
437 DA1 ( $t = 3.05, p < 0.01$ ), but insignificant with DA2. This result suggests the influence of OWCO on earnings quality which  
438 supports the agency theory.

439 The insignificance of independent directors on the audit committee for both measurements (DA1 and DA2) implies  
440 that the independent directors on the audit committee are ineffective in overseeing the influence of the financial reporting  
441 process on earnings quality. Thus,  $H_2$  is not supported. The finding could be justified by the nature of the job undertaken  
442 by the independent directors in terms of the committees they serve. In addition, the result indicates that audit committee  
443 expertise (ACEPERT) is not related to earnings quality. The possible explanation might be due to lack of independence  
444 (Defond, Hann & Hu, 2005). The Big4 audit firm also has no significance with DA1 and DA2.

445 For control variables, the ROA coefficient is significantly negative with both DA1 and DA2 at the 1% level. The  
446 current study finds that firm performance is positively related to earnings quality. This is consistent with Abdul Rahman  
447 and Ali (2006) who argue firms with low performance have the tendency to engage in earnings management. Meanwhile,  
448 Leverage (LEV) is found to have significantly positive relationship with DA1 at the 1% level, indicating that higher  
449 leveraged firms are more motivated to engage in earnings manipulation in order to avoid debt covenant violation. In other  
450 words, higher leverage leads to a higher level of earnings manipulation. Firm size (FSIZE) is negatively significant with  
451 DA1 at the 1% level, indicating that large firms report higher quality of earnings since they are closely monitored by the  
452 financial processes in the firms. Sales growth (SGROWTH) is in a positively significant relationship with DA1 at the 10%  
453 level, consistent with the finding in Warfield *et al.* (1995), indicating that increasing sales growth motivates the managers  
454 to engage in 'smoothing' earnings management. LOSS is found to be insignificant with discretionary accruals.

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## 456 6. Conclusion

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458 The study finds some evidence that the extended M-Jones model of Yoon *et al.* (2006) is robust in detecting discretionary  
459 accruals in the Malaysian Main Market listed companies. The results provide evidence that outsourcing internal audit  
460 function, more investment in internal audit function and external audit fees increase the level of earnings quality.  
461 However, the results also indicate that some audit committee characteristics (such as size, independence, meeting  
462 frequency, financial expertise and chairman being former audit partner) may not contribute to enhancing earnings quality.  
463 The study also finds ownership concentration leads to low earnings quality. External audit by Big4 audit firms and non-  
464 audit services fees are not associated with earnings quality. However, the scope of the study is limited to the Malaysian  
465 Main Market listed companies for a period of study of four years from 2009 to 2012. Therefore, it is suggested that future  
466 research should examine other variables, such as internal auditors' characteristics and use different measurements to  
467 capture audit committee characteristics.

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# Financial Risk Analysis of Portuguese Textile and Tourism Companies

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## Abstract

*Textile and tourism sectors are two important industries in the Portuguese economy. However, its high exposure to both internal and international economic volatility make the companies operating in these economic sectors particularly vulnerable to economic crises, such as the ones which have been impacting Portugal and the European Union. The objective of this paper is to evaluate and understand the impact of size and age on the financial health of textile and tourism companies, measured by economic indices. An empirical based model is proposed. Its implications are derived and tested on a sample of 4061 Portuguese companies from textile and tourism sectors, during the period 2005-2009. The findings suggest that age has a major impact on the risk of failure, rather than size. Whereas the effect of age is generally positive regarding the financial health of the company, the effect of size is less clear and ultimately depends on the age of the company.*

**Keywords:** Age, size, business failure, textiles and tourism.

## 1. Introduction

Although the first empirical studies of bankruptcy prediction have been developed around the thirties by Fitzpatrick (1932) and Smith and Winakor (1935), the topic gained a new visibility and new academic relevance in the sixties, with the researches of Beaver (1966) and Altman (1968). Since then a growing number of researchers has investigated on this topic.

At a time when the national and international scene is marked by an economic and financial crisis, and in times of market downturn and economic difficulties, to understand why some companies fail and others don't, is a topic of extreme interest. The economic consequence of company's failure is enormous, especially for employees, investors and creditors.

During the last four decades a growing number of researches came up with formulas to predict the bankruptcy of a company. The set of predictive variables proposed on the studies is considerably heterogeneous. Age and size are two variables well investigated, however previous research is not clear about how age and size affects business failure, especially we do not know how these models perform when tested with Portuguese companies.

The objective of this paper is to evaluate and understand the impact of size and age on the financial health of textile and tourism companies, measured by economic indices, and therefore also evaluates their risk of failure. Its implications are derived and tested on a sample of 4061 Portuguese companies from textile and tourism sector.

58 **2. Literature Review**  
59

60 It can be said that in all these decades of empirical research on bankruptcy prediction failed to produce agreement on  
61 which variables are good predictors and why (Hol et al., 2002). However, in all those models mentioned above, there are  
62 several works that, through different perspectives consider size, age and sector as key variables to explain the probability  
63 of failure and growing businesses.

64 Some studies have concluded that the size is negatively correlated with the probability of failure (Thompson, 1976;  
65 Altman et al., 1977; Ohlson, 1980; Evans, 1987; Hall, 1987; Chen and Lee, 1993; Audretsch and Mahmood 1995;  
66 Cummins et al., 1995 or Turetsky and McEwen, 2001).

67 Chen and Wong (2004) reported that one of the main factors which significantly affect the financial health of  
68 companies is its size. Honjo (2000) used a proportional hazards model to show that software companies with an  
69 important size are less likely to fail. Turetsky and McEwen (2001) argue that large firms are expected to have better risk  
70 management. For Berger and Udell (1995), the oldest the company is, the lower are costs of external financing. In the  
71 same sense, Holmes et al. (1994 ) mention that smaller companies often have more limited access to financing and a  
72 greater financial cost. Mazzi (2011) reported that family firms are, in general, significantly younger than nonfamily firms.  
73 Similar finding was obtained by Villalonga and Amit (2006), Lee (2006) and Miller et al. (2007).

74 Serrano et al. (2005) argue that small firms are more likely to fail than large enterprises. The authors added that  
75 the ratios depend on the size of the company, but the way it does it, varies over different countries. Buehler et al. (2006)  
76 found that the percentage of companies that fail decrease with age.

77 In the literature on corporate risk there are also authors who use size as an explanatory variable in their models of  
78 business failure prediction (Ohlson , 1980; Peel et al., 1986; Peel and Peel, 1988 or López et al., 1998).

79 The results obtained by Audretsch and Mahmood (1995) suggest that exposure to the risk of new firms tend to be  
80 larger in highly innovative sectors. These authors argue that new firms can reduce the risk of failure by increasing their  
81 size, indicating that the structure of ownership and size of young companies have influence on the probability of survival.  
82 Audretsch (2001) finds that young companies do not have economies of scale. He also states that some companies  
83 manage to successfully grow and others remain small and ultimately may have to exit the market.

84 On the subject we also highlight the contributions of Fariñas and Moreno (2000) and Calvo and Garcia (2006).  
85 Using a sample of Spanish companies Fariñas and Moreno (2000) concluded that the failure of firms declines with age  
86 and size. Calvo and Garcia (2006) carried out an empirical study to analyze the structure of financial risk the Spanish  
87 industry in the period 1997-2001, analyzing the impact of the size and age of the company. The findings of the will  
88 towards the existence of an inverse relationship between the size and age of the company and its financial risk.  
89 Concerning the impact that causes the size and age of the company on risk variables analyzed, these authors concluded  
90 that the size factor is more relevant than the ability to return the ancient debt and economic profitability of the company,  
91 and a higher incidence in antiquity capitalization and financial stability of the companies.

92  
93 **3. Methodology**  
94

95 **3.1 Selection of the sample**  
96

97 To develop this study, we used the information of the annual accounts (balance sheet and income statement) collected  
98 from the SABI database. The sample comprises 4061 companies from sectors of textile and tourism. The information  
99 collected refers to the year 2005-2009.

100  
101 **3.2 Variables**  
102

103 The variables are the size and age. The variable age measures the time in years since the constitution of the company till  
104 the year of 2009. This variable is categorized in three categories: less than 5 years, between 5 and 15 years and more  
105 than 15 years.

106 For the size of the companies we follow the Commission Recommendation 96/280/EC of 3 April 1996, considering  
107 four categories. The size of the company is measured also in an ordinal scale: micro companies, small companies,  
108 medium companies and large companies. However, due to the inexistence of large companies with less than 5 years,  
109 and the relative very low frequency of large companies in the sample, the analysis was performed excluding those  
110 companies. Hence only three categories for size were considered in the analysis.

111 Five continuous indices were collected to measure the financial health of the company. These five variables have a



great power to discriminate and classify the financial state and the risk of failure of the company according to Calvo and Garcia (2006).

These indices are:

X1 = (Net profit + Depreciation expense + Provisions) / Liabilities;

X2 = (Current assets - Current Liabilities) / Total assets;

X3 = Equity / Total assets;

X4 = Operating profit (or loss) / Total assets.

### 3.3 Statistical Analysis

Since there are four metric dependent variables (the four indices) and two ordinal predictor variables (size and age), the first goal is to evaluate the significance of the differences across groups defined by the predictor variables, to be able to conclude the significance of the impact of at least one of the predictor variables (size or age) on the indices measured.

Univariate analysis of variance (ANOVA) is a statistical technique that is used to determine whether samples are drawn from populations with equal means, so it is the adequate statistical instrument to evaluate the impact of predictors on each of the five dependent variables separately. This approach has the disadvantage of ignoring the possibly correlation between the dependent variables, and so a significant or nonsignificant ANOVA may be identified erroneously.

When one wants to simultaneously explore the relationship between several categorical independent variables and two or more continuous dependent variables, the statistical technique recommended is the multivariate analysis of variance (MANOVA), which is an extension of ANOVA. MANOVA procedure optimally combines the multiple dependent variables into a single value that maximizes the differences across groups, assessing how the dependent variables differ as a whole across the categories of the independent ones. Only after a significant MANOVA individual ANOVAs are performed to evaluate the impact of predictors on each of the dependent variables.

Therefore, MANOVA seems to be the adequate procedure as a starting point of the present study, as MANOVA can detect differences among the dependent variables, even when univariate tests show no differences. If a significant difference is achieved, separate ANOVAs can be employed to address the individual differences for each dependent variable.

Before applying these statistical procedures, it is important to check the presence of outliers. ANOVA and MANOVA are especially sensitive to outliers and their effect on Type I error.

The assumption of univariate normality in case of ANOVA or multivariate normality in case of MANOVA must be also checked. As in ANOVA, MANOVA tests are believed to be robust against violations of multinormality when the individual group sizes are large enough, which means that the impact on the final results are negligible. Monte Carlo studies (Mardia 1971; Olson 1974) show that departures from multivariate normality of MANOVA test statistics may reduce statistical power, but generally with only small effects on the type I error.

The next issue to be addressed is the equality levels of variance (in the case of one dependent variable, ANOVA) or equality of the covariance matrices (in the case of multiple dependent variables, MANOVA) across the groups, so that the variance (ANOVA) or the covariance matrices (MANOVA) for each group, are not concentrated in only a limited range of the categories of the predictor variables. If unequal variance/covariance across groups is present, the standard errors are affected and consequently the results of the tests. The effect of this is more severe when the sample size of the groups are small or very different.

In the present study some extreme points for each group were identified and eliminated prior to the analysis. The assumption that the data on each group conforms to a multivariate normal was checked and found to be violated. The same happens with the univariate normality distributions. The equality of the covariance matrices is also not met, nor the equality of variances for each of the dependent variables.

With these obstacles it is advisable to perform alternative procedures.

A nonparametric method, based on permutation tests, permutational MANOVA (McArdle, 2001; Anderson, 2001) was performed. For the permutational MANOVA (Anderson, 2001) the test statistic is a multivariate analogue to Fisher's F-ratio. The p-values are estimated using permutations. Under a true null hypothesis, the groups of multivariate observations can be exchangeable. Thus, permutations are performed to achieve new values for the statistic, giving the entire distribution of the statistic under a true null hypothesis.

This test is a test for differences in location among groups of multivariate observations. The test requires that the observations are independent and that they have similar distributions. It does not require the assumption of multivariate normality as MANOVA does. However, this test (as the parametric one) is sensitive to heterogeneity of variances. This means that a significant difference among groups may be due to differences in dispersion and/or differences in location.

166 Although the statistic sensitivity to differences in variances among groups, it takes no account on the covariances among  
 167 variables, as the parametric MANOVA (which assumes not only the equality of the variances but also that the  
 168 covariances of the variables do not differ across groups) (Anderson, 2001). Hence, this test is less demanding concerning  
 169 assumptions than the parametric MANOVA. The test was performed resorting on the vegan R package (R, 2011;  
 170 Oksanen et al., 2013)

171 The results achieved by the permutational MANOVA are resumed in table 1

172 **Table 1.** Permutational MANOVA

	Degrees of freedom	Sums of squares	p-value
Size	2	5.62	0.008
Age	2	34.41	0.001
Size*Age	4	7.84	0.009

175 The interaction term represents the joint effect on the dependent variables of the two predictors, size and age. If the  
 176 interaction is nonsignificant the effects of the factors are Independent, which means that the effect of one factor is the  
 177 same for each level of the other factor and the main effects can be interpreted directly. The result ( $p=0.009$ ) points to the  
 178 existence of strong evidence of interaction between size and age. Hence, the main effects of size and age must be  
 179 interpreted with caution. Those main effects show that the variable age shows a little stronger impact than size over the  
 180 dependent variables.  
 181

182 A parametric MANOVA was also performed (table 2), despite the unmet assumptions, to compare to the results  
 183 obtained by the permutational MANOVA. The results show moderate to strong evidence of interaction, confirming the  
 184 findings already obtained with the permutational MANOVA. Concerning the main effects, the outcome points to a  
 185 nonsignificant result concerning size, and reinforces the strong effect of age (table 2) achieved by the preceding test.  
 186

187 **Table 2.** MANOVA

		Statistic	p-value
Size	Pillai's Trace	0.002	0.344
	Wilks' Lambda	0.998	0.344
	Hotelling's Trace	0.002	0.344
	Roy's Largest Root	0.002	0.111
Age	Pillai's Trace	0.027	< 0.001
	Wilks' Lambda	0.973	< 0.001
	Hotelling's Trace	0.028	< 0.001
	Roy's Largest Root	0.026	< 0.001
Size*Age	Pillai's Trace	0.008	0.018
	Wilks' Lambda	0.992	0.018
	Hotelling's Trace	0.008	0.018
	Roy's Largest Root	0.006	< 0.001

189 As both MANOVAs show significant results, the study of the impact of size and age on each of the four dependent  
 190 variables is required. As the sampled populations have distributions away from normality and do not have similar  
 191 variances, four permutational ANOVAs and four two-way ANOVAs were undertaken and compared. Moreover, the results  
 192 were also reported by a robust alternative to the sample mean and median for estimating the location (Huber's M-  
 193 estimator) for each of the dependent variables.  
 194

195 Table 3 displays the results obtained by the parametric and permutational ANOVAs with both main and interaction  
 196 effects.  
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204 **Table 3.** Univariate ANOVAs (parametric and permutational ANOVAs)  
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Independent	Predictors	Parametric ANOVAs		Permutational ANOVAs	
		Sums of Squares	p-value	Sums of Squares	p-value
x1	Size	0.279	0.573	0.98	0.131
	Age	1.747	0.030	1.39	0.061
	Size*Age	1.173	0.320	1.17	0.317
x2	Size	1.907	0.028	0.73	0.262
	Age	16.208	0.000	14.40	0.001
	Size*Age	3.591	0.009	3.59	0.015
x3	Size	0.318	0.492	3.67	0.003
	Age	16.966	0.000	18.52	0.002
	Size*Age	2.647	0.019	2.65	0.025
x4	Size	0.036	0.460	0.240	0.007
	Age	0.086	0.160	0.090	0.128
	Size*Age	0.430	0.001	0.430	0.011

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Only variable X1 show no evidence of interaction between size and age. By checking the sum of squares and the p-values of each dependent variables, it is patent the bigger importance of age over size in explaining the financial risk of failure, except for variable X4, where size becomes significant ( $p = 0.007$ ) for the permutational ANOVA. This result must be interpreted with caution, since this is also the variable that shows the stronger evidence of interaction.

The results are supported by Huber's M-estimator (Huber 2009) (table 4) for each group across each of the dependent variables. These results also reveal a direct association between age and the financial health of the companies (except for the impact on variable x4 of micro and small companies), which means that older companies have less risk of failure. This direct association is also found when analyzing the association between size and the dependent variables without controlling for age. However, when controlling for age, one achieve to different results (table 4). The interaction between age and size does not allow the interpretation of the impact of size alone, as interaction can confound the effect of size.

**Table 4.** Huber's M-estimators

		x1	x2	x3	x4
Micro companies	Less than 5 years	,077	,017	,136	,046
	Between 5 and 15 years	,083	,104	,262	,030
	More than 15 years	,076	,188	,374	,022
Small companies	Less than 5 years	,067	,002	,151	,038
	Between 5 and 15 years	,098	,057	,257	,034
	More than 15 years	,103	,176	,389	,029
Medium companies	Less than 5 years	,061	-,199	,133	,011
	Between 5 and 15 years	,078	,029	,298	,031
	More than 15 years	,121	,188	,413	,034

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#### 4. Conclusion

In the economic literature there are many studies to consider size and age as key variables to explain the probability of failure and growing businesses. The objective of this paper is to evaluate the impact of size and age on the financial health of textile and tourism companies, measured by economic indices. From empirical study we can draw the following conclusions.

Age has a stronger impact on the risk of failure than size. This result is not consistent with the obtained by Quirós and Lisboa (2014) and Pérez et al. (2004). However, due to the significant interaction effect present, the individual results must be controlled for the effects of the other predictor. Particularly, this is true concerning the effect of size.

The impact of size must be interpreted independently for each level of age. Whereas the effect of age is generally positive regarding the financial health of the company, the effect of size is less clear and depends on the age of the company.

Due to the inexistence of large companies with less than 5 years, and the relative very low frequency of large

companies in the sample, the analysis was performed excluding those companies. To overcome this limitation, a larger sample will be used in a future research, in order to try to have a proxy sample of every industry.

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# Forensic Classification of Information Sources by the Mode of Representation

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## Abstract

The examination of the criminalistic information sources is of great theoretical and practical importance for execution of the crime control tasks. The aim of the present study is examination of the criminalistic information sources and their classification by the method of representation. The author of the article classifies the significant forensic information, basing on the analysis of research sources and the practice of detection and investigation of criminal cases. On the grounds of the survey, the author suggests practical guidelines on the most efficient usage of significant forensic information for the fight against crime.

**Keywords:** forensic information, information sources, vestiges of a crime, track formation mechanism, investigation of crimes.

## 1. Introduction

The widespread adoption of scientific advances, improvement of scientific and technical methods to combat crime caused a significant expansion of the forensic information sources range and methods of their study. The volume of such information sources as photographs, molds, mechanical copies, records, drawings has increased. A number of new technical means of information reproduction, transformation and transmission is successfully used in the fight against crime. Through the new means of reproduction technology there is carried out the transfer and the exact fixation of sounds and images; revealing object properties, directly inaccessible to the eyesight, due to its limited sensitivity, the study of transient processes, solution of a number of statistics, classification and logic problems.

The successful development of the methods of forensic investigation is only possible on the ground of a broad, active use of the modern achievements of natural, engineering and humanities sciences, creatively processed in expertise.

The science and technology reveal the new possibilities of detection, fixation and study of forensic information.

However, it should be taken into account that the modern scientific and technical devices are fully used as a means to commit and conceal the crime, which significantly complicates the task of forensic investigation and proof.

The task of forensics is to comprehend these possibilities and determine the conditions of their implementation in the process of forensic activities on detection and investigation of crimes.

In this context, the development of sources classifications, contributing to elucidation of the possible use and development of the study methods of forensic information sources is of primary importance.

One of such classifications is the information sources classification through the method of information reflection.

Individual questions about using forensically relevant information in combating crime have been previously considered by individual scientists, among them are the works of R.P. Fisher and R.E. Geiselman (1992), A. Aubakirova (2000), V. A. Volynskiy (1994), C.E. O'Hara and G.L. O'Hara (1988), W.B. Sanders (1977), M. A. Tolegen et al. (2013), M. Nakayama (2002), E.J. Bernard (2007) and others authors.

Meanwhile, separately, the issues devoted to the information sources classification by the reflection method were not considered previously.

## 2. Research Methodology

The methodological basis of the research comprises the dialectical theory of cognition, formal logic, forensic methodology and academic forensic conceptions. The author applied academic methods of cognition (analysis, synthesis, statistical technique) in the research. Also, in the research there have been utilized the mathematical, cybernetic, and ad hoc approach of forensic and other studies, in particular, systemic structural analysis and information security theory bases.

56 Furthermore, in the study there was used an analysis of criminal cases, with the purpose of exploration of the  
57 forensic information application experience, as well as for deficiency exposure of the investigation subjects activity.  
58

### 59 3. Results and Discussion

60 Among the objects of research by the specified grounds, there are distinguished two main groups:

- 61 – the objects, peculiar properties of which have probative value (direct sources of information);
- 62 – the objects, containing evidentiary information on the properties of other objects (indirect sources of  
63 information).

64 The notion of mediated sources can be compared with the notion of a trace. Under the traces in a broad sense, we  
65 understand, as noted above, all the changes of material conditions related to the events under investigation. This applies  
66 to both individuals and items, for instance, traces of the hands, feet, transport, animals, etc., as well as any changes that  
67 show the circumstances of the event under investigation. In this case, the objects themselves can be termed as tracks,  
68 also material particles and the changes in their state. For example, clothing of a criminal, cigarette butts, food debris is  
69 called traces of the offender; changes in the position of furniture at the murder scene – the traces of fighting; insects  
70 detected on the body, and smells – traces of a corpse's rotting, etc.

71 A presentation is often referred to the traces-prints of events – images of this event, memorized in the minds of  
72 living persons. In this broad sense, any sources of forensic information about the events under investigation, any sources  
73 of evidence should be understood as traces (Volynskiy V. A., 1994). As of the evidence, the "evidence is called every  
74 fact, having a purpose to cause belief in the existence or non-existence of any circumstances constituting the object of  
75 the study" (Aubakirova A., 2000).

76 The notion of mediated information source has a more specialized meaning. The indirect sources are only part of  
77 the sources of forensic information, although the most significant. A peculiarity of the mediated information source is that  
78 the intrinsic properties of the sourced o not have the probative value, but the properties of the other object reflected in it.

79 For example, an arm trace or a footprint of a criminal as a mediated source of information has value only insofar as  
80 it reflects the properties of the human who left them, it allows to find and expose the culprit. The conception preserved in  
81 the mind of the witness, is also important not as the intrinsic properties of the witness, but as a display of persons,  
82 objects, and events related to the crime.

83 The methodological value of dividing sources of forensic information in the direct and indirect lies in the fact that  
84 this division allows to correctly identify the subject (problem) *ц*а the research, the methods and techniques of research,  
85 as well as the conditions of use of the evidence resulting from the research.

86 In the direct source of information the properties of the source itself are of the probative value. The research  
87 problem is to detect and fix these properties. It can be solved by direct perception and the information source research.

88 Thus, during examination of the instruments of crime (knife, firearms, etc.) there are clarified the properties of  
89 these objects, which allow using them as an instrument of attack or defense, and determine their attribution to the  
90 category of "cold weapon", "firearms". These properties include: the length of the blade, the handle construction, the  
91 possibility of a shot etc.

92 During the inspection of inferior goods the task is to detect those properties that characterize its inconsistency with  
93 standards and specifications and, in any event, limit the possibilities of its use.

94 The subject and objectives of the study significantly change in the presence of indirect sources of information.  
95 Direct examination of the evidence here is impossible, since the probative value is inherent not in the properties of the  
96 source but in the properties of an object reflected in it and extraneous to it.

97 Data on the properties of the inferior goods can be obtained from photographs of the product, and data on the  
98 crime weapon – from the testimony of a victim or a witness. It is clear that in these cases, not the properties of the  
99 photographs or the witness are of importance but the properties of the represented objects.

100 The conditions and opportunities of the study vary along with the subject. The representation reproduces only  
101 some particular aspect of the original, any separate part of its properties in specified conditions. Therefore, representation  
102 research is much more limited in features and more complicated technologically. Exploring the subject on the photograph  
103 or description, the investigator does not always have the opportunity to fully explore the subject to perform the necessary  
104 measurements, carry out experiments with it, take it apart, and so on, not to mention the fact that he in principle cannot  
105 establish the properties of the object that are not displayed (for instance, composition, taste, smell of the subject)  
106 (Azarenko S. N. and Brushkovsky K. B., 2006).

107 The specificity of the mediated information source study lies in the need to study the mechanism of reflection of the  
108 evidentiary information. Reflection of one object in another is always associated with the transformation of the displayed  
109

110 properties. The properties of the represented object are displayed in a modified form, in the form of a natural code.  
111 Establishing them requires special research, "deciphering" the data contained in the reflection. Such study is carried out  
112 only through studying the mechanism of the reflection formation. After establishing the mechanism of the reflection  
113 formation, we acquire the key to "deciphering" the actual data containing there.

114 Investigation of the mechanism of reflection is all the more difficult than the signal is stronger converted into  
115 displayed information.

116 "Reading" the pressure traces is easier than the traces of sliding and friction; "deciphering" the usual reproduction  
117 picture is easier than the picture of the scene in the invisible rays, containing bright, colour and perspective  
118 transformations; even more difficult it is to estimate the testimony of a minor witness, susceptible to influence and inclined  
119 to fill the gaps in perception by active imagination.

120 In addition to transformations, the information signal in reflection is interfered by noise, which may lead to signal  
121 distortion, loss or weakening. Thus, the adverse conditions of the photographic process can lead to "fogging" or defects in  
122 the emulsion layer; disease of the witness and his interest in the case can cause distortion of the true picture of events  
123 observed by him.

124 In cases of multilayer reflection the mechanism of reflection formation of all degrees is investigated. Thus,  
125 establishment of the object properties by the trail at the scene requires studying the mechanism of formation of this track.  
126 Solution of the same issues through the photo of the trace, found at the crime scene, is additionally connected to the  
127 assessment of conditions of the photographic process. The testimony at the fourth hand, for their correct evaluation,  
128 requires determining the perception conditions and reproduction of the fact in each of the four degrees of representation.

129 The problem of the mechanism of reflection formation is, thus, a central issue of the studies of any mediated  
130 information sources.

131 In the trace evidence, for example, the central place is occupied by the classification of traces depending on the  
132 conditions of their formation (static, dynamic, three-dimensional, surface, layers, exfoliation, etc.) and experimental study  
133 of the very conditions of trace formation.

134 When using the testimony of witnesses, victims, suspects, the central issue is the mechanism of mental reflection  
135 of the fact. This problem, in view of its importance, is the subject of a special branch of forensic psychology – psychology  
136 of testimony of witnesses and suspects, given during investigation and in court. The processes of perception, formation of  
137 representations, the mechanism of memory and playback of the perceived are developed in detail.

138 The assignment of the source of information to the direct or mediated is directly related to the definition of methods  
139 and techniques of his research. In this regard, the considered division has direct practical application in the field of  
140 forensic investigation of sources of information.

141 The principle of division of objects and representations operates not only in the actual forensic, but also in other  
142 legal identification studies.

143 Various methods and techniques of research of direct and indirect sources of information are easy to follow on any  
144 objects and tasks of forensic investigation.

145 Let us compare the direct examination of the corpse at the scene and its inspection through the protocol; the direct  
146 examination of the break-in tools and their study on the photograph; direct inspection of the stolen things and their study  
147 through the victims' testimony. It is easy to verify that the methods and techniques of information sources research in the  
148 given and similar cases are significantly different.

149 The methodical value of the considered classification is significant in those cases where the same physical object  
150 can be studied both as a direct and mediated information source, as well as in those cases where the difference between  
151 the object and the representation is not clearly expressed, as usual. Therein, the assignment of the object to the number  
152 of direct or indirect sources of information is directly linked with the definition of objectives and methods.

153 Let us consider some of these cases. An object, damaged in the result of the crime, such as a building or a  
154 household item, can be studied both as a direct and mediated source of information. If such object is regarded to  
155 determine the damage caused by a crime, it acts as a direct source. At the same time, the intrinsic properties of the  
156 object that define its purpose are essential.

157 If such an object is investigated in order to establish the perpetrators of break-in and the used technical means, it  
158 acts as a representation. At the same time, not the intrinsic properties of the damaged item have the probative value, but  
159 the properties of the extraneous objects or persons displayed in the traces. From the properties of the same damaged  
160 subject of importance are only those properties that form the representation and determine the quality of the track  
161 (density, hardness, smoothness, grain structure, stratification, etc.).

162 It is clear that the methods and techniques of research, as well as the nature and extent of the necessary  
163 knowledge will be quite different. In the first case a merchandiser should be involved in inspection as an expert, while in



164 the second – a specialist in forensic technology (trace expert).

165 A photo can also be a direct or indirect source of information. In the first case, the intrinsic properties of the  
166 photographic image are of importance, i.e. its content, form, performance technique, making it an art object, a house  
167 ware item, a pornographic product, etc. In the second case, a picture serves as a reflection of objects and persons, which  
168 allows establishing and identifying these objects and persons.

169 The representation may take the form of an object while at the same time be a mediated information source. So,  
170 sculptural portraits or death masks made using varying technical methods with the deceased persons are a presentation  
171 of a real human head and outwardly look like objects, though are essentially reflections. The method of their study fully  
172 corresponds with the research methodology of the mediated sources of information. This fact should be borne in mind in  
173 the classification of some complex objects of study.

174 The items of mass standard production can be studied both as a direct source of information, and as mediated  
175 sources – presentation. When we study the properties of the product, its quality, completeness, standardization, and so  
176 on, it acts as a direct source of information. A similar situation occurs in the study of materials and substances. Thus, a  
177 toxic agent (poison), found in a person accused of murder may also be explored bot as an object and as a reflection,  
178 although, in this case, their difference is displayed not as clearly as in the previous examples.

179 In the first case, the features of a substance, found in a charged offender are considered important that indicate its  
180 purpose and characterize its toxic effect (the composition, concentration, lethal dose, nature of the action, etc.). Any kind  
181 of random harmless impurities are considered here as irrelevant.

182 In the second case, when comparing this substance with a substance added to the food of the victim, the relative  
183 value of the features may differ. Actually the pharmacological properties of the poison will have meaning only as generic  
184 properties of the substance under examination. Particularly important will be the features that characterize the specificity,  
185 the origin of the matter from a particular source.

186 As can be seen, in this case as well, the research method will be different. In the first case, recognition –  
187 pharmacological or forensic chemical study of the substance to determine its nature, origin and purpose. In the second –  
188 a comparative identification study of the substance in order to establish the source of origin of the objects being  
189 compared.

190 As can be seen from the above, the distinction between direct and indirect sources of information is of essential  
191 methodological value. It allows to correctly identify the subject and objectives of the study, and to choose the most  
192 appropriate methods and techniques of research.

193 In cases when the same object acts both as a direct and mediated source of information, the considered division  
194 indicates the difference in tasks and methods of research of the same object, provides a comprehensive identification of  
195 all evidence essential for the case.

196 The use of mediated sources of information in the process of forensic work has become the subject of direct legal  
197 regulation. It obligates forensic scientists to conduct further intensive development of the issue of mediated sources of  
198 forensic information.

199 The division of the sources of information into direct and indirect should not be confused with the division into the  
200 original sources and derivatives. The latter are based not on the method of facts representation by the information source  
201 but on the method of the source formation and its distance from the primary source of information about the fact.

202 As noted above, the considered dividing is often identified in terminology, and in the essence. Meanwhile, there are  
203 two independent divisions, conducted on different logical grounds. The original sources of information are not always  
204 direct.

205 The witnesses of the crime, the traces of the offender, traces of transport, traces of weapons, traces of animals of  
206 all kinds etc. found at the crime scene – are some of the examples of mediated information sources, which are, at the  
207 same time, the original sources of information about the facts (Nurgaliyev B. M. and Elenyuk G. A., 2006).

208 The victim or the suspect, as the objects of examination, are direct sources of information. In case of interrogation  
209 of these people and analysis of their testimonies, they become mediated sources of information. However, both in the first  
210 and in the second case, they perform as the original information sources. The trace, found at the crime scene, and its  
211 photographs – are mediated sources of information. At the same time, the first is original and the second – derivative.

212 As shown above, the content of the derived source of information is always the same fact as the fact contained in  
213 the original source of information; the only difference is the completeness and accuracy of the reproduction.

214 The mediated source can comprise an essentially new fact in comparison with the actual content of a direct source  
215 of information.

216 Obviously, the considered divisions have different logical foundations. At the same time, the purpose and the role  
217 of these classifications varies as well.

As shown above, the purpose of distinguishing the sources of information into the original and derivatives is to implement the principle of research directness. The role of this division is to facilitate the resolution of the question of comparative information value of the existing or potential sources of information, for the investigator and the court.

The division of the sources of information into direct and indirect has a different meaning. Its significance lies in determining its research method, based on the analysis of the fact representation method through the source of information. In this case, there is resolved not the issue of the information source choice, but the choice of the method of forensic investigation.

The mediate information sources are used not instead, but equally with direct sources, being the means of fixation and examination of the factual data contained in them. The use of mediated sources in that capacity allows selecting any technique of transmission and representation of information, which is the most convenient for resolution of the specific research problems.

Thus, in studying the representations there are widely used the techniques of reflections transformation by shape, colour, brightness, relief, contrast, etc. For instance, during a fingerprint identification the fingerprints seized from the crime scene, are not compared directly with the fingerprints of the detainee, but with fabricated dactylograms; in the identification of a weapon by a bullet seized from the corpse, the latter is not directly compared with the weapon, but with the traces of the weapon bore on experimental bullets, etc.

This fact, not completely explainable from the position of dividing the sources of information into the original and derivatives, is quite understandable and natural, if it is considered in terms of dividing the sources of information into direct and indirect.

The principles of application of mediated information sources should be the basis for the active intervention of the investigator and the judge in the process of transmission, reproduction and examination of the evidentiary information. These principles justify the use of all legally acceptable techniques and methods of evidence research.

#### 4. Conclusion

Thereby, it must be concluded that development of the classifications of forensically important information sources that contribute to elucidation of the possible use and development of the examination methods of these sources is essential to the quality of a criminal investigation and combating crime.

The sources of significant forensic information by the mode of representation are distinguished into:

- immediate information sources;
- mediated information sources.

The meaning of separation of the forensic information sources into immediate and mediated is that such division allows to correctly define the object of the research, methodology and techniques of the study, as well as the conditions of utilization of the actual data obtained in the research result.

Attribution of the information source to the immediate or mediated is directly related to determination of the methods and techniques of its examination. In this connection, the separation under consideration acquires a direct practical appliance in the field of forensic information sources research.

In addition, it must be pointed that division of forensic information sources allows correct identification of the subject (problem) of research, the methods and techniques of research, as well as the conditions of application of the evidence resulting from the research.

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# Interdependence between Institutional Ownership and Leverage of Free Cash Flow: The Development of Agency Theory Model in Balancing Conflict of Interest in Indonesian Company

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## Abstract

Agency conflict arises due to the differences of interest between owner, manager and creditors. Therefore, the researchers are trying to find the appropriate model in order to reduce the agency conflict issues that occur. The uncommon thing which became the originality and the recency of this study is to consider the interdependence relationship of institutional ownership variables and leverage to assess the appropriate control of the agency conflict that occurs by considering the real situation and circumstances faced by the company when the investment opportunities is high and low as well as high and low company risk. This study uses data of listed companies in Indonesia Stock Exchange (IDX) with the data for 12 years. The analysis technique used is simultaneous equations with GMM estimation techniques (Generalize Method of Moment). This research provides practical implications for owners, managers, creditors, investors, and capital market regulation in considering decisions related to the mechanism controlling agency conflicts through institutional ownership, leverage on free cash flow faced by companies in Indonesia, so that they can make decisions and provide useful strategic considerations useful for the companies, government regulation, banks (lenders), and society.

**Keywords:** Agency Conflicts, Institutional Ownership, Leverage, and Free Cash Flow

## 1. Introduction

Most of listed companies in Indonesia have institutional shareholders in the form of business which is often as a representation of the company's founder. This ownership is called Institutional Ownership. So institutional ownership will oversee and bind the management to act in according to the interests of shareholders (Mahadwartha, 2004). Therefore, it is important to be able to assess in terms of institutional ownership in Indonesia. In the other hand, to control the agency conflict can be done through leverage by "invite" third parties (creditors or debtholders, hereinafter referred to as the creditor) to participate in supervising the management and operational of the company generally. Leverage bind the management through their obligation to repay the debt. This binding reduces the ability of management to conduct the use of free cash flow for personal interest (perquisites) for example: luxury office space, business travel exceeds the standard positions, provision of facilities that do not comply with the requirement, and others that do not add value to the operating companies (Cohen and Cyert, 1965: 355). At the time of the shareholders to supervise the use of leverage, it is expected to reduce the utilization of free cash flow by the management. Therefore, further research is needed to examine leverage in order to reducing agency conflict. The main objective of this study is to prove that institutional ownership and debt policy can be used as a control mechanism against free cash flow in Indonesian company so that it can reduce conflict caused by inappropriate free cash flow.

Based on this explanation, institutional ownership variable, leverage, and free cash flow need to be observed in an attempt to do mechanism controlling of the agency conflict that occurred in companies in Indonesia. The unique thing of this study is to consider the situation and circumstances faced by the company as investment opportunities that can affect relationships of interdependence that occur between institutional ownership and leverage on free cash flow. The study which has been done before has not examined the interdependency relationships that occur between institutional ownership and leverage by observing the situation and condition of the company. Therefore, this study examines the interdependence relationship between institutional ownership, leverage and free cash flow, as well as considering theoretical framework which is made in reference to situation and conditions of high and low investment opportunities as well by using the relevant control variables and using simultaneous equations to get better analysis results.

## 2. Literature Review

### 2.1 Institutional Ownership

Pozen (1994) argues that institutional ownership will act to support shareholders if the suppression which is done have economic value or directly affect the stock price. Listed companies in Indonesia have different structures composition. Most of the listed companies have shareholders in the form of business entities which is often as a representation of the company founder. This study called the institutional ownership as internal institutional ownership. Stocks exchange which are sold on public shareholders also owned by institutional investors. Institutional ownership in public stock is called institutional ownership external. Ismiyanti (2003) found that the average of internal institutional ownership in the period 1997-2001 reach 66% of the total shares outstanding. This shows that 34% spread to public investors (individuals), management, commissioners, and external institutional ownership. This is different than in the United States, the external institutional ownership reached 52.36% of the total shares outstanding (Chen and Steiner, 1999).

Jensen and Meckling (1976) stated that institutional ownership has a very important role in minimizing agency conflicts that occur between managers and shareholders. The existency of institutional investors are considered capable of being an effective monitoring mechanism in any decision made by the manager. This is due to the institutional investors involved in strategic decision-making is not easy to believe the earnings manipulation. According Tarjo (2008) institutional ownership is ownership of shares owned by institutions or institutions such as insurance companies, banks, investment companies and other institutional ownership. Institutional Ownership has significance part in monitoring management because of the presence of institutional ownership leads to more optimal control. Monitoring will ensure prosperity for the shareholders. The influence of institutional ownership as a supervisor agent showed through their big investment in the capital market. High levels of institutional ownership will lead to greater oversight efforts by institutional investors so as to preclude opportunistic behavior of managers. Wien (2010) states that institutional ownership has advantages such as: (1) Has professionalism in analyzing information in order to test the reliability of information. (2) Have a strong motivation to implement tighter controls over the activities occurring within the company.

### 2.2 Free Cash Flow

Jensen (1986) defines free cash flow is the remainder of the funding the entire project which resulted in net present value (NPV) positive which discounted at the rate of relevant capital costs. This free cash flows that often become the trigger of divergence of interests between shareholders and manager. When the free cash flow available, manager allegedly going to waste the free cash flow and caused inefficiencies in the company or will invest the free cash flow with small return (Smith and Kim, 1994). White et al (2003) defines free cash flow as available discretionary to the company. Free cash flow can be used for discretionary uses such as acquisitions, capital expenditure to the orientation of growth (growth-oriented), debt payments, and payments to shareholders in the form of dividends. Ross et al (2000) defines free cash flow as corporate cash that can be distributed to creditors or shareholders who are not used to working capital (working capital) or investment in fixed assets. For companies that do capital expenditures, free cash flow will reflect clearly which company that still has the ability in the future and which are not. Free cash flow is said to have content of information when free cash flow gives signals to shareholders (Rosdini, 2009).

Penman (2001) defines "free cash flow as cash from operating earnings after withholding some of the profits as assets and a net cash generated from operations that demonstrate the company's ability to pay claims for debt and equity". Substantial free cash flow will lead to incorrect behavior of managers and bad decisions which are not for the shareholders interest. In other words, managers have a tendency to use excess profits to consumption and opportunistic behavior because they receive the full benefits from such activities, but are less willing to bear the risk of costs incurred. This leads to the hypothesis control to create and increase the debt (Jensen, 1986). How to resolve the alleged use of free cash flow by manager as described earlier, Jensen (1986) suggested the need for the establishment of a debt is called "control hypothesis". Thus, shareholders of the company will have increased control over their management team. For example, if the company issued new debt and use the result to attract outstanding shares or pay dividends, management is required to expend cash to pay interest and principal on the debt which simultaneously reducing the amount of free cash flow (Isrina, 2006). Jensen (1986) argue that contrary to the pecking order theory hypothesis is managers have an incentive to finance investment from internal capital with the intention of increasing the resources that can be controlled by them. This effort is intended to reduce the supervision of the capital markets that occurred when the company had to increase the debt capital (Easterbrook, 1984).

### 2.3 Leverage

Leverage is an alternative way to relocate supervision cost by the owner to the creditor, the use of debt also encourages managers to act more disciplined to avoid bankruptcy (Harris and Raviv, 1990 and Megginson, 1997: 335). Research Maloney, McCormick and Mitchell (1993) find that debt improve management in making decision. These findings support the statement that debt is surveillance or monitoring (monitoring) to control the agency conflict. Nevertheless on the other hand the growth debt cause the debt agency conflict since there will be more interest from other parties to the company. The more interest, the more difficult to align the interests of each party then agency conflict increases. Friend and Lang (1988) also found that leverage is used to reduce the agency conflict by inviting external parties to participate in conducting surveillance to the management.

Bhatala, Moon and Rao (1994) found that there is a substitution effect between institutional ownership with the external leverage in controlling agency conflict and showed that ownership structure affects the agency conflict. Bhatala, Moon and Rao (1994) in this case also tested the balancing of agency theory (or often called a trade-off models of agency cost) that there are agency costs when using the control method of agency conflicts through debt or dividends so that the company concerned that lower agency costs . The action taken by the company is making exchange (trade-off) between leverage and dividend for lower agency costs. The linkage between leverage, dividend, managerial ownership and institutional ownership discussed by Crutchley, Jensen, Jahera and Raymond (1999), who found that the balancing of agency theory supported in the relationship of interdependency leverage and dividend policy, leverage interdependency to managerial ownership, and relationship interdependency of managerial ownership to institutional ownership, but is not supported for the relationship of leverage interdependency to institutional ownership.

## 3. Hypothesis Formulation

### 3.1 The influence of institutional ownership on free cash flow

At the time company has high investment opportunities status, the higher investment opportunities the company has. In these conditions the company requires more funds from free cash flow to invest since of high investment opportunities. On the other hand, at the time company has low investment opportunities status, the company has a low investment opportunities. In these conditions small company requires funds from free cash flow to invest because of the low investment opportunities. Institutional shareholders will use free cash flow for investmen when the investment opportunities high. On the contrary, when the investment opportunity is low the institutional shareholders will not use free cash flow. Therefore, when the investment opportunity is high, free cash flow is relatively small, whereas at the investment opportunity is low, free cash flow is relatively large. Therefore, the hypothesis formed as follows:

H <sub>1a</sub> : Institutional Ownership has negative effect on free cash flow at the time when the investment opportunities status is low
H <sub>1b</sub> : Institutional Ownership has positive effect on free cash flow at the time when investment opportunities status is high

### 3.2 The influence of leverage on free cash flow

At time when the company has high investment opportunities status, the company has high investment opportunities. In these conditions the company requires substantial funds from free cash flow to invest because of the high investment opportunities. On the other hand it requires high increase of the debt to be able to control the high free cash flow that can be done by the creditors because of high risk level to ensure that the investments have performed optimally. At the time when the company has low investment opportunities status, the company has low investment opportunities. In this condition the company only needs small fund of free cash flow to invest because of the low investment opportunities. Therefore, controlling through leverage is needed at the time of low investment opportunities than at the time of high investment opportunities due larger free cash flow. Therefore, leverage can be used as a control for free cash flow. Therefore, the hypothesis is formed as follows:

H <sub>2a</sub> : leverage negatively affects free cash flow at the time of high investment opportunities status
H <sub>2b</sub> : leverage negatively affect free cash flow at the time of low investment opportunities status

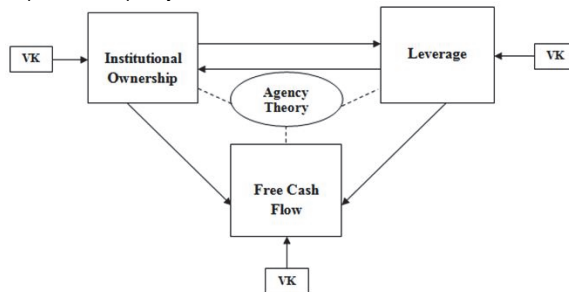
### 3.3 Interdependence relationship of leverage and institutional ownership

Institutional ownership represents the power source that will lead to optimal monitoring increase to the company performance. This means that the greater the percentage of shares owned by institutional investors will lead monitoring efforts more effective because it can control the opportunistic behavior by managers. This monitoring activity will reduce agency costs because it allows the company to use lower levels of debt (Isrina, 2006). According to Crutchley et al (1999), the effect of leverage on institutional ownership is positive. High leverage caused the company monitored by the debtholder lead managers to act in accordance with the debtholders and shareholders interest, so that this condition will attract the entry of institutional ownership. The study results by Wahidahwati (2002) showed that the presence of institutional ownership in the manufacturing industry have a significant effect on corporate leverage. This is consistent with Moh'd et al (1998) that institutional investors in the manufacturing industry aware that their presences can monitor the company manager behavior effectively. At the time of high investment opportunities, free cash flow relatively become smaller. Therefore, the control can be done through institutional ownership or leverage, while at the time of low investment opportunities, free cash flow relatively become larger. Therefore, the control can be done altogether through institutional ownership and leverage. Therefore, the hypothesis is formed as follows:

- H<sub>3a</sub>: Institutional Ownership and leverage has negative relationship at the time of high investment opportunities.  
H<sub>3b</sub>: Institutional Ownership and leverage has positive relationship at the time of low investment opportunities.

## 4. Conceptual Framework of Research

Based on a literature review and formulation of hypotheses, the models in the study of interdependence relationship between institutional ownership and debt policy to free cash flow, as follows:



#### Description:

**VK:** Research control variables that affect the institutional ownership, leverage, and free cash flow.

—: The relationship described explicitly.

-----: The relationship described implicitly.

Figure 1. Research Framework Concept

## 5. Research Methods

The data used in this study consists of stock market data and financial statement data of manufacturing companies in Indonesia from 2001 to 2012 at the Indonesia Stock Exchange (IDX). The study sample consist of companies in Indonesia that provides stock market data information and complete financial statements for all periods of analysis. Separation of high investment opportunities samples and low investment opportunities is by using book to market value of assets as a proxy of investment opportunities. The following are some of the main variables, namely: (1) Institutional Ownership; Institutional ownership which is used is the internal institutional ownership which owned by a legal entity that listed as a non-public shareholder. This information can be known through financial statements listed in the Indonesia Stock Exchange (IDX) and cross-checked with the data Indonesian Capital Market Directory (ICMD) . Internal institutional ownership is symbolized INST. The formula used to calculate the internal institutional ownership (INST) proportionas is as follows: INST = Internal Institutional Ownership Percentage; (2) Leverage; Debt Policies (leverage) symbolized as LEV. Debt interest burden proxy from total debt minus accounts payable and tax debts. The use of debt interest burden refers to the study of Baskin (1989) that debt without interest burden such as debt for trade is not capital source. The formula used to describe the leverage (LEV) as follows:  $LEV = (\text{Debt interest burden}) t / (\text{Total Fixed Assets}) t$ ; (3) Free

204 Cash Flow; Free cash flows use Ross et al (2000) calculation. Free cash flow is symbolized in FCF. The formula used to  
205 calculate free cash flow (FCF) as follows:  $FCF = OCF - Tax - lexp - Cdiv - Pdiv$ . This study uses simultaneous equations with  
206 GMM estimation techniques (Generalize Method of Moment) to test the research hypothesis. Simultaneous equations  
207 used in this study because the variables of institutional ownership and leverage in an analytical model are the  
208 interdependent endogenous variables (Greene, 2000).

209 The research method with GMM estimation technique (Generalize Method of Moment) used in this study since  
210 GMM estimation technique (Generalize Method of Moment) can reduce the impact of heteroscedasticity and GMM  
211 (Generalize Method of Moment) has been able to reduce the high residual correlation between the equations in this  
212 study.

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214  
215

## 6. Data Analysis Results

216 Here are the results of data analysis showed the influence of institutional ownership and leverage on free cash flow. In  
217 this research also uses the control variable that is operating cash flow, public ownership, risk roa, managerial ownership,  
218 return on assets, risk roa, asset structure, growth assets, interest bearing debt by considering group of companies  
219 condition which is high investment opportunities and low investment opportunities.

220  
221 **Table 1.** Analysis Regression Result of Generalized Method of Moment (GMM) Group of Companies with High  
222 Investment Opportunities

223

Panel A - Depeneden Variable: Free Cash Flow (FCF)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTERCEPT	-0.045925	0.171049	-0.268488	0.7883
INST_OWN	-0.075915	0.265298	-0.286152	0.7748
LEVERAGE	0.190904	0.072829	2.621274	0.0088***
OCF	0.962877	0.245045	3.929382	0.0001***
RISK_ROI	-0.158753	0.068325	-2.323509	0.0202**
MGR_OWN	13.11899	6.630383	1.978617	0.0480**
ROA	-0.041364	0.216391	-0.191154	0.8484
SA	-0.152505	0.054040	-2.822088	0.0048***
AGR_ST	0.013826	0.004363	3.168596	0.0016***

R<sup>2</sup> 0.123713

Adj R<sup>2</sup> 0.114175

Panel B - Depeneden Variabel: Institutional Ownership (INST\_OWN)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTERCEPT	0.881826	0.012954	68.07137	0.0000
LEVERAGE	-0.000111	0.004894	-0.022764	0.9818
PUB_OWN	-0.837066	0.029181	-28.68549	0.0000***
OCF	0.043731	0.027077	1.615090	0.1064*
RISK_ROI	-0.010543	0.004632	-2.276076	0.0229**
ROA	0.002254	0.005094	0.442411	0.6582
SA	0.008445	0.003705	2.279483	0.0227**

R<sup>2</sup> 0.513599

Adj R<sup>2</sup> 0.509640

Panel C - Depeneden Variabel: Leverage (LEVERAGE)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTERCEPT	0.307980	0.089092	3.456888	0.0006
INST_OWN	-0.318020	0.118360	-2.686886	0.0073***
OCF	-0.847901	0.280275	-3.025243	0.0025***
RISK_ROI	0.898505	0.017795	50.49073	0.0000***
MGR_OWN	-7.324582	2.724459	-2.688454	0.0072***
ROA	0.046921	0.127735	0.367329	0.7134
SA	0.751973	0.025083	29.97899	0.0000***
AGR_ST	-0.063428	0.003478	-18.23632	0.0000***

R<sup>2</sup> 0.988631

Adj R<sup>2</sup> 0.988523

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225  
226 **Description:** \*\*\*, \*\*, \* significant at probability level of 0:01, 0:05, and 0.1  
227

**Sources:** Data Processed



Based on Table 1 shows that the group of companies of high investment opportunities show that higher institutional ownership, the lower free cash flow, but the higher the leverage, the higher the free cash flow. The influence of institutional ownership on free cash flow at group companies of high investment opportunities is negative at 0.7748 while the leverage effect on free cash flow is positive and significant at 0.0088. This shows that the hypothesis (H<sub>1a</sub>) and hypotheses (H<sub>2a</sub>) is accepted. On the other side, the interdependence relationship between institutional ownership and leverage on group companies of high investment opportunities is negative. It is shown from the relationship between leverage towards institutional ownership is negative and the effect of institutional ownership on the leverage is negative. This shows that the hypothesis (H<sub>3a</sub>) accepted.

**Table 2.** Results of Generalized Method of Moment (GMM) Regression Analysis Group of Companies of Low Investment Opportunities Low

Panel A - Dependent Variable: Free Cash Flow (FCF)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTERCEPT	-0.313036	0.112139	-2.791508	0.0053
INST_OWN	0.159235	0.144739	1.100156	0.2714
LEVERAGE	0.091300	0.046952	1.944556	0.0520**
OCF	1.621644	0.329829	4.916623	0.0000***
RISK_ROI	-0.108932	0.082336	-1.323026	0.1860*
MGR_OWN	3.368446	1.260018	2.673331	0.0076***
ROA	0.457819	0.425334	1.076376	0.2819
SA	0.037117	0.048768	0.761103	0.4467
AGR_ST	0.007633	0.006642	1.149235	0.2506
R <sup>2</sup> 0.088537				
Adj R <sup>2</sup> 0.078616				
Panel B - Dependent Variable: Institutional Ownership (INST_OWN)				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTERCEPT	0.870100	0.020147	43.18732	0.0000
LEVERAGE	0.023712	0.010997	2.156341	0.0312**
PUB_OWN	-0.844527	0.030186	-27.97775	0.0000***
OCF	-0.127730	0.047464	-2.691076	0.0072***
RISK_ROI	0.016324	0.006501	2.510859	0.0121***
ROA	0.073075	0.091097	0.802163	0.4225
SA	-0.001185	0.014655	-0.080848	0.9356
Variable	Coefficient	Std. Error	t-Statistic	Prob.
INTERCEPT	0.451089	0.056506	7.983083	0.0000
INST_OWN	0.199067	0.074669	2.665979	0.0077***
OCF	0.519090	0.236932	2.190878	0.0286**
RISK_ROI	-0.063324	0.039335	-1.609886	0.1076*
MGR_OWN	-5.130900	1.245256	-4.120357	0.0000***
ROA	-0.579461	0.273659	-2.117452	0.0343**
SA	0.104969	0.046178	2.273142	0.0231**
AGR_ST	-0.013721	0.012721	-1.078559	0.2809
R2	0.025160			
Adj R2	0.015889			

**Description:** \*\*\*, \*\*, \* significant at a probability level of 0:01, 0:05, and 0.1

**Sources:** Data Processed

Based on Table 2 shows that the group companies of low investment opportunities show that higher institutional ownership the higher free cash flow but the higher leverage, the higher free cash flow. The influence of institutional ownership on free cash flow in group companies of low investment opportunities is positive at 0.2714, while the effect of leverage on free cash flow is positive and significant at 0.0520. This shows that the hypothesis (H<sub>1b</sub>) and hypothesis (H<sub>2b</sub>) is accepted. On the other side, the interdependence relationship between institutional ownership and leverage in the low

investment company group is positive and significant. It is shown from the relationship between leverage towards institutional ownership is positive and significant at 0.0312 whereas the effect of institutional ownership on the leverage is positive and significant at 0.0077. This shows that the hypothesis (H<sub>3b</sub>) is accepted.

## 7. Discussion

The influence of institutional ownership on free cash flow to high investment opportunities company group is negative. It shows that institutional shareholders are taking advantage of the free cash flow for investment. Therefore, the higher the institutional ownership, the lower free cash flow because it has been used for investment. This is related to institutional ownership which have major stake in the company so that institutional shareholders are trying to maximize the profits by using free cash flow. The influence of leverage and free cash flow on the high investment opportunities company group is positive. This shows that the debt is used as a control to free cash flow, it means that the higher the debt, the higher the free cash flow due to the high investment opportunities, free cash flow is used for investment so that control mechanisms is needed through leverage. Therefore, the use of free cash flow for investment in high investment opportunities will be controlled through debt policy. Interdependency relationship between institutional ownership on leverage to the high investment opportunities is negative but not significant. It shows that the relationship between institutional ownership and leverage is tend to lead into substitution relationship but not significant, it means to perform the control mechanism on free cash flow can be done through institutional ownership or leverage due to at the time of high investment opportunities shows free cash flow which is relatively small.

The influence of institutional ownership on free cash flow to the low investment opportunities company group is positive. It shows that institutional shareholders lack in taking advantage of the free cash flow for investment because of the low investment opportunities. Therefore, the higher the institutional ownership, the higher free cash flow due to low investment opportunities. The influence of leverage to free cash flow on low investment opportunities company group is positive. It shows that the debt is used as a control to free cash flow, it means the higher the debt, the higher free cash flow due to low investment opportunities since free cash flow is rarely used for investment so that control mechanisms through leverage is needed. Therefore, free cash flow that not used to invest in low investment opportunities will be controlled through leverage. Interdependency relationship between institutional ownership on leverage to the low investment opportunities company group is positive and significant. It shows that the relationship between institutional ownership and leverage is a complementary relationship, it means to perform the control mechanism of the free cash flow is done altogether through institutional ownership and leverage because at the time of low investment opportunity showed that free cash flow is relatively large.

## 8. Conclusions and Recommendations

At the time of high investment opportunities, free cash flow is relatively small because it is used to invest so that the higher institutional ownership, the lower free cash flow. At the time of low investment opportunities, free cash flow is relatively large because it is not used for investment, the higher institutional ownership, the higher the free cash flow. At the time of high investment opportunities and low debt to monitor the usage of free cash flow as a control mechanism through the creditors. At the time of high investment opportunities high then the pattern of interdependency relationship between institutional ownership and leverage is negative, but at the time of low investment opportunities, the pattern of interdependency relationship between institutional ownership and leverage is positive or complementary. Here are some suggestions from this study : (1) For company owner, they may consider control mechanism on free cash flow through institutional ownership and leverage; (2) For creditors or the banks may consider the results of this study related to the company policy on leverage so that creditors can optimize to provide credit to the company; (3) Suggestions for the next research is to consider the performance of the company as a variable in the testing model so it able to show the effect of the control mechanisms do on free cash flow. In addition, consider testing as inter-variable non-linear.

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# Trends in Development of Corporate Organizational and Managerial Innovations in Russia and the Principles of Lean Production

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## Abstract

The great interest in the concepts, principles, and tools of lean production is caused not only and not so much by the "fashion" for the organizational and managerial innovations, as by the need to find new reserves to improve production efficiency (in particular, in the oil extraction industry). In Russian (including Soviet) theory and practice of labor management, there are examples of successful application of innovative tools aimed at optimizing transaction costs. Nevertheless, according to the authors, the frequent problems of implementing the tools of lean production in the practices of Russian companies are related primarily to the distortion of the essence of these principles, with the formalism and instrumental attitude of the implementers, as well as with the lack of an innovation management system.

**Keywords:** lean production, kaizen, innovative model of corporate development, scientific management of labor, system of performance indicators.

## 1. Introduction

In the Soviet Union, the process of improving labor management based on achievements of science and best practices was defined by the term "scientific management of labor", which today is generally understood as improvement of organizational forms of the use of human labor in a particular work collective. In the USSR, one of the first theorists of the science of organization was A.A. Bogdanov, the author of the study "Tectology. The Overall Organizational Science" [Bogdanov, 1922]. Publications by Professor O.A. Ermansky, in particular, of the book *The Taylor's System, The Scientific Management of Labor and Production, and the Taylor's System* [Ermansky 1925] are of great interest. The problem of the scientific management of labor appears to them as "a rare combination of strong theoretical interest and the practical value of an urgent problem". The most significant contribution to the development of the scientific management of labor and production was made by A.K. Gastev. Scientific ideas and beliefs of A.K. Gastev were implemented in the work of the Central Institute of Labor.

The self-isolated and developing actively in the 1960-70s in the USSR scientific management of administrative work (SMAW) was dedicated to summarize the practical information, develop the theory and methodology of the rationalization and improvement of work processes of managers and specialists [Bogdanov, 1922].

Even at that time, there already were critical publications, the authors of which emphasized the insufficient research efforts in this field against the background of good intentions and high expectations from SMAW. V.I. Remnev wrote "Unfortunately, the activity for rationalizing the management apparatus based on scientific approach is understood sometimes only as the sum of efforts that can be reduced to the best furniture arrangement, ordering the document flow, and implementation of new equipment. This view of SMAW is unduly narrow. You cannot develop relatively minor problems and forget about the large-scale and fundamental elements of management; although, it would be wrong to get involved in global issues only and forget about details and particulars. Both of them are important. Understanding SMAW as a system of minor organizational efforts held at the lower levels is nothing but a "late welcome", reducing it to a "home trade" [Remnev, 1973, pp: 7-12]. Even then, some researchers insisted on systemic approach to elucidating the properties and relationships of rationalization objects, although in those circumstances it was, first of all, related to the interaction of public administration bodies and socialist enterprises. Later, in 1970s-1980s, SMAW narrowed to records keeping issues [Livshits, 1974]. The complexity and importance of the modern labor management, which also involves parallelism (simultaneity) of the flow of several labor operations, currently requires experts and practitioners to engage

57 the entire set of tools and knowledge of the management theory and practice. Obviously, the rich heritage of the scientific  
58 management of labor in Russia may be involved in addressing such problems.

## 60 2. Analysis of the Current Practice

61  
62 Today, most of the progressive approaches to labor management are combined within the framework of the general  
63 concept of lean production. It is believed that lean production is not an independent concept [Erokhin, 2009]. It had been  
64 developing gradually, over many years, and was a natural result of the accumulation of experience in organizational  
65 innovations at the Toyota Company. In the early and mid-1980s, there were publications and writings that described the  
66 Toyota Production System (TPS) [Shingo, 2010], and programs of studying the principles of TPS were launched in  
67 several universities. Generalizing the experience of Toyota, John Krafcik [Krafcik, 1988] introduced the term «lean» (fast,  
68 antonym – wasteful). Two main criteria characterizing the system of lean production at that time were supply of resources  
69 sharp on time and automation.

70 In Russia, hundreds of companies have declared that they will reform the management of their production systems  
71 based on the lean production principles. They include JSC AVTOVAZ, JSC Russian Aluminum, JSC UAZ, JSC Severstal,  
72 JSC SIBUR Holding, JSC Uralsmashzavod, JSC VSMPO-AVISMA Corporation, enterprises of the GAZ group, and others.  
73 The financial institutions are represented by OJSC Sberbank of Russia, JSC Vneshtorgbank [Order No. 898, 2010].

74 In the Republic of Tatarstan, the lean production principles have been implemented to some extent and continue  
75 being implemented at JSC KAMAZ, JSC "Production Association "Elabuga Vehicle Plant", the Federal State Unitary  
76 Enterprise "Production Association "Sergo Plant", JSC "S.P. Gorbunov Kazan Aviation Production Association", JSC  
77 Spartak, JSC Kazankompressormash, JSC SOLLERS-Elabuga, JSC Kwart, JSC Nizhnekamskshina, JSC Kazan  
78 Helicopter Plant, JSC Almeteyevsk Pipe Plant, JSC Vakuummash, JSC Tatneft, and others.

79 Having appeared in the late 1990s, the term "lean thinking" has recently become actively used in relation to  
80 intellectual work [James, Womack, and Daniel, 1996]. Use of this approach in the management of intellectual labor is  
81 acknowledged possible in case of [Matthew, 2011]:

- 82 – anthropocentric basis of transformations;
- 83 – admitting information as the basis of the price of intellectual labor. Therefore, information should be produced  
84 by the right person in the right form at the right time at the lowest price.

## 86 3. Task Statement

87  
88 Can the principles and tools of lean production be successfully implemented in a Russian company? How can it be done  
89 in large corporations? If these questions are answered, the effect of implementation of this idea from the standpoint of  
90 reducing the time costs and other resources' consumption, avoiding duplication of costs, ensuring wide availability and  
91 continuous heredity of knowledge, etc. can be very strong.

## 94 4. Methodology

95 Currently, the concept of "lean production" is used by companies in many countries and in different sectors [Efimov,  
96 2011]. The concept assumes that all activities of a company can be classified as follows: operations and processes that  
97 add value for the consumer, and the operations and processes that do not add the value. Thus, anything not adding value  
98 for the consumer is qualified by lean production as the loss, and should be eliminated [Maskell and Baggaley, 2010].

99 The model of innovative development of JSC Tatneft is based on the lean production concept and its technologies.  
100 It mainly refers to the integrated model, to be exact – it is at an intermediate stage of transition from the G4 to G5 model  
101 [Rothwell, 1994]. The innovation process is of network nature for units of a company [Yudina, 2008]; however, for the  
102 whole company it is of parallel nature. We can distinguish the following characteristic features of this model:

- 103 - integration of R&D with production;
- 104 - cooperation with suppliers and buyers;
- 105 - horizontal cooperation;
- 106 - the practice of establishing cross-functional work groups;
- 107 - existence of an extensive feedback system;
- 108 - active implementation and use of information systems and technologies.

109 Formation of the innovative capacity is related to the internal and external environment [Ashirova, Garifullina,  
110 Serikova, and Yudina, 2014]. At the same time, the conditions of formation of an innovative model are more related to the

factors of the internal environment, and the external environment provides the conditions for its implementation. With a view to the formation and development of innovative models the company implements methods and tools of lean production, formalizes and standardizes the innovation process, as well as familiarizes its employees with the innovative activity, and appropriately motivates them. All this is aimed at human capacity development, implementation and development of information systems and IT technologies, as well as development of the corporate culture of JSC Tatneft. The interaction of business units based on modern IT technology on a real-time basis at the premises of the Electronic Corporate University (ECU), the Auction of Business Ideas (ABI), the Center of Excellence (CoE), allows implementing the innovative capacity and transform it into the innovation capital. For example, the combination of human capital and information technologies and systems lead to greater efficiency of the production (liquidation of losses, improvement of the efficiency of oil production, etc.) by detecting the actual production problems of the company and their optimal solution. This ultimately has a positive influence on the change in the competitiveness of JSC Tatneft and further sustainable development of the company [].

To assess the level of implementation of lean production in the structural units and subsidiaries, JSC Tatneft has developed a system of indicators grouped into seven blocks. The indicators are calculated after the cycle of auditing all facilities of the joint stock company.

**The first block of indicators** includes the system indicators targeting reflection of the general trends of lean production implementation in the structural units and subsidiaries of JSC Tatneft. This group includes:

1. Presence of an action plan for the implementation of lean production ( $I_{LP1}$ ): if there is a plan and it is implemented on time, 1 point is given, and if there is not – 0 points.
2. The share of specialists who are certified in tools and techniques of the lean production in the ECU system ( $I_{LP2}$ ). This indicator is calculated as the ratio of managers, specialists, clerks who have passed certification in the methods of lean production in the ECU system to the total number of managers, specialists, clerks. If the result is less than 10%, 0 points is given; from 10% to 25% – 1 point; from 25% to 50% – 2 points; from 50% to 75% – 3 points; over 75% – 4 points.
3. The share of workers certified in tools and techniques of the lean production ( $I_{LP3}$ ). It is calculated as the ratio of the number of workers certified in tools and techniques of lean production to the total number of workers. If the result is less than 10%, 0 points is given; from 10% to 20% – 1 point; from 20% to 30% – 2 points; from 30% to 50% – 3 points; from 50% to 80% – 4 points; over 80% – 5 points.
4. Availability of information boards with the results of the implementation of lean production in public places ( $D_{LP4}$ ). If the boards are present and relevant information is published on them, 1 point is given; if no relevant information is on them – 0 points.

**The second block** includes the indicators of implementation of the "5S Workplace Organization" tool. The 5S system is a system designed to create and maintain high quality and comprehensive working environment in structural units and subsidiaries of JSC Tatneft, and is aimed at increasing the labor productivity and quality of its results, creating safe working environment. It is based on the five stages of workplace arrangement (sorting, keeping in order, keeping clean, standardization, improvement) [Fabrizio and Tapping, 2008]. This group includes six indicators characterizing it:

1. Presence of the section in the action plan for the implementation of the "5S Workplace Organization" tool ( $D_{5S1}$ ). If there is a developed plan and it is implemented on time, 1 point is given, and if there is not – 0 points.
2. Application of the visualization method (contouring, marking, the method of road signs, "What was then" – "What is now", visualized work instructions, color markings) ( $D_{5S2}$ ). This indicator is calculated as the ratio of the number of workplaces, which apply the visualization method, to the total number of workplaces. If the result is less than 25% – 0 points is given; from 25% to 65% – 1 point; more than 65% – 2 points.
3. The share of workplaces of workers standardized under the 5S system (upon which four stages of the 5S system have been implemented) ( $I_{5S3}$ ). This indicator is calculated as the ratio of the number of workplaces of workers, upon which the four stages of the 5S system have been implemented, to the total number of workers' workplaces. If the result is less than 10%, 0 points is given; from 10% to 25% – 1 point; from 25% to 40% – 2 points; from 40% to 60% – 3 points; from 60% to 80% – 4 points; over 80% – 5 points.
4. The share of workplaces of managers, specialists, clerks, standardized under the 5S system (four stages of the 5S system have been implemented) ( $I_{5S4}$ ). This indicator is calculated as the ratio of the number of workplaces of managers, specialists, clerks, upon which the four stages of the 5S system have been implemented, to the total number of workplaces of managers, specialists, clerks. If the result is less than 10%, 0 points is given; from 10% to 20% – 1 point; from 20% to 30% – 2 points; from 30% to 45% – 3 points; from 45% to 60% – 4 points; over 60% – 5 points.
5. The share of workplaces, upon which the fifth stage of the 5S system ("Improvement") is being implemented

165 (D<sub>5S5</sub>). This indicator is calculated as the ratio of the number of workplaces, upon which the fifth stage of the  
166 5S system is being implemented, to the total number of workplaces. If the result is less than 10%, 0 points is  
167 given; from 10% to 20% – 1 point; from 20% to 30% – 2 points; from 30% to 60% – 3 points; over 60% – 4  
168 points.

169 6. Conducting the internal audit of compliance with the 5S System (D<sub>5S6</sub>). This indicator is intended to determine  
170 whether there is internal audit in the structural units and subsidiaries of JCS Tatneft, or there is not. If there is  
171 a developed and implemented internal audit, 1 point is given, and if there is not – 0 points.

172 **The third block** includes the indicators of implementation of the "Total Productive Maintenance (TPM)" tool. The  
173 TPM system is aimed at maximizing the efficiency of the equipment operation throughout its life cycle, as well as  
174 encouraging people to participate in the production self-service [Marchwinski and Shook, 2005] in the structural units and  
175 subsidiaries of JCS Tatneft. This group includes the following indicators:

176 1. Availability in the action plan of the section for implementation of the "Total Productive Maintenance (TPM)"  
177 tool (I<sub>TPM1</sub>). If there is a developed plan and it is implemented on time, 1 point is given, and if there is not – 0  
178 points.

179 2. The share of key equipment, for which TPM standards have been developed (I<sub>TPM2</sub>). We need to note that key  
180 equipment includes equipment, which is directly engaged in the production of the final product. This indicator  
181 is calculated as the ratio of the number of units of the key equipment, for which TPM standards have been  
182 developed, to the total number of units of key equipment. If the result is less than 10% – 0 points is given; from  
183 10% to 50% – 3 points; more than 50% – 4 points.

184 **The fourth block** of indicators assesses the completeness of implementation of the "Value Stream Mapping" tool.  
185 Mapping the value stream is aimed at creating a simple and intuitive graphical diagram showing the material and  
186 information flows needed to provide the end consumer with a product or service [Rother and Shook, 2005]. The map of  
187 the value stream allows immediately seeing the problems of the flow and, based on its analysis, identifying all wasteful  
188 expenditures and processes, and on this basis developing an improvement plan. The group includes the following  
189 indicators:

190 1. Presence of the section in the action plan for implementation of the "Value Stream Mapping" tool (D<sub>VSM1</sub>). If  
191 this section is present and implemented on time, 1 point is given, and if it is not – 0 points.

192 2. The share of units, in which value stream mapping is applied (I<sub>VSM2</sub>). This indicator is calculated as the ratio of  
193 units, in which value stream mapping is applied, to the total number of units. If the result is less than 10% – 0  
194 points is given; from 10% to 50% – 3 points; more than 50% – 5 points.

195 3. Application of methods of searching for the root cause of the problem (using the Ishikawa or Pareto diagrams,  
196 the method of "five why", etc.) (D<sub>VSM3</sub>). If at least one of the methods of searching for the root cause of the  
197 problem is used, 1 point is given, if none is used – 0 points.

198 4. Presence of an action plan for achieving the "target" state of flows (D<sub>VSM4</sub>). If there is a developed plan, and it  
199 is implemented on time, 1 point is given, and if there is not – 0 points.

200 5. The estimated economic benefit at achievement of the desired stream condition (I<sub>VSM5</sub>). This index is assessed  
201 differentially so that the maximum value is 3 points, and the rest are assessed proportionally to the maximum  
202 value.

203 **The fifth block** of indicators is aimed at assessing the implementation of the "Training Within Industry (TWI)" and  
204 "Standardized Work" tools. The TWI training program is aimed at accelerated training of highly qualified workforce, saving  
205 manufacturing know-hows and experience of generations in the corporate knowledge base [Deming, 2007]. The  
206 "Standardized Work" tool is aimed at developing standard operations performance tables; drafting process flow sheet for  
207 standard operations; developing charts of standard operations, etc. This group includes three indicators:

208 1. The share of workplaces of workers equipped with process charts (I<sub>TWI1</sub>). This indicator is calculated as the  
209 ratio of the number of workplaces of workers, for whom the standards of workplaces according to the 5S  
210 system have been developed, to the total number of workplaces in an office. If the result is less than 10%, 0  
211 points is given; from 10% to 20% – 1 point; from 20% to 30% – 2 points; from 30% to 45% – 3 points; from  
212 45% to 60% – 4 points; over 60% – 5 points.

213 2. Availability of multimedia training materials (I<sub>TWI2</sub>). This indicator targets identifying availability of multimedia  
214 training programs, courses, etc. If they are present, 1 point is given, and if there are none of them – 0 points.

215 3. Assigning mentors to newly adopted workers (I<sub>TWI3</sub>). If the condition of the indicator of securing a mentor for  
216 newcomers is met, 2 points are given; in case this indicator is not met – 0 points.

217 **The sixth indicator** – implementation of other tools and techniques of lean production (D<sub>LTP</sub>). This indicator  
218 assesses the development and implementation by structural units and subsidiaries of JCS Tatneft of tools and techniques

219 of lean production, not listed in the previous groups of indicators, such as KANBAN, Single Minute Exchange of Dies  
220 (SMED), alignment, etc. If they have been implemented and are present, 1 point is given; if such methods and tools are  
221 not introduced – 0 points.

222 **The seventh block** assesses the staff development and involvement in the innovative activity. These indicators  
223 are aimed at determining the activeness of employees, as well as on the analysis of the innovative capacity of human  
224 resources. In this group, the following three indicators, on which it is based, are singled out:

- 225 1. The number of filed kaizen proposals per employee ( $I_{KP1}$ ). This indicator is calculated as the ratio of the total  
226 number of kaizen proposals filed for a certain period, to the number of employees. The maximum value of the  
227 indicator is 3 points, and the remaining are assessed in proportion to the maximum value.
- 228 2. The share of implemented kaizen proposals ( $I_{KP2}$ ). The indicator is calculated as the ratio of implemented  
229 kaizen proposals to the submitted ones. If the indicator reaches 80% or more, 3 points are given; if this value  
230 is not achieved – 0 points.
- 231 3. Availability of information boards on lean production in public places ( $D_{BPP}$ ). This indicator is one of the  
232 indicators assessing the activeness of involving employees in the innovative activity. If there are boards on  
233 lean production, 1 point is given, and if there are none of them – 0 points.

## 234 5. Results

235 Thus, all the seven blocks of assessment may be combined into the audit system (Table 1).

236 **Table 1** – The system of audit of the level of implementation of the principles and tools of lean production in structural  
237 divisions of JSC Tatneft

Sq. No.	Indicator description	Number of indicators	Maximum score
Application of lean production methods		23	61
1	System indicators	4	10
2	Implementation of the 5S workplace organization system	6	19
3	Implementation of the TPM system	2	5
4	Implementation of the Value Stream Mapping method	5	11
5	Implementation of the Training Within Industry (TWI), Standardized Work methodologies.	3	8
6	Implementation of other instruments of lean production (KANBAN, SMED, etc.).	1	1
7	Staff development, involvement in innovative activities	2	7

242 The developed audit criteria were tested on real objects – the OGPDs of JSC Tatneft. The level values provided in Table  
243 2 are valid, i.e. obtained by calculating the actual performance indicators at the facilities. But the used OGPD names are  
244 symbolic due to the confidentiality of information for external users.

245 **Table 2** – Results of auditing the implementation of the lean production system at OGPDs of JSC Tatneft (as of  
246 10.03.2014)

Sq. No.	OGPD	Level of implementation of lean production tools		Target level (as of 01.07.2014)	
		Actual level, score	% of MAX	Score	%
1	OGPD-1	12	19.67	30.5	50
2	OGPD-2	21	34.43	30.5	50
3	OGPD-3	13	21.31	30.5	50
4	OGPD-4	9	14.75	30.5	50
5	OGPD-5	13	21.31	30.5	50
6	OGPD-6	20	32.79	30.5	50
7	OGPD-7	13	21.31	30.5	50
8	OGPD-8	5	8.20	30.5	50
9	OGPD-9	9	14.75	30.5	50
	OGPDs average	12.8	20.95	30.5	50

250  
251



## 6. Discussion

Table 2 shows us that as of 10.03.2014, the average rate of implementation of the lean production system at OGPDs of JSC Tatneft is equal to 12.8 points on a 61-point scale, which corresponds to 20.95%. The most active elements and techniques of lean production are implemented at OGPD-2, which scored 21 points (or 34.43%) and OGPD-6 – 20 points (or 32.79%). However, it should be noted that as of 07.01.2014, the indicators of these OGPDs had not yet reached the target level of 30.5 points (or 50%). Kind of outsiders in the process of implementing the system of lean production are OGPD-8, which has the lowest rate – 5 points (or 8.20%), OGPD-4 and OGPD-9, the audit of which resulted in 9 points for each of them (or 14.75%). Thus, the audit showed that the level of implementation of lean production at OGPD of JSC Tatneft is insufficient. That can speak volumes: of relative inactivity at lean production implementation, formal approach to implementation, as well as existing difficulties in providing conditions for lean production implementation in structural divisions of JSC Tatneft.

## 7. Conclusion

This guideline is rather simple and reflects the level of implementation of lean production in divisions of JSC Tatneft. During the implementation stage, this approach is rational and can objectively reflect the level of response of the controlled system to administrative influence. But at the same time, the guideline primarily reflects the organizational aspects related to providing conditions for implementation of the tools and technologies of lean production. At that, it ignores issues related to understanding the causes of the lean production implementation. The productivity of this organizational innovation, in our opinion, should be assessed by the value of liquidated wasteful expenditure of resources.

Thus, the study showed that implementation of the principles and tools of lean production is possible even in large Russian companies, and, implementation time can be quite acceptable. But the efficiency of introduction of this innovation is hard to evaluate due to the fact that in large organizational systems there is a high level of risk of substitution of the assessment of implicit, complex for measuring parameters with the explicit ones, but which are not essential and do not reflect the main effects.

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# Problems of Institutional Provision of the State's Economic Security

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## Abstract

*In modern conditions reforming of the economy is most actively manifested in its balanced state, providing vital interests of society and dynamic socio-economic development. An important prerequisite for ensuring economic security of the state is the stability and sustainability of the national economy which presupposes property protection in all its forms, creation of reliable conditions and guarantees for business activities deterring the factors that destabilize economic development. Economic security of the state is determined by the level of productive forces development and socio-economic relations, the extent of the use of scientific and technological progress in the economy, as well as by the structure of foreign economic relations. The relevance of the study of economic security is due to the emergence of new threats that destabilize the sustainable economic development of the country. The purpose of the research is to identify the features of institutional economic security of the state, institutional contradictions of its economic security, to consider different methodological approaches to the assessment of the overall security of an economic entity, to conduct a comparative analysis of the economic security of Russia in the international scale.*

**Keywords:** national security strategy, economic security, integral indicator of security, indicators of socio-economic development, institutional support.

## 1. Introduction

Economic security is a complex socio-economic category, which is influenced by ever-changing conditions of material production, external and internal threats of economy. Economic security is the basis of national security. National security is an essential prerogative of the state which is implemented in close cooperation with the economic agents. As an integral part of national security, economic security is the basis for formation of the military, technology, food, information and environmental safety (Tumin, V.M., A.G. Koryakov and E.P. Nikiforova, 2013). Economic security reflects the ability of the relevant political, legal and economic institutions of the state to protect interests of its key stakeholders in national economic traditions and values.

## 2. Materials and Methods

To assess the economic security in Russia, a system of indicators that reflect its place in the world economic system is used (Grigoreva, E.A., 2010). Indicators characterize the gap between indices, which, on the one hand, describe territorial space and natural resource potential, and on the other - financial capacity, gross domestic product and international trade volume and, above all, the level and quality of life. A comparison of the actual values of economic security indicators with their threshold levels that characterize various aspects of national economy security, allows to judge the dynamics of the individual components of economic security at the international level and to conduct their comparison (Ranjan Roy, Ngai Weng Chan and Ruslan Raini, 2013).

The study of literature allowed to select multiple points of view on the definition of the concept of "social and economic security". Socio-economic security depends on the level of self-sufficiency and self-financing of the region, the development of its economic potential (industrial, labor, natural, investment, innovative, scientific). Socio-economic security of the region is determined by the stability of regional economic systems' functioning (nucleating production, territorial-economic complex of the region as a whole) (Khairulloev, D.S., Saipullaev, U.A., 2014). In this case, as methodological basis of the study of socio-economic security the authors have chosen a systematic approach.

National security is a case when one or more of the vital interests of our state, and / or are threatened to such an extent that it could lead to social disruption. It covers both the security threat by deliberate human acts (security) and threats from natural disasters, system or process errors, human error or natural anomalies such as extreme weather

57 conditions (safety) (Mennen, M.G., van Tuyll, M.S. 2014). For the analysis of national security the author proposed risk  
58 assessment methodology (MIKR 2009).

59 National security is considered as a public good that is an increasing function of military spending and a negative  
60 function of the strategic environment (F-de-Cordoba, G., Torres, J.L., 2014). The author examines the economic security  
61 through dynamic stochastic models. Currently, the most common is a methodological approach that is based on the  
62 determination of relative values normalized to respective threshold levels of separate economic indicators of security  
63 (Butorin, V.K., Tkachenko, A.N., Shipilov, S.A., 2007). It is assumed that the minimum possible value of the  $i$ -th  
64 normalized specific index  $\beta_{i,\min} = 0,01$  corresponds to a low level of economic security with fixed values of the other  
65 specific indicators. And, conversely, the greatest possible value of  $i$ -th normalized specific index  $\beta_{i,\min} = 0,01$   
66 corresponds to a high level of economic security with fixed values of other specific indicators. Unit value of  $i$ -th  
67 normalized specific index  $\beta_{i,\min} = 0,01$  corresponds to threshold level of economic security of the state.

68 The calculation results of normalized specific indices which characterize the individual components of the  
69 economic security of the national economy of Russia, the USA, Japan, Germany, Britain, Italy, South Korea and China for  
70 2000-2013 allowed to estimate various aspects of the economic security of these states (Ismagilov, R.F., 1999;  
71 Senchagov, V.K., Gubin, B.V., Ivanov, E.A., 2013). Methodological approach (Butorin, V.K., Tkachenko, A.N., Shipilov,  
72 S.A., 2007) to assess the level of economic security allows, on the one hand, to estimate the changes dynamics in the  
73 economic security of the state as a whole, and on the other - to compare levels of economic security of national economy  
74 in different countries.

75 Integral index of the overall security of an economic entity  $Z_{\text{over}}$  can be determined by the method of I. Petrenko  
76 (Petrenko, I.N., 2006), aggregating its security indices  $Z_i$  of basic security spheres:

$$Z_{\text{общ.}} = \sum_{i=1}^3 \alpha_i z_i$$

77 where:

78  $i = \overline{1,3}$  - the number of security sphere of basic level including:

79  $i = 1$  - natural and environmental spheres;

80  $i = 2$  - production induced and industrial sphere;

81  $i = 3$  - anthropogenic and social sphere;

82  $\alpha_i$  - weighing coefficient of  $i$ -th indicator of basic level security;

83  $z_i$  - security indicator of  $i$ -th sphere of basic level.

84 Security indicator  $z_i$  of each  $i$ -th sphere of basic security level of a business entity is determined by a combination  
85 of  $m_i$  security indicators  $y_{ij}$  of the integral level (e.g. in the economy, politics, etc.):

$$z_i = \sum_{j=1}^{m_i} \beta_{ij} y_{ij}$$

87 where:

88  $m_i$  - the number of security indicators of the integral level to be included in the formation of the security indicator  
89 (aggregate) of baseline  $z_i$ ;

90  $j = \overline{1, m_i}$  - a number of the security sphere of the integral level;

91  $\beta_{ij}$  - weighing coefficient of  $j$ -th index of security of the integral level;

92  $y_{ij}$  - security indicator of  $j$ -th sphere of the integral level.

93 This methodological approach to assessing the overall security at the micro level precludes the discussion about  
94 the limited critical value of thresholds of economic security. This is explained by the fact that an integral indicator of the  
95 overall security is formed from a set of indicators and their weighing coefficients and is a dynamic feature of the overall  
96 security of an economic entity. In this case, the threshold levels of economic security are not its extremely critical values,  
97 and act as a reference level.

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### 3. Results

The National Security Strategy of the Russian Federation (RF) until 2020 (Granberg, A.G., Danilov-Daniliyan, V.I. et al., 2002) that was approved by Presidential Decree dated May 12, 2009 № 537 identified the following indicators of the state of national security:

- the unemployment rate (the share of the economically active population);
- decile coefficient;
- growth level of consumer prices;
- the level of public external and internal debt as a percentage of GDP;
- the level of resources for health, culture, education and science as a percentage of GDP;
- the level of annual updating of weaponry, military and special equipment;
- staffing level with military, engineering and technical personnel.

The Strategy states that the list of the main indicators of the state of national security may be adjusted based on the monitoring results of the state of national security. Let us consider the actual and threshold values of macroeconomic indicators which reflect the main features of RF national interests (Table 1).

**Table 1**

Threshold and actual values of economic security indicators in Russia in 2013

Indicator	Threshold value	Actual value
GDP, bln., rub.	29200	21665
Share of engineering in industrial output, %	25	22,2
Grain harvest, mln. ton.	70	78
Capital investment, % in GDP	25	15,8
Share of the innovative products in the total industrial production, %	15	3,3*
Ratio of stock addition of minerals to exhausting reserves in place, %	125	in most types - less than 100
Federal budget expenditures for national security, % in GDP	3,0	2,6*
Expenditures for citizen science, % in GDP	2,0	0,3*
Percentage of population with incomes below the subsistence level of the total population, %	7,0	15,8*
The ratio of average per capita income to the subsistence minimum, times	3,5	2,8*
Income ratio of 10% of the most wealthy and of 10% of the poorest population (coefficient of funds), time	8	14,9
Unemployment rate by ILO methodology, % of the economically active population	5	7,7
Monetization (M2) at the end of the year, % in GDP	50	25
The volume of gold reserves by the end of the year, billion dollars	40	182,2
External and internal public debt, % in GDP by the end of the year	60	16,1
The ratio of the cost of servicing the external public debt to total expenditure of the federal budget, %	20	4,6*
Inflation level, %	125	110,9
Federal budget deficit, % к BBП	3,0	budget surplus
The share of imported food in the total volume of food resources, %	25	40

Note: \* - estimates of the Ministry of Economic Development and Trade Ministry, the Finance Ministry to the draft of the federal budget for 2013.

Table 1 shows that the values of individual indicators (inflation, budget deficit, public debt) were below the threshold, and the volume of foreign exchange reserves is several times higher than threshold level.

The Russian Security Council approved the official list of socio-economic indicators of economic security (Prokopov, B.I., 2008) that reflect critical points of the Russian economy development (Table 2).

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**Table 2**  
Socio-economic indicators of economic security of the Russian Federation

Indicators	Threshold values
The amount of investments,% of GDP	25
Expenditure on research,% of GDP	2
The proportion of people whose income is below the subsistence minimum,%	7
Life expectancy, years	70
Decile ratio, times	8
The crime rate (per 100 thousand people)	5
Inflation level, %	20
External public debt, % of GDP	25
Budget deficit,% of GDP	5
Money supply, M2,% of GDP	50
The share of imports in domestic consumption, total: including food%	30 25
Unemployment rate (ILO methodology),%	7

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The indicators presented in Table 2 characterize the limit values beyond which normal course of economic and social development is hindered and it leads to the formation of destructive tendencies in the national economy of the country (Kadochnikova, E.I., Khisamova, E.D., 2014).

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The economic literature has repeatedly raised the issue of poor sectoral structure of the Russian economy (Glukhov, E.V. and V.V. Glukhov, 2013; Feofilova, T.Y., 2012). Fuel and raw materials base of Russian production and export threatens the stable functioning and development of the economy. Predominance of processing industries in the economic structure is due to their high capabilities in terms of sustainability and profitability of production. In the engineering and chemical industries new high-tech products come to the fore: manufacturing computers and laser technology, automation, equipment for nuclear power, microbiological drugs and materials. In Russia, the share of processing industries and sectors which define scientific and technological progress, not only lags behind the developed countries, but also tends to decrease (Socio-economic indicators of the Russian Federation. Federal State Statistics Service. [Electronic resource]– URL: <http://www.gks.ru/>).

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In 2013, in the sectoral structure of the Russian industry the share of electric power accounted for 9.3%, fuel industry - 18.4%; metallurgy - 18%; forest, woodwork and timber industry and paper - 4.7%; chemical petrochemical - 9.6%; mechanical engineering and metal processing - 18.1%; light and food industry - 18.1% (Socio-economic indicators of the Russian Federation. Federal State Statistics Service. [Electronic resource]– URL: <http://www.gks.ru/>). The structural backwardness of Russian economy entails its instability and limits its development opportunities. Proceeds from the sale of mineral raw materials and energy products are completely determined by the market and do not depend on the efforts of manufacturers (Vorobiev, A.E., Balykhin, G.A., Komashchenko, V.I., 2007; Ankudinov, A.B. and O.V. Lebedev, 2013). This means that changing economic situation in the world, discovery of new large oil fields outside Russia, a technological breakthrough in the use of new construction materials and fuel sources, development of resource saving technologies may reduce the need for mineral resources and lead to a significant fall in their prices. Thus, the problem of structural modernization of Russian economy is paramount in ensuring competitiveness and economic security (Grigoreva, E., Fesina, E., 2014).

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#### 4. Conclusion

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National Security Concept of the Russian Federation notes that the threats in the Russian economy are of integrated nature. They are due to the weakening of the scientific-technical and technological potential of the country, economic disintegration, social differentiation of the society, devaluation of spiritual values, the criminalization of social relations, growing terrorism and organized crime (Safullin, M.R., L.A. Elshin, A.I. Shakirova, P.O. Ermolaeva and M. I. Prygunova, 2013; Malaev, V.V., Nizamutdinov, I.K., 2014). However, the listed threats are not disclosed in full in the document, which does not allow to define their specific boundaries, their reality and severity and to develop a unified national approach to neutralize threats. National Security Concept of the Russian Federation does not reflect the major threats to the economic development of the regions where the criminalization of the economy is significant. In particular, it does not consider economic and tax crimes, shadow economy, gray labor market. Since the adoption of this document economic, social

and political situation in Russian regions, as well as in the world has changed significantly (Gubaidullina, T.N., 2015). This means that the criteria for economic security remain constant because they consist in maintaining the state of protection of the vital interests of the national economy and the population, but the factors and conditions of economic security are constantly changing, reflecting the processes of transformation of the Russian economy, leading to the emergence of new threats and dangers in the development of social and economic system.

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# Economic and Psychological Aspects of Importance of Real Madrid Brand in Marketing Communication

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## Abstract

This article discusses the importance of brands in marketing communications. Our objective is aimed to provide a perspective on the mark in terms of psychological and economic determinants of the success of the company in the market. Through the company Brand Finance data show the value of the world's 10 most valuable brands, compared to 2013 and 2014 year as the net present value of expected cash flows corresponding label. The article also presents the top 10 most valuable football clubs and more detailed analyzes chosen brand of football club Real Madrid and the organization that owns it. From several points of view we discuss the dynamics of the development of the brand, its financial value, logo, personality, colors, slogan, jingle and expansion in the market. We present a brief historical overview, current status, while most interesting element linked to the expansion of the brand across continents, to the Arab world, which is associated with the treatment team logo reflecting the cultural and religious traditions. Article presents a synthesis of psychological aspects and economic indicators at the level of analysis of the financial health of the organization, distribution of income, turnover, debt, team building and success in the global market.

**Keywords:** financial management; EBITDA; brand; marketing communications; Real Madrid;

## 1. Introduction

The latest development in entrepreneurial and corporate environment has shown that corporations are push to increase the emphasis on usage of marketing methods in order to increase profitability. This unique trend of concentrated changes has caused the success or the failure of product realization to be established by its brand and brand awareness.

The sporting activities are the proof that also this part of social life has a potential to be not just the activity for free time and entertainment for wider social groups; but it has the opportunity to become the main profit generating sector for corporation. One the example of connections between economy and sport is the widely spread favorability of the football (in American English football refer to soccer). The world globalization trend is encouraging and in the same time enabling the creation of big and strong brands which based on theirs global networks of supporters is able to achieve significant economic success.

The sporting and economic triumphs of various football clubs such as FC Barcelona, Manchester United, Real Madrid and others, prove that those clubs are able to attract more and more investors and numerous sponsors. By selecting the brand of popular clubs the consumers are presenting their statements of their personal ideologies and they are expressing it by using the symbols of selected brands. Based on this we can conclude that brand itself is a source of the economic strength which is measurable by the level of revenues - usually in million Euros.

## 2. Value of the Brand

In general, based on the current economic dynamics a brand and its value is one of the most significant attributes for success. A perception of particular brand differs, "A brand price is established by the desire of a buyer to own" (Olins, 2009, p. 202), "A value of the brand represents a group of associations and attitudes towards brand in overall value chain...". (Přibová, 14, p. 29) The term 'brand value' is in general defined by its financial value, although its evaluation due to its character as an intangible asset can be difficult but not impossible; which have been proven in respect to various brands and by changes of its ownership structures.





















The numbers of companies such as Forbes, Interband or Brand Finance are focused on creating the ranking of



57 various types of brands based on their market value. An advisory firm, Brand Finance has been publishing ranking of the  
58 most valuable brands for last couple of years. In general, the ranking is created based on specific financial information  
59 and detailed information about revenues. This approach differs from those which are focused on measuring and ranking  
60 the strength of brands. The ranking creation focused on measuring the strength of the brands is considering broader  
61 spectrum of financial indicators, such as net margin, average income per customer, marketing and advertisement costs or  
62 other qualitative indicators such as influence of a brand and customers' loyalty.

63 The Table 1 below shows the most valuable brands form global perspective based on the methodology published  
64 by Brand Finance for the year 2014. Brand Finance considers into this ranking one unique attribute which focuses on  
65 costs which would have occurred if some entity would decide to use this brand and it would genera present and future  
66 expected revenue. (Brand finance, 2014)

67 **Table 1.** 10 brands with the highest value in 2014  
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Rank	Rank		Logo	Name	Country	Brand Value (USD \$ Millions)		Brand Rating	
	2014	2013				2014	2013	2014	2013
1	➔	1		Apple		104,680	87,304	AAA	AAA
2	➔	2		Samsung Group		78,752	58,771	AAA	AAA
3	➔	3		Google		68,620	52,132	AAA+	AAA+
4	➔	4		Microsoft		62,783	45,535	AAA	AAA-
5	⬆	10		Verizon		53,466	30,729	AAA-	AA+
6	⬆	7		GE		52,533	37,161	AAA-	AA
7	⬆	11		AT&T		45,410	30,406	AA	AA+
8	➔	8		Amazon.com		45,147	36,788	AAA-	AAA-
9	⬇	5		Walmart		44,779	42,303	AA+	AA+
10	⬇	6		IBM		41,514	37,721	AA+	AA+

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72 **Source:** (Brand finance, Global 500, 2014)  
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74 The increasing importance of building the brand is supported by the facts which in year 1962 showed that average  
75 company had 62% of value tied in physical assets. This number had been decreasing ever since and over next couple of  
76 decades in 1992 it reached the level of 32% and in year 2000 its level was just 20%. (Sasko, 2010) The presented trends  
77 are being supported by various researches conducted at the companies from USA and Great Britain. The results show  
78 that about 80% of values of companies are represented by intangible assets, although the companies' brands represent  
79 at least 20% of that value. (McDonald, 2009)

80 The high brand value provides its owner various advantages such as loyal customers who are attracted by the  
81 brand and this can be accompanied by price increases from owner perspective. The high prices and brand reputation are  
82 influential factors focused on customers with certain psychological site to it and it acts as a guarantor of quality and  
83 success. A psychological success lies with the consumer willingness to pay more for something which has proven to be  
84 useful and favorable and has as well very positive ratings and broad affectation for consumers markets.  
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86 **3. Analysis of the Real Madrid Brand**  
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88 Real Madrid was founded on 6th March 1902 (at that time as "Madrid Club de Fútbol") under a president Julian Palacios.  
89 In 1912, club had 450 members and from their financial contributions it was possible to build and consequently move club  
90 activities into the first official football stadium named O'Donnel Stadium, which was the first fenced stadium at that time in  
91 Spain. The main ambition of the Real Madrid Club it was to become the most famous club from global perspective. The





















founders came with a revolutionary idea which helped to form history of the club and it can be considered as the first marketing move in history of Real Madrid Club. On 17th of May 1902, shortly after the club had been founded the first football tournament had been organized in honor of the coronation of King Alfonso XIII.. This was a unique opportunity to attract attention and new supporters. The tournament visitors and supporters were expecting to see royal family in live and the opportunity to cheer with royal family for the same club created opportunity for the club to generate high revenue from highly priced tickets which helped in further club development efforts. The final tournament results were not so satisfying from sporting side of thing where Real Madrid failed to succeed in competition of F.C. Barcelona and Vizcaya (current Athletic Bilbao). The other side of the tournament had provided the club with strong royal and government connections which resulted in renaming the club to "Real Madrid Club de Fútbol" in 1920. From this year onwards, the club has been psychologically different from other club, which has been pointed out by its excellence, uniqueness and character. (Bourne, 2014)

### 3.1 Business activities

At a football pitch the Real Madrid creates complex product which has extraordinary good sales. The football matches are represented as an individual product which purpose is "being sold" and at the same time it is a foundation and starting point for other economic activities of the club on the market. The sporting activities itself are not the only one domain of the sport and organizations conducting business activities in this sector. In order to achieve the highest level of success a diversification of business activities is necessary. Based on these, currently, the penetration of the business styles into the sport is more visible and significant and the essential commercialization has penetrated every sporting sector.

Based on the top notch marketing and revenues from commercial activities the Real Madrid has become even more popular over last years. The biggest part of the club income is generated via TV rights, advertisements on the football jerseys and by the numerous sponsorships which are achieved by the most lucrative business deals. One of the psychological phenomena is an image of football players and based on their personalities, football popularity and performance are generating enormous income for the club. The pure fact that Real Madrid at this moment has most of the players with the highest value and strong income generating potential; those facts in combination with psychological image put Real Madrid at the top of the ranking table of the most valuable brands (Table 2).

**Table 2.** TOP 10 most valuable football brands in 2014

Rank		Brand Value (USD \$ Millions)		Brand Rating				
2014	2013	Logo	Name	Country	2014	2013	2014	2013
1	1		Bayern Munich		896	860	AAA	AAA
2	3		Real Madrid		768	621	AAA+	AAA+
3	2		Manchester United		739	837	AAA	AAA+
4	4		FC Barcelona		622	572	AAA+	AAA
5	8		Manchester City		510	332	AAA-	AA-
6	6		Arsenal		505	410	AAA-	AA+
7	5		Chelsea		502	418	AAA-	AA
8	7		Liverpool		469	361	AAA-	AA
9	10		Borussia Dortmund		327	260	AAA-	AA
10	24		Paris Saint-Germain FC		324	85	AAA-	A+

**Source:** (Brand finance, The Brand Finance Football, 2014)

Real Madrid sells its own products in their own shops and via its distribution and marketing is realized via numerous distribution channels, such as internet, TV or radio. The other very important components of the club income are advertisement objects, jerseys, various shows and events (football matches, business meetings, festivals, celebrations

etc.). For instance, Real Madrid yearly jersey sales are around a one and half million jerseys where the price of one jersey is on average about 81 Euros. Another statement of the income generating strength of the Real Madrid club brand is the Addidas shop sales at the stadium. This shop is the most profitable one from the global perspective and on average it has yearly around 2 million shoppers. (Real Madrid news, 2013)

### 3.2 Characteristics of the Real Madrid brand

In 1920, the King of Spain gave the club permission to use new name "Real Madrid Club de Fútbol" and from this point this name became official name of the Real Madrid football club. Real Madrid is owner of various forms of its name which are presented as brands, such as Realmadrid.com, MyMadrid, eMadridista, Realmadrid. Those brands purpose is to market and represent vast range of club's products and services which are offered by the club (for instance advertisement objects, clothes, communication via computer networks). (Ditte, 2012) Other parts of this brand are logo, players and other personnel, slogan and anthem.

The Real Madrid logo has gone through various changes since the club foundation (see Picture 1). One of the most visible changes was omission of the crown from the logo which was executed in 1931, in time of so called "second republic". The work "real" had been stripped from a title of the club and purple strip had been added to the club logo, which represented a region in Spain call Castile - region of Madrid City. Two years after the civil war had ended the Real Madrid had re-designed the logo by adding the royal crown, although the purple strip has remained there until nowadays. Psychological changes of the logo were dynamic changes and perception of ne society influences and other political changes in the country.



Figure 1. Historical changes of the Real Madrid logo. Source: (Real Madrid Football Club Logo History, 2014)

For the sport club, it is characteristic to present themselves' by their players and managers. Due to the fact that Real Madrid brand present itself as synonymous of strength, success or winning, therefore the management is very much focused on rigorous selection of the personnel which are often in public eye and should be sub-instrument in achieving set goals. During the history of the club; there has been many instances when club has focused on attracting world class players with additional exceptional qualities (those beside football skills), such as Di Stéfano, Zidane, Ronaldo, Beckham, Kaká or C. Ronaldo. (Soccerbible, 2012) Those qualities were focused on securing the great sporting achievements together with positive perception of the club from public which was certain guarantee of the value and this was consequently transferred into the other business activities.

The major color of Real Madrid from the beginning it has been color white and the inspiration for this color was taken from the club Corinthians FC. Based on this color the nickname 'Los merengues' was created which in translation means 'white'. In general, the white color represents elegance and grandeur and therefore the club is aiming to maintain its activities in this spirit. Another colors which are being presented as the club colors are golden, red and blue. Those colors are presented in club's logo and it represents a symbol of royal power.

Real Madrid, as a trademark brand, doesn't have any official or registered slogans which are so common amongst other brands. For certain type of slogan can be considered a Spanish words connection "Hala Madrid" what in translation means "Go Madrid" or "Forward Madrid". These words connection or slogan is widely used by fans, club executives or club supporters expressing its support towards club.

Similarly to clubs' personnel and slogans, the sport sector is specific as well in term s of creating the own anthem. A purpose of club anthems is to increase awareness about brands which is as well being presented in media but the main purpose of an anthem is to increase cohesion of fans and its relations toward particular brand.

Whereas, the purpose of a name, logo and club popular personnel is to present itself as a trademark(-s) primary used for differentiation in the market based on color, slogan and anthem and all this factors act as unique identifier from the psychological perspective.

178 3.3 Consumer market  
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180 A success on the market is determined by the ability of company to explore and conquer a share of the market. Size of  
181 the market is determinant only if the company can explore this opportunity. The general economy law states that the  
182 bigger share of the market can company achieve the more profitable company will become.

183 Activity of any sport club is mostly determined by the size of particular market the club is operating in and by its  
184 number of fans, fan clubs and overall popularity amongst consumers. Consumer markets for realization of Real Madrid  
185 products can be groped down into four main segments. The segmentation of the market is based on geographical  
186 location, such as European market, Asian market, North American market and African market. Mentioned markets are  
187 targeted via different types of marketing strategies and activities mainly due to the character of those markets and its  
188 consumers.

189 According to study of the agency Sport+Markt from 2010, Real Madrid is a club with second biggest fan base in  
190 Europe. This strong position is mostly based on appearances during regular football season in Spain and based on  
191 appearances in the most prestigious football club competition on the World - The Champions League, which is being  
192 played on the European continent (Keselak,2010)

193 The football is the most popular sport in Europe without any close competition but in the North America, soccer has  
194 to 'fight' for its place on the field of popularity with the most popular sport which is American Football. Currently, a  
195 dominance of traditionally very strong sports in North America has started to weaken, which is due to several factors.

196 Firstly, this is mainly due to the fact that American TV stations have started to buy sporting rights for broadcasting  
197 the European football leagues and modern social and digital media have enabled American fans to establish and  
198 maintain contact with foreign leagues, clubs and players. Secondly, the biggest football clubs, including Real Madrid, are  
199 in the process of building the massive marketing structure which has global reach far beyond the local markets. Another  
200 factor is that continuously growing Hispano-American minority is supporting football and football loyalty has been growing  
201 cross the whole American market. Real Madrid applies flexible marketing strategy and its reactions are changing based  
202 on the changing preferences of football fans on the American market which helps to increase the fan based overseas. As  
203 mentioned previously, the constantly growing population of Hispano-Americans helps to strength market positions for  
204 football clubs. Natural inclination of Hispano-Americans towards Spanish language is obvious and this is one of the  
205 factors why this minority is primary focused on football clubs from Spain. According to government survey conducted in  
206 2011 in the USA, there are more than 34 million Americans older than 5 years who are speaking Spanish which  
207 represents 12.3% of total American population older than 5 years. (Gonzalez-BARRERA, 2013)

208 *Asian market* - from the perspective of its population size has significant enticement for any organization which is  
209 basically in 'sales' business. In the geographical location, Real Madrid presents itself mostly during off-season matches.  
210 The new trend in Spanish league considering Asian market is customization of airing times for live matches in order to  
211 attract fans and viewers from other side of the globe from distinctively different time zones. One of the main marketing  
212 strategies of Real Madrid is based on pre-seasonal tournaments and matches which are being played before or after the  
213 main season of its home league. From Real Madrid perspective this activity is mostly focused on American and Asian  
214 market.

215 *Arabic market* - this market is the newest one in global expansion plans for Real Madrid and the ambition to  
216 expand consumer market was presented in March 2012. Real Madrid Club together with emirates government Rasal-  
217 Khaimah announced commencement of its mutual project named 'Real Madrid Resort Island'. This Resort Island will be  
218 thematic park and tourist complex located in the north of United Arab Emirates and it will operate under the Real Madrid  
219 brand. According to project, the park should include amusement park, the first open stadium next to sea, the first  
220 holographic football performances, Real Madrid museum, numerous sport activities, sport port, residential development,  
221 luxury hotels, regeneration centers with wellness oriented even on most demanding clients. This project should be  
222 completed by the year 2015 and it should be the entry gate for mutual African-Asian market. (Transfermarkt, 2013) The  
223 location has been selected based on two factors; two billion potential visitors market in range of 4 hours flight and it  
224 should attract (also in terms of capacity) one million visitors in its first year. The current president of Real Madrid Club,  
225 Florentino Pérez announced after the project presentation: '*Connection of Real Madrid with Emirates is a synonym of*  
226 *professionalism, success and it strengthens the Real Madrid brand and it as well increases the brand awareness. All our*  
227 *allies will be very proud of the Real Madrid Resort*'. This statement had been followed by statement from Sheikh Khaid  
228 bin Faisal bin Sultan Al Qassimi '*It is exciting project developed in cooperation with the global brand. We are very proud*  
229 *that Real Madrid has chosen Emirates and we appreciate the vision and we have million reasons to be optimistic about*  
230 *this project. This will change the United Arab Emirates and we are ready to welcome a progress and millions of visitors*  
231 *who will come to visit 'Real Madrid Resort Island'*'. (Ditte, 2012)

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The brand expansion cross the continents could be an effective tool for global marketing campaign which has started to be implemented by Real Madrid. Because of the Real Madrid Resort Island project, Real Madrid agreed to implement some extraordinary changes towards its logo by eliminating the cross from the royal crown (Picture 2). (Real Madrid buang tanda salib pada logo, 2012)



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**Figure 2.** Differences between official Real Madrid logo (left - see top of the crown), the logo used for the Real Madrid Resort Island project (in the middle) and the official Real Madrid Resort Island logo (right). Source: (Real Madrid buang tanda salib pada logo, 2012), (Madridismo, 2012)

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This decision had been considered as a positive concession towards non-Christian regions where the project will be located and significance of this decision had been amplified by the fact that Spain is traditionally very strongly devoted Christian country.

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### 3.4 Internet, radio, TV and social networks

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Currently during the busy league season which is exceptionally demanding in Europe, Real Madrid uses for further expansion on new markets mostly modern mass distribution channels, such as internet, radio and TV. Significant moved towards further expansion was the creation of the more fans friendly club webpage. The need from the psychological point of view for this step was so strong that club recognized necessity to address wide audience with specialized pages in different languages under local domains. For instance, pages have been created in Spanish, English and Arabic language ([www.realmadrid-arabia.com](http://www.realmadrid-arabia.com)), Japanese (local domain - [www.realmadrid.jp](http://www.realmadrid.jp)) and in 2012 it was expanded by Indonesian language (local domain - [www.realmadrid.co.id](http://www.realmadrid.co.id)). Further to expansion, it proved to be very helpful to create the own TV channel which has been done and now for fans is available Realmadrid TV. This channel is being broadcasted 24 hours daily since 2004 and it includes news, interesting details, matches, trainings and similar activities. The channel is being broadcasted on non-coded (unlocked) waves in English and Spanish languages. In 2008, as the first club, Real Madrid had created radio channel which offers inside information about players, club and daily developments and events.

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Another very popular way for strengthening and expanding of the fan base is via social networks. The club has selected Facebook, Google+, Youtube and Twitter as main social network channels for active communication with its users.

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One of the proofs of the strength of Real Madrid is information from the report of 'League of professional football at the social networks'. This report is being compiled by IAB Spain which is focused on digital marketing in cooperation with marketing agency Ontwice. The report from June 2011 stated that advertisement value of the official webpage of Real Madrid is more than 30 Million Euros, whereas the value of Barcelona FC is approximately 13 Million Euros. In comparison, the fan base of Barcelona FC on the Facebook was at that time 18 million fans whereas the Real Madrid fan base was 16 million fans. (My Marketing World, 2012) It is almost impossible to measure the impact of marketing strategies due to its dynamical character, however increasing brand awareness on the social networks leads potentially to higher sales and to higher market share. (Vejačka, 2012)

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The most recent survey conducted by company Perfect which was published two days prior the beginning of the World Cup 2014 in Brazil showed that Real Madrid, Manchester United and Barcelona FC are amongst the best football clubs from social media and webpage optimization perspectives. (Bourne, 2014), (Brand Perfect: Goal!, 2014)

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### 3.5 Value of the Real Madrid brand

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The value of Real Madrid brand is being presented by the official report published by the global consultancy firm Brand

279 Finance which is mainly focused on brand evaluations. This consultancy firm has been publishing the ranking of the most  
280 valuable club brands since 2005. Historical development of the Real Madrid brand value is being presented by the Graph  
281 1 since 2005 (excluding data for 2008 which were not publicly available). Brand Finance conducts brand evaluations  
282 based on methodology known as 'Royalty relief'. This methodology considers clubs as not the owners of the brand but as  
283 third parties who are required to purchase licensing in order to use a particular brand.  
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287 **Figure 3.** Historical development of the Real Madrid brand value (mil. £). Source: (Vařovský, 2012)  
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289 Based on the historical development of the Real Madrid brand we can conclude that club manages to achieve continuous  
290 growth of its value till 2011. Between year 2005 and 2011, Real Madrid managed to achieve the most valuable brand  
291 status in years 2005, 2006, 2007 and 2010. For instance, in 2009 this status was claimed by Manchester United,  
292 although the year later this status was claimed again by Real Madrid with brand value of 386 million £ which represented  
293 29% year to year growth. This growth had been achieved by high profile player transfers, such as C. Ronaldo, Kaká  
294 and Benzema. Based on these transfers, the club has started a new area under president Florentino Pérez called  
295 'Galácticos' which attracted massive interest from global media. However, the sport achievements lacked behind those  
296 projected ones and the completed satisfaction was not achieved. In year 2011, it had been third year in a row that Real  
297 Madrid did not win the Spanish League and had not won the Champions League in almost a decade. These  
298 dissatisfactions and lack of sporting achievements caused the decrease in brand value despite the revenue growth. The  
299 brand value growth had been only 3.9% which meant that Real Madrid was surpassed by Manchester United as the most  
300 valuable brand. The worst ranking for Real Madrid was in 2012 when the club fell to third place in ranking table behind  
301 Manchester United and Bayern Munchen. The weak state of Spanish economy pushed the values of all Spanish clubs  
302 toward negative growth, where Real Madrid brand value fell to 374 million £ which represented 7% drop in 2012 from the  
303 value of 401 million £ in year 2011. (Vařovský, 2012)

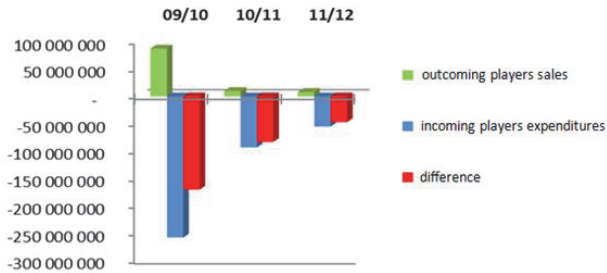
304 Considering the current economic situation within European economies more innovative approach need to broad  
305 forward in order to improve a performance of individual countries and its business subjects. The fact that all of the global  
306 economies are facing zero or minimal economic growth has impact on all industries and sub-sectors. Over last year or so,  
307 there has been some positive information about performance improvements, although the feeling of extended crisis is still  
308 upon us including public as well as private sectors. (Szabo, 2013) The Spanish economy has not improved sufficiently to  
309 wipe the dip it took 5 years ago and the importance of foreign markets and fans is currently even more significant for  
310 domestic clubs and especially Real Madrid.  
311

### 312 3.6 Building of the team and successes 313

314 Real Madrid brand is the unsplitable part of 'madridism' conception. The basic principle of this conception is appraising  
315 the superiority and winning at any cost. The club is personificating a Spanish sporting approach 'machacar' which means  
316 'to crush (without mercy)' and therefore it is very important for a brand to maintain each of its conceptions. In case of Real  
317 Madrid, this idea of being superior is express via its players; specifically by its expensive world class players which should  
318 ensure that club will achieve required results with unique flavor of elegance which is specific for the brand of this  
319 organization.

320 Florentino Pérez had begun during years 2000 and 2006 the strategy of assembling the team from so called  
321 'Galácticos', and this approach has been maintained in this second term as club president. Immediately in season  
322 2009/2010 the massive reconstruction of the squad started when 13 players left the club in value of 87.5 million Euros  
323 and 9 new players came in worth of 257.4 million Euros, although 62% of this amount was due to incoming transfer for C.

324 Ronaldo and Kaká. Specifically those two players should be at that time the main engine behind sporting results and  
 325 prestige for Real Madrid brand. Over next two seasons the expenditure for transfers decreased, although it still exceed  
 326 the income from sold players, where in season 2010/2011 income was just 10 million Euros and expenditure 93 million  
 327 Euros, and in season 2011/2012 income was 8 million Euros and expenditure 55 million Euros. (Transfermarkt, 2013)  
 328 Graph 6 shows above mentioned expenditures, income and difference from sold and bought players.  
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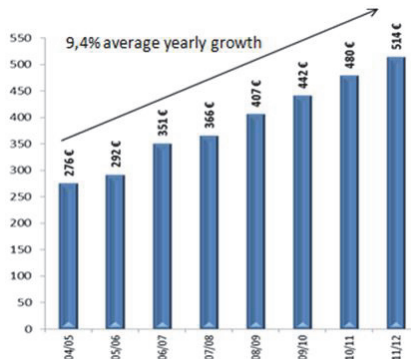


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332 **Figure 4.** Comparison of the players transfers fees. Source: (Vaľovský, 2012)  
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334 The Real Madrid approach towards building its brand based on buying profit generating players has been reflected on the  
 335 ranking of the top ten most expensive players' transfers, where Real Madrid has five players, such as Cristiano Ronaldo,  
 336 Kaká, Zinedine Zidane, Luis Figo a Ronaldo de Lima. (Szabo, 2013) The attractive game play is psychological aspect  
 337 which has capabilities to help a football brand to ensure strong support and viewers; however it isn't a guarantee for any  
 338 future or end of season success.  
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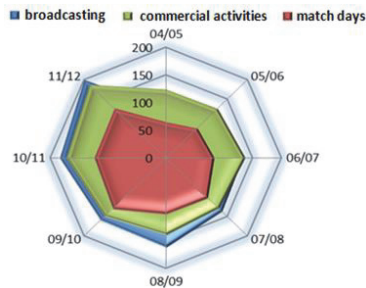
340 **3.7 Financial background**

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 342 In general, strong brand requires solid financial base and structure based on which can launch any progression efforts.  
 343 Strong financial position enables football clubs to buy expensive players, launch various projects and conduct different  
 344 activities. Those activities conducted by clubs then have psychological effects on consumers and fans which help expand  
 345 a reach of the brand. Revenues and level of debt during the certain period of time enable clubs to create trustworthy  
 346 signals at the side of consumers, investors, fans, sponsors and those signals do influence position towards brand from  
 347 economic perspective. According to report from Deloitte Football Money League in season 2004/2005 Real Madrid had  
 348 started its 8 years long run as top brand from economic perspective. Graph 3 shows the revenues of Real Madrid which  
 349 had been achieved over its most successful seasons from season 2004/2005 to 2011/2012. An average yearly revenues  
 350 growth has been capped at around 9.4% and in the last season Real Madrid managed to generate revenues of more than  
 351 500 million Euros which has not been achieved yet by any other elite sports club from global perspective. (Realmadrid.  
 352 Annual Report 11/12, 2012)



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355 **Figure 5.** Revenues of Real Madrid. Source: (Realmadrid. Annual Report 11/12, 2012)

356 In general, football club revenues come from various activities. According to report from Deloitte, football clubs generate  
357 revenues from three main activities, such as income from TV rights, commercial activities and from match days. This  
358 segmentation of the revenues is presented by Graph 4. TV rights activity includes mostly the rights given to TV stations  
359 for broadcasting its football matches which is negotiated separately for different market segments. Over the years income  
360 from all three main activities had achieved growing trend and from season 2007/2008 Real Madrid income from TV rights  
361 exceeded other two revenues generating activities due to the new contract with company Mediapro in value of 1.1 billion  
362 Euros with contract length of seven football seasons. Other revenue generating activities are generally focused on  
363 sponsoring, merchandising and licensing. These revenues were the biggest ones in seasons from 2004/2005 until  
364 2006/2007. This period of time is well known as the first term of 'Galácticos' project and during those seasons the main  
365 frame of Real Madrid squad has been built from players like Beckham, Zidane and Ronaldo. This fact and squad  
366 structure had allowed the club to generate significant revenues from licensing and merchandising. The revenues from  
367 match days are mostly generated by ticket sales and stadium services. Over those seasons the stadium improvements  
368 had been implemented numerous times and main changes were capacity expansion and conformability improvements.  
369 These activities helped club to generate additional income from same fixed assets and therefore the utilization of clubs'  
370 assets had been improved as well. The other change was noted as increase in ticket pricings which could be achieved  
371 due to expansion of provided services and its quality. During season 2012/2013 revenues from match days were in value  
372 of 119 million Euros (23% of total income), income from commercial activities 211.6 million Euros (41% of total income)  
373 and revenues from TV rights were 188.3 million Euros (36% of total income). (Deloitte: Football Money League, 2014)  
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377 **Figure 6.** The Real Madrid income structure. Source: (Vařovský, 2012)  
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379 The level of income had been the main driver behind an affordability of the club towards new transfers (and other  
380 employees). Players' wages are very important negotiation tool for club management during transfer's season and this is  
381 strong psychological factor of the brand. The value for transfers cannot be according to 'fair-play' UEFA regulation more  
382 than 70% of club's income. Table 3 shows salaries, sales and ration indicator of these two metrics. This ratio indicator  
383 remained mostly same over the years with year to year change around 1%; however the exception was season  
384 2009/2010.  
385

386 **Table 3.** Salaries, sales and ratio indicator of salaries/sales for Real Madrid  
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	04/05	05/06	06/07	07/08	08/09	09/10	10/11	11/12
<b>Salaries (mil. €)</b>	144	137	168	168	187	190	216	236
<b>Sales (mil. €)</b>	276	292	351	366	407	442	480	514
<b>Salaries/Sales</b>	52%	47%	48%	46%	46%	43%	45%	46%

388  
389 **Source:** compiled by authors (Realmadrid. Annual Report 11/12, 2012)  
390

391 The presented ratio of salaries and sales is very often used as an expression of effectivity of the club which is very  
392 important while evaluating the financial future of the club. If the ratio value is low it means that club has strong  
393 precondition to achieve strong financial position.

394 Another factor which expresses the financial stability of the Real Madrid brand is level of debt. We had compared  
395 four seasons from 2008/2009 until 2011/2012. During these seasons financial statements showed that club had taken on



396 various bank loans and this was a visible change in comparison to previous seasons. The club had been 'loan free'  
397 establishment since 2002 until the 2008/2009 season. Table 4 shows the calculation of the debt according to the UEFA  
398 methodology based on financial 'fair-play' directive and according to internal Real Madrid financial statements. The  
399 methodology of debt calculation from Real Madrid side differs in following inclusions: besides general bank loans (debts)  
400 it includes transfer payables/receivables, investment payables focused on stadium and training centers and other buy-  
401 backs from licensing.  
402

403 **Table 4.** Calculation and development of the Real Madrid debt (thousands €)  
404

	08/09	09/10	10/11	11/12
1. Bank loans	149 706	166 517	145 762	143 309
2. Cash and cash equivalents	111 619	92 731	97 769	113 237
3. Net bank debt (2-1)	38 087	73 786	47 993	30 072
4. Transfer payables	228 684	175 927	125 646	90 354
5. Transfer receivables	17 968	64 897	49 456	35 095
6. Transfer fees - difference (4-5)	210 716	111 030	76 190	55 259
7. Debt according to UEFA (3+6)	248 803	184 816	124 183	85 331
8. Other creditors	80 894	59 749	45 538	39 327
9. Debt according to Real Madrid (3+6+8)	329 697	244 565	169 721	124 658

405 **Source:** compiled by authors (RealMadrid. Annual Report 11/12, 2012), (RealMadrid. Annual Report 9/1, 2010)  
406

407 According to Table 4, a level of the debt (bank loans) based on both methods was more or less same and the biggest  
408 debt was in season 2008/2009. This was mainly due to players' transfers for the season 2009/2010. Over next four  
409 seasons based on the increase in income Real Madrid had managed to lower its debt by 65.7% (according to UEFA) or  
410 respectively by 62.19% (according to Real Madrid).  
411

412 In order to evaluate the firm's ability to repay debt a financial indicator Debt/EBITDA is often used. This indicators  
413 show the ratio of Debt to Earnings (before interest, tax, depreciation and amortization) and the lower the indicator value is  
414 the better it is for company. The value of Debt/EBITDA shows number of years in which would company repays its debt  
415 according to current level of income. This indicator is presented in Table 5.  
416

417 **Table 5.** Development of EBITDA and calculation of the indicator Debt/EBITDA  
418

	08/09	09/10	10/11	11/12
EBITDA (million €)	105	146	151	154
Debt (UEFA)/EBITDA	2,4	1,3	0,8	0,6
Debt (Real Madrid)/EBITDA	3,1	1,7	1,1	0,8

419 **Source:** compiled by authors (RealMadrid. Annual Report 11/12, 2012), (RealMadrid. Annual Report 9/1, 2010)  
420

421 Financial situation of Real Madrid is reasonably satisfying which is supported by its ability to repay outstanding debt. Debt  
422 reduction is influenced (positively) by yearly growth of the clubs EBITDA which helps to create positive evaluation of the  
423 club from financial institutions standpoint and the overall position of Real Madrid brand.  
424

#### 425 4. Conclusion

426 Based on the presented analysis of economic and psychological aspects of brand significance in marketing  
427 communication we had focused our interest on evaluation of brand in relation to organizational success on the market.  
428 The brand enables company to motivationally and psychologically communicate with customers and via this  
429 communication company achieve its sales and new markets expansions. Trademark and logo are the main recognition  
430 components for brand users. It is undisputed psychological fact that customers' attitudes and brand perceptions do  
431 influence final behavior of customers towards firms' products and therefore overall success of companies on the market.  
432

433 Conducted research of chosen Real Madrid brand provided results which prove that future club projections are  
434 based on strengthening of club brand by commercialization and investing to right players. Additional requirements for  
435

club's success are expansion of commercial activities from international perspective and by achieving a stable financial background. There are many brands with high value however not many of those brands are able to achieve successful status on the market. It is difficult to distinguish whether high income had created strong brands or already strong brand had been a driver behind high income. However, it is very clear that one relates to the other and both of those factors are co-influencing each other. The ability of Real Madrid brand to basically sell anything what is related to the club is main driving power behind high income. The clear parallel between high income and ability to increase the brand awareness has psychological effect on its fans and the whole market.

The best enlighten of income versus debt situation and its position towards profit is defined by general saying – "Revenue is for vanity, profit is for sanity." At the end revenues or income look attractive in financial statements, however an ability of company to generate profit is the main attribute for any debt consolidation and overall financial stability.

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# Selective Appraisal of the Liability of Financial Institutions with Use of E - Banking and Payment Systems

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## Abstract

*This paper seeks to examine the impact of Information and Communication Technology (ICT) on the provision of financial payment services in Nigeria. We have carried out a selective appraisal of the liability of financial institutions as well as payment system providers that have deployed ICT tools in the delivery of their services in relation to cases of forgery, fraud, mistake and system failure; while assuming at all times that the customer or client is faultless. The paper examines the selected issues within the precincts of the extant legal regime in Nigeria with a view to ascertaining if they suffice for the regulation of the relationship between customers and financial institution.*

## 1. Introduction

Information and Communication Technology (ICT) and its tools have had an unprecedented impact on financial Institutions and payment systems in Nigeria in the past decade. For example, the issuance of debit cards by financial institutions and card payment schemes like phone cards provide a good source of liquidity, income and loan for the issuer. This is because, upon receipt of payment for the electronic value that is issued, there is a time lag before the value purchased and issued is redeemed and spent, thus, creating a float which the issuer can make use of, interest - free. (Aniyic, 2004) More obvious, is the fact that the incorporation of ICT tools into the mechanics of the Nigerian banking and payment system services poses challenges to the Nigerian legal jurisprudence as a result of the fact that it has raised legal issues some of which our existing legal framework seems illequipped to deal with. For example, while the advancements and innovations in ICT are progressing at a geometric rate, the necessary regulatory framework is progressing at an arithmetic rate. Also, electronic products such as the Automated Teller Machine (ATM), which was invented to ease the problem of cash withdrawal is now fast becoming a nemesis for the users as complaints trail its use. This development has given birth to more than was bargained for by all parties to the relationship in terms of liability which usually is apportioned on the basis of fault.

## 2. Forgery

The possibility of forgery of ICT -tools utilised by financial institutions is a reality. Most electronic products deployed by financial institutions in Nigeria are based on the smart card technology and they have fallen prey to forgers as the technology for this exists and is within the reach of all who can pay for same.

Smart cards like ATM, Debit and Credit cards have fallen prey to forgers; the technology for this exists and is within the reach of all who can pay for same. Our focus is the determination of the liability of financial institutions whose e-tools have been fraudulently copied and as a result of which a client suffers is a determination of the legal status of a smart card and the accompanying PIN: combined are they analogous to a signed cheque? It is submitted that combined, a smart card and PIN are analogous to a signed cheque. This submission is premised on the knowledge of what the signed cheque and the smart card combined with the PIN are used to accomplish.

A signed cheque is used to convey mandate to the financial institution. This is the use to which a smart card and PIN is put. To make possible their use, the signature and the PIN are a shared secret: the financial institution usually has in its database; a sample of the customer's signature and in the case of smart cards, the financial institution also has in its database the PIN of its customer with which it compares and confirms the identity and mandate of the customer. It is this mandate that nowadays, is being forged. Thus, where a card which was fraudulently copied or stolen and the fraudulently acquired PIN is used to interact with a financial institution with the aim of making a withdrawal, it is submitted that the mandate which is consequently conveyed when the duplicate card and the fraudulently acquired PIN is used, amounts to

56 a forged mandate and is tantamount to a no mandate from the customer/ client and the financial institution cannot  
57 premise its debiting the latter's account on this. And in a situation where there is no mandate preceding the debiting of a  
58 client/ customer's account, it is submitted that a financial institution who has debited a client' account is liable to make a  
59 refund of the amount debited without mandate to the affected client/ customer. This is because it is trite that a financial  
60 institution is only entitled to pay in accordance with a valid mandate from its customer; that a forged mandate is not a  
61 valid mandate.

62 Furthermore, certain concepts contained in the *Bills of Exchange Act* which does not relate to negotiability are  
63 adaptable to e-banking and payment systems services and are thus, capable of making the financial institution's liability  
64 for the forgery as espoused above. The Act provides that where a signature is forged, the forged signature is wholly  
65 inoperative and no right to enforce payment thereof against any party thereto can be acquired through or under that  
66 signature. (See section 24, Bills of Exchange Act, Cap. B8 Laws of the Federation of Nigeria, 2004; *Latumji v. Cooperative  
67 Bank of Western Nigeria Ltd.*(1979); *Nig. Advertising Service Ltd. v. UBA Ltd.* (1965).

68 Thus, it is submitted that in relation to an e-service or product provided by a financial institution of which there has  
69 been a forgery which was not due to the customer's fault or negligence, the liability accruing there from, is that of the  
70 financial institution. (*Nig. Advertising Service Ltd. v. UBA Ltd., supra*)

71

### 72 3. Fraud

73

74 Statistics show that financial losses due to bank fraud in Nigeria increased from N105 million in 1989 to N6,367 million in  
75 1999. This shows approximately 98% increase in loss due to bank fraud within a ten - year period (Igbinovia, 2003).  
76 Fraud in financial institutions which have deployed ICT - tools manifests in various forms and could be perpetuated by  
77 either staffs of the financial institutions, customers, or third parties. The situation is alarming and has given birth to a  
78 myriad of reactions. The Central Bank of Nigeria (CBN) recognising the pervasiveness of e-banking and payment  
79 systems in Nigeria and the propensity of them being used to perpetuate fraud, formulated the Central Bank of Nigeria  
80 Guidelines on Electronic Banking in Nigeria of August, 2003 (hereafter referred to as the 'Guidelines'). These Guidelines  
81 are to regulate the use of e-tools as well as provision of e-serb by financial institutions in Nigeria.

82 The Guidelines are an attempt at checkmating fraud perpetuated by bank staff and criminal third parties. Amongst  
83 other things, they stipulate that banks providing internet banking services should put in place procedures for the  
84 maintenance of the bank's website, ensure that only authorised staff are allowed to update or change information on the  
85 website and ensure that the Internet Service Provider (ISP) has incorporated a firewall to protect the bank's website  
86 where it is out - sourced. Thus, where the bank, due to its negligence and/or professional laxity, fails to comply with the  
87 directives of the CBN, it is submitted that the delinquent bank is liable to the customer who is defrauded subsequent to an  
88 unauthorised access of his/her records or information with the bank.

89 The foregoing submission is premised on the fact that a bank is under a duty to exercise reasonable care and skill  
90 with regards to the customer's affair (*Benson v. Otuor* (1975); *Agbanelo v. UBN [2007]*) and that the Guidelines are a re  
91 - statement of that duty. In *Agbanelo v. UBN Ltd. (supra)*, the Supreme Court held *per Ayoola, JSC* that:

92 A bank has a duty under its contract with its customer to exercise reasonable care and skill in carrying out its part  
93 with regard to operations within its contracts with its customers. The duty to exercise reasonable care and skill extends  
94 over the whole range of banking business within the contract with the customer.

95 Thus, when a bank fails to exercise reasonable care and skill with regards to its customers' affairs, it is submitted  
96 that the bank is negligent and has failed to observe the standard expected of a reasonable banker. The foregoing is  
97 applicable, *mutatis mutandi* to other non-banking financial institutions and payment systems providers. Furthermore, the  
98 Guidelines state that bank will be considered liable for fraud arising from card skimming and counterfeiting in relation to  
99 ATM cards.

100

### 101 4. Mistake

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103 The mistakes that could probably occur in relation to transactions involving financial institutions providing services along  
104 the line of e-banking and payment systems and their customers are numerous. For example, in relation to electronic  
105 credit or funds transfer, where a paying institution due to an administrative or clerical mistake and under a mandate given  
106 by the payer to the paying institution, makes payment to an unintended payee, it is submitted that a mistake of fact has  
107 occurred. The position of the law in relation to mistake of facts is that, the money paid is recoverable from the beneficiary,  
108 who in this case is the unintended payee by means of an action for money had and received or for money paid under a  
109 mistake of fact. Also, an affected party can invoke the equitable doctrine of tracing, to recover the money mistakenly

110 transferred to the unintended recipient.

111 The right of the payer or paying bank to recover an amount paid due to a mistake of fact is a common law remedy  
112 and is enforced by the plaintiff bringing an action against the payee or the receiving bank for the recovery of money had  
113 and received by the defendant for the use of the plaintiff. The claim is a purely personal one and it is therefore  
114 enforceable whether the defendant still has the money received by him or not.

115 Alternatively, a paying bank can invoke the doctrine of tracing. This will enable the former to recover the amount  
116 debited from the financial institution. The equitable tracing remedy could be extended so as to enable a bank which is  
117 induced to make a payment under a mistake to recover the amount credited from that bank. The court has held that a  
118 bank which pays money under a mistake of fact to a collecting bank may either recover the amount paid from the  
119 collection bank's customer or from the collecting bank itself to the extent of the credit balance on the customer's account,  
120 or may alternatively trace the amount through the customer's account, into any assets paid with it, or receive it, in  
121 the event of the customer's insolvency, out of his general assets. (*Banque Belge v. Hambrouk* (1921); *Chase Manhattan  
122 Bank NA v. Israel British Bank Ltd.* (1981))

123 It is submitted that if money is paid under a mistake of fact, the equitable title in the property therefore remains  
124 vested in the payer and the payee is subject to a corresponding fiduciary duty to make restoration of what has never been  
125 his property. The paying bank may, therefore, recover funds paid to the receiving bank under a mistake of fact or, if they  
126 are further transferred into an account at another bank, it may recover them out of that account. The bank may also claim  
127 and enforce a charge over assets acquired with the funds obtained from it. However, it does not follow that the holder of  
128 the account with the paying bank whose account is initially wrongly debited may assert a similar tracing claim. His rights  
129 are limited to having his account with the paying bank re-credited.

130 The grounds of which payment may be recovered because it is made under a mistake of fact do not depend on the  
131 manner in which the payment is made: they are dependent on the fact that payment is made under a mistake.  
132 Consequently, a payment made due to a material mistake of fact or other such error may be recoverable either from the  
133 payee or from the receiving bank, whether the payment is by means of an electronic transfer or any other electronic  
134 means.

135 Furthermore, where a person pays money to another under a mistake of fact, the payer is *prima facie* entitled to  
136 recover the money paid under the mistake of fact (*Barclays Bank Ltd. v. WJ Simms, son & Cooke (Southern) Ltd. &  
137 Anor.*[1979]). The foregoing is possible if the payment made in error was made as a result of a mistake of fact and the  
138 payee is not an agent, who had thereafter paid out same to his principal. See the dictum of Sir Greene, MR in *Gowers v.  
139 Lloyds & NPF Bank* (1938).

140 However, where the receiving institution has paid out the money to the payee the money is recoverable; but in this  
141 case, the option is to take out an action against the payee. In such a situation, the receiving institution is an agent of the  
142 payee and the latter is the position of a principal and it is the position of the law that it is the principal that can be sued in  
143 the above case (*National Westminster Bank Ltd. v. Barclays Bank Intl. Ltd.* (1974)).

144 Also, an error or mistake could result from the activities of the staff of the financial institution. For example,  
145 authorised personnel in the course of entering information in the database of the financial institutions could enter a wrong  
146 digit, which would bring about consequences that are as varied as the ken of the entire humanity. It is submitted that the  
147 financial institution is liable to the customer/client in so far as it is proven that the staff acted in a manner, which is less  
148 than what is expected of a person of his/ her status position; while acting within the limits of the dictates of his/her  
149 employment and in such a situation, the employer - the financial institution - would be vicariously liable.

150 Thus, notwithstanding the seemingly exotic nature of transactions carried out with the aid of ICT - tools, banks and  
151 other financial institutions that have deployed them, are liable to make a refund of the money erroneously paid to them as  
152 collecting bank as is the case with in a traditional paper-based transaction.

153

## 154 5. Systems Failure

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156 In a situation where a customer suffers financial loss due to an ATM or Electronic Fund Transfer (EFT) systems failure or  
157 malfunction, which a financial institution is experiencing or has experienced, the aggrieved customer may decide to seek  
158 recompense from the former. The question, which will be a corollary to the foregoing state of affairs, is: "*can the financial  
159 institution avoid the claim brought against it, or call it pass the burden of settling the claim to another party*"?

160 In resolving the above question, the point of reference will ultimately be the formal contract between the banker or  
161 e-payment service provider and the customer. *Lord Justice Bankes (Joacilimson v. Swiss Bank Corporation* [1921], held  
162 that there are a number of implied super-added obligations beyond the one specifically mentioned in *Foley v. Hill* [1848].  
163 In *Agbanelo v. UBN Ltd.* [2007], the Supreme Court held that in addition to the obligation as a debtor which the bank

owes its customer, it is under a duty to exercise reasonable care and skill in carrying out its part of the contract between it and the customer.

However, parties to contracts are in principle, free to limit or exclude the obligations attached to their various undertakings and/or obligations in and arising from the contract by the inclusion in amongst the terms of the contract, an exemption, limitation or exclusion clause (Sagay, 2000, 159 *et. seq.*). Thus, financial institutions providing e-banking and payment services can and do insert in their terms of agreement with their customers exemption/exclusion clauses.

It is here submitted that where a financial institution, due to systems failure or malfunction, does not meet up with its obligation under the contract between it and its customer; the former is in breach of the terms of the contract, and it amounts to a fundamental breach when the aftermath of the failure of one of the party to perform a primary obligation has the effect of depriving the other party of substantially the whole benefit which it was the intention of the parties that the injured party should obtain from the contract.

The focus of this discourse presently turns on whether in circumstances as that espoused above, the inserted clause will at all times avail financial institutions in view of the duty upon them. The issue is resolvable with the application of the time honoured canons of the law of contract as well as the provisions of the laws of the various States of the Federation which regulate contracts and contractual agreements to the relationship between a financial institution which has deployed e-tools in the delivery of services to its customers and the latter. The leaning of the law in Nigeria has made it impossible for a party that is guilty of a fundamental breach to rely upon an exemption clause so as to escape liability (*IMNL v. Pegofor Industries Ltd. [2005]*, 17 - 18 and 24 - 26: section 190 of Contracts Law, Cap. 32. Revised Laws of Anambra State, 1991).

As a result of the foregoing, it is submitted that a financial institution which has deployed e-tools and which has incorporated an exclusion/exemption or limiting clause cannot escape liability where there has been a system failure as a result of its negligence which has resulted in a fundamental breach of the contract. This is because, a fundamental breach of the terms of the contract amounts to a destruction of the substratum of the contract and would entitle the aggrieved party to seek to refuse further performance of the contract where same is possible; and any exemption/exclusion clause inserted in the contract will not be enforced in favour of the e-tool deploying financial institution. The position of the financial institution is worsened if it is shown that it had been negligent.

Furthermore, in the case where there is no formal contract or express term between the parties - like is the case of the relationship between some banks in Nigeria which provide e-services who compel their customers to use ATM cards without the latter applying for signing any document relating to the ATM facility, or agreeing to any express term in relation to the ATM facility - insofar as there is a relationship between the financial institution and the customer that could be construed as that between a professional and a client, it is implied that the financial institution will exercise reasonable care and skill in rendering service to the client.

## 6. Conclusion

There is no gainsaying the fact that the incorporation of ICT tools into the mechanics of service delivery by financial institutions in Nigeria poses challenges to the legal regime in the polity. However, without doubt, it is submitted that the challenges are capable of being taken care of by the provisions of the polity's legal regime. To this end, judicial activism is enjoined: for it is with this that the dynamics which these new challenges pose can be met, head on. It is submitted that this imbroglio is resolvable by the grafting on to this esoteric situation the principles of tort and the provisions of the law of contract.

The adoption of the foregoing proposal is a better strategy compared to the clamour for the making of a body of laws targeted at the e-milieu as well as ICT, for it will allow for piecemeal development of the law in relation to transactions within that environment. It is also submitted that an attempt to bring the law in pace with technological change by enactment amounts to an exercise in futility for as fast as the law strains to catch up with technological change, the latter moves ahead to outpace the law.

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# Regulatory Impact Analysis in Legal Research: Way Forward for Malaysian Legislation

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## Abstract

This article discusses the role of a new mechanism called "regulatory impact analysis" (RIA) in enacting new or amended legislation. RIA requires an impact study of the proposed legislation on the subjects of the law (society or industry) that centers on quantitative and qualitative approaches. The quantitative approach is mainly on searching for impacts based on data and figures while the qualitative method applies a multi-criteria approach. In short, the RIA has the requirements for the making of good law. Malaysia has introduced a similar mechanism although the effort is still in its infancy. This article examines related documents on RIA in Malaysia and why it is needed.

**Keywords:** RIA, Malaysia, cost-benefit analysis, law, legislation

## 1. Introduction

Regulatory impact analysis (RIA) is a process of systematically identifying and assessing effects of regulatory proposals by using consistent analytical methods, such as cost-benefit analysis and multi-criteria analysis. RIA is a comparative process which is based on determining the underlying regulatory objectives sought and identifying all the policy interventions capable of achieving them. RIA has been used in virtually all OECD countries (Jacobs 1997; OECD, 2003; 2008). However, in Malaysia a systematic form of RIA has never been undertaken in the enactment of proposed legislation. As a result, some legislation has been withdrawn or not effectively enforced. The Malaysian government has suggested that the enactment of new or amended legislation be preceded by the undertaking of a RIA. The problem is that many legal researchers in Malaysia have no or little knowledge about RIA.

Regulations are an essential part of the toolkit of policy instruments that governments can use to achieve their objectives (Sunstein, 2003). Their widespread effects on different groups in society are often hidden or difficult to identify. RIA can help ensure a good understanding of how individuals and society will be affected by a regulation (Radaelli, 2004). Thus, the government needs to work systematically to ensure that the regulations they develop and implement are of high quality, since the costs of enforcing poor quality regulations are substantial (Radaelli, 2005).

The problem is that many legislations or regulations in Malaysia are enacted without undergoing RIA or only after consultation with small groups. Government Circular No 1 of 2013 titled "Policy on the development and implementation of regulations" requires all government agencies to undertake a RIA before introducing new regulations. The RIA process is under the supervision of the Malaysia Productivity Corporation.

The objective of this article is to discuss the initiative currently undertaken by the Malaysian government in using RIA as a tool for producing good and effective legislation and regulations. This article will be useful for Government agencies, local governments, statutory bodies and their officials who are involved in legal planning and enforcement.

## 2. Methodology

The research methodology is primarily qualitative. In legal research, data collection relies on primary and secondary data (Yaqin, 2007). Primary data refers to legislation, parliamentary hansards, and court cases from Malaysia and foreign countries. Secondary source are based on publications such as articles, journals, books, student theses, and official documents. The approach adopted will be a comparative analysis - adopting and modifying documents from foreign and local jurisdictions (Zahraa, 1998). For this research, primary data will be analysed based on rules of interpretation such as literal, golden, mischief, and purposive rules. Finally, all data collected will be analysed using all legal research methods, namely, historical, jurisprudential, comparative, descriptive, analytical and critical. This method is also called content analysis, although it is not based on coding as is usually done in other social science or economic research. Multi-criteria



56 analysis (MCA) is also used to allow systematic and transparent decisions to be made besides enabling a quantification  
57 of major regulatory effects on cost-benefit impacts analysis. MCA basically uses the qualitative method. However, for this  
58 article, the author adopts the descriptive method which is appropriate to explain this new initiative embarked by the  
59 government. This methodology is appropriate because the tool (RIA) is still new and there is currently no published  
60 example to show how RIA is used in enacting new or amended legislation/regulations.  
61

### 62 3. Background of RIA

63  
64 The United States developed RIA in the 1920s (Morall, 1997). It started with economists developing the methodology in  
65 counting costs and benefits in a given project. Later, other disciplines contributed to the effort by providing justifications  
66 and comments on the usefulness or otherwise of RIA in particular cost and benefit (CBA) analysis. Adler and Posner  
67 (2000) edited a book debating various issues including definitions, reform and justifications of CBA from various multi  
68 disciplinary approaches. The book shows that CBA is a rich area of interdisciplinary work although economists have  
69 defined and elaborated on the central cost-benefit methodology.

70 RIA's initiative actually began from international organisations such as the OECD. Many governments of developed  
71 countries have published guidelines on how to undertake RIA on prospective or new legislation. A substantial body of  
72 literature has emerged explaining the philosophy and mechanism of RIA. Its most important contribution to the quality of  
73 decisions is not the precision of the calculations used but the action of analysing, questioning, and undertaking real-world  
74 impacts and exploring assumptions (OECD, 2003). Poor quality regulations increase compliance costs for businesses  
75 and other groups, and lead to unnecessary complexity and associated uncertainty as their obligations reduce the ability of  
76 governments to achieve their objectives (OECD, 2008). The RIA framework provides a useful basis for any policy  
77 development process and not just those that may consider regulatory options or result in a cabinet paper. However, the  
78 RIA requirements are formally triggered by a submission to the cabinet (NZ Treasury, 2009). A management tool is used  
79 to set the criteria of what level of risk a company is willing to accept, i.e., risk matrix. It often involves public opinion and is  
80 on a long term basis (Wilson, Mc Cuthcheon, 2003).

81 Europe has significantly contributed to the development of the RIA with regulations there driven by  
82 competitiveness, sustainable development, and good governance. These three concepts influenced the regulatory "swing  
83 pendulum" in Europe, from the precautionary principle to regulatory impact analysis (Lofstedt, 2004). RIA has been  
84 considered a popular reform strategy in OECD countries and almost all have adopted its programmes (Jacobs, 1997).  
85 RIA is already a cornerstone for legal developments in the European Union and has been used for "better regulations"  
86 and "good regulatory governance" (Radaelli, 2004; 2005).

87 Industry has long been using CBA as a formal method in drafting standards for the development of safety-critical  
88 systems on an industrial scale (Bowen & Stavridou, 1993). Any research project is always based on RIA in a comparative  
89 perspective. RIA explores all limitations and possibilities by analyzing the costs and benefits and also obtains the best  
90 practices in industry (Radaelli, 2004).  
91

### 92 4. RIA Initiative for Malaysian Legislation

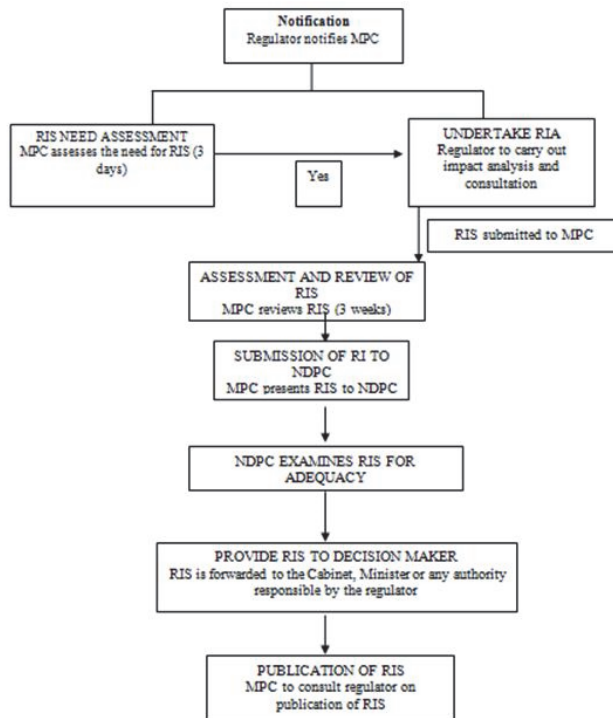
93  
94 The Malaysian Public Service Department through its Circular No. 1 of 2013 outlines the government's policy on the  
95 development and implementation of regulations especially with regard to undertaking RIAs. The circular states that  
96 regulation-making processes must be streamlined and updated to ensure effective and fair administration besides  
97 upgrading the quality of new regulations. To that end, a RIA needs to be carried out as it has the capacity to upgrade  
98 transparency, equality, and accountability in public administration. This new government policy will create a good  
99 regulatory environment for developing sound economic conditions that will attract foreign investment and facilitate  
100 businesses. Thus, the RIA process should be based on:

- 101 (i) *Sound analysis: the reasons for the introduction need to be clearly identified. The justification of the selected*  
102 *method is based on an analysis of the options available and after making an assessment on the impact of the*  
103 *alternative options;*
- 104 (ii) *Informed decision making: decisions makers, faced with a range of options for achieving the government's*  
105 *objectives, must understand the implications and be informed about the likely impact of the available options*  
106 *before deciding; and*
- 107 (iii) *Transparency: the information on which the government's regulatory decisions are based should be publicly*  
108 *available. (Best Practice Regulation Handbook, 2013)*

109 The Circular further states that RIA is required to ensure that the regulations have a clear objective, taking into

110 account the best alternative policy based on cost-benefit analysis, besides seeking input and views from all interested  
111 parties. In other words, a qualitative and quantitative analysis is required in ensuring the enactment of good legislation.  
112 Cost-benefit analysis is based on qualitative research and sound knowledge of micro economics is necessary for that  
113 purpose. There are instances where it may not be possible to apply qualitative research and a quantitative approach  
114 would be more appropriate. The quantitative approach here refers to an engagement of the public or industrial opinion  
115 through various mechanisms such as questionnaires, interviews, or focus group discussions.

116 The circular emphasizes that the requirement for RIA is only for regulations that have an impact on business,  
117 investment, and commerce. It also covers implementation aspects. Basically, a regulation coordinator must be appointed  
118 to be responsible to implement the national policy on the development and implementation of regulations. RIA must be  
119 concluded with a regulatory impact statement (RIS). The RIS process is shown in the chart below.  
120



121  
122

123 **Source:** Quick Reference Best Practice Regulation Handbook, July 2013, MPC.

124

125 The RIS is a document prepared by the regulator (Ministry, etc) in support of a regulatory proposal after consultation with  
126 affected parties. It records the important steps undertaken during the RIA process including assessments based on cost-  
127 benefit analysis and views of other parties concerned. RIS is presented to the cabinet as the decision maker with several  
128 options (usually 3) proposed by the regulator. The three options are: (i) not doing anything, (ii) proposing a new or  
129 amended regulation; (iii) proposing a non-legal mechanism such as guidelines.

130

### 131 5. Cost Benefit Analysis

132

133 Cost benefit analysis (CBA) is the main tool in RIA; in fact some writers believe that without CBA the undertaking of RIA  
134 would be meaningless (Boardman et al, 2011). This is true to a certain extent because eventually the government would  
135 want to see the financial impact of any given project. As financial resources are scarce they have to be used for projects  
136 that yield higher results or that avoid higher risks or costs. CBA would help the government or agency to prioritize their  
137 works or plans (Layard & Claister, 1994). Thus, CBA remains the core in RIA and without it the overall picture of a project

138 or legislation would not be clearly seen. CBA was actually developed in USA in the 1920s though it was then mainly  
139 confined to economic perspectives (Teyfik, 1996). This has to be true as the economists have defined the CBA  
140 methodology especially on big government projects and plans. However, over time, experts from other disciplines have  
141 also contributed to the development of CBA especially those from philosophy, psychology, and law (Adler & Posner,  
142 2001).

143 Economists have done good technical work in elaborating on the quantitative methodology such as how to  
144 compensate variations and in discounting costs and benefits over a certain period. The purely economic CBA however  
145 has been challenged where there are scenarios or situations which cannot be surveyed quantitatively (Wilson &  
146 McCutcheon, 2003). In certain scenarios, employing some other methodology would be better such as quality-based  
147 assessment or (non-monetized) multi dimensional assessment. Thus, the normative justifications for CBA have emerged  
148 explaining how a given project can be assessed without necessarily using the economic CBA methodology. Debates on  
149 the usefulness or otherwise of the CBA have arisen from time to time but it is not the purpose of this article to elaborate  
150 on it. Suffice to say that it has its own supporters and detractors, and is now viewed from many perspectives although the  
151 economic factor remains the primary consideration underlying it.

### 152 153 5.1 Local Experience

154  
155 The Department of Occupational Safety and Health, Malaysia (DOSH) has assigned the author and his group to  
156 undertake an RIA relating to the amendment of the Occupational Safety and Health Legislation. Legislations pertaining to  
157 industrial safety in Malaysia are the Occupational Safety and Health Act 1994 (OSHA) and the Factories and Machinery  
158 Act 1967 (FMA). These two Acts which are enforced simultaneously have caused some problems to the DOSH and the  
159 industry. There are provisions of the Acts which address the same subject-matter but are inconsistent against each other,  
160 and there are also matters which are unclear as to whether DOSH has the power to act or not. Provisions which are too  
161 cumbersome and costly for DOSH to act upon require review; for example, whether there is the need to inspect all  
162 machines regardless of their potential to danger at work places. Currently, significant resources are spent by DOSH to  
163 inspect low risk machineries which in fact contribute to a very small number of injuries or fatalities in the workplace. The  
164 legal requirement to inspect machines every 15 months needs to be reexamined together with the suggestion that high-  
165 risk machinery inspections be extended to once every 5 years. The intervals between inspections can be extended under  
166 the proposed amendment provided an employer manages to show capability in managing the risk properly. Against these  
167 issues, DOSH has proposed to re-examine the legislation with the possibility of merging the two Acts. Malaysia should  
168 undertake RIA for this purpose, and the most important activity in this assessment is to measure the financial implications  
169 of the proposed merger of the Acts including the introduction of new provisions.

170 For evaluating the financial implications using CBA a questionnaire was distributed to employers in various  
171 economic sectors to collect relevant data on number of machines, time taken, and cost involved in implementing the new  
172 provisions. Data was also directly collected from DOSH. The data was collated and projections made for a specific  
173 duration (10 years) to measure the costs and benefits. Beside the CBA, a qualitative evaluation was also conducted for  
174 analyzing the implications of the proposed merger of the legislations. This new experience of undertaking RIA in  
175 proposing a new or amended Act (OSHA) arguably is the beginning of a new era in law-making in Malaysia. It is already  
176 proven elsewhere that safety regulation would be effective if RIA (CBA) is undertaken before its enactment (Wilson &  
177 McCutcheon, 2003; Bowen & Stavridou, 1993).

### 178 179 6. Conclusion

180  
181 The RIA manual can be used by the government and researchers in analysing the impact of proposed legislation or  
182 regulations on society. It will be good for the economy of the country as it will increase the efficiency and effectiveness of  
183 law making. This is a new endeavour in Malaysia as previously no proper RIA was carried out prior to enacting  
184 legislation. The effect of making laws without the benefit of RIA is that some legislation has been withdrawn or not  
185 effectively enforced. With this new requirement put in place before an Act or regulation is legislated, it is hoped that  
186 Malaysia will produce good law for the country and its people.

### 187 188 7. Acknowledgment

189  
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## Examining the Effective Social and Economic Factors on Underground Economy

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### Abstract

The expansion of underground economic activities is a reality in today's world and it plays a vital role in the economy and the lives of people in many countries. The aim of this study is to examine the effect of 8 variables (income level, education level of the individual, spouse's education, feeling of relative deprivation, unemployment, risk and severity of punishment, family background and the price gap between the formal and informal market) on the tendency of people to act in underground economy activities with a social and economic approach. Sistan and Baluchistan (eastern frontier province of Iran) is the case of this study with the sample size of 300 people. Logit model has been used to determine the people of two groups, which consist of people who act in underground activities and non engaged people. The results show that the unemployment and the feelings of relative deprivation in terms of social have a positive and significant effect on tendency of people to underground activities. But there are negative significant relationships between the level of individual spouse's education, the level of individual education, family background, income level and feeling of relative deprivation economically and the tendency of people to carry out activities in underground economy.

**Keywords:** Underground economy, Unemployment, Education, Logit, Relative deprivation

### 1. Introduction

Existence and development of shadow economy is a well-known fact in today's world. Some parts of economic activities are performed hide in all countries in order to evade the legal limitations. This indicates the importance and necessity of attention of policy makers to shadow economy. On the other hand, given that in many of the world shadow economy has a vital role in all aspects of economic, political and social life, understanding of the reasons of shadow economy is important.

Most societies attempt to control these activities through various measures such as punishment, prosecution, economic growth or education. Gathering statistics about who is engaged in underground (or criminal) activities, the frequency with which these activities occur, and the magnitude of such activities, is crucial for making effective and efficient decisions regarding the allocation of a country's resources. Given that the individuals who are engaged in these activities do not want to be identified, it is very difficult to get accurate information about underground activities. Hence, the estimation of shadow economy activities can be considered a scientific passion for knowing the unknown. Moreover, little is known about what motivates individuals to work in the shadow economy or request such work (Schneider et al., 2001).

Many studies have been conducted about the factors associated with the people tendency to the underground economy that mainly include evasion of taxes and regulations and economic exchanges. Unfair tax rates in the people views and difficult job requirements and the need to obtain a business license encourage people to underground economy. Given that most of the researches have been done in the macro perspective, it is not possible to know who are acting in underground economy. Therefore, if government wants to limit or eliminate various forms of hidden economy, it

58 should investigate micro dimensions of hidden economy (Ryskavj, 1993). The studies about underground economy  
59 mainly focus on affecting economic factors on this phenomenon. Government failure in eliminating this part displays that  
60 an interdisciplinary approach is needed to analyze this phenomenon. Considering social factors in addition to economic  
61 factors affecting the tendency of people to underground activities can help to identify better the factors affecting the  
62 underground economy. This study seeks to address the social factors affecting the people tendency to act in  
63 underground economy, with emphasis on smuggling activities.

64 The concerns about underground economy will be encouraged experts to explore the issue of why people moved  
65 to work in the shadow economy. From this perspective, this study attempts to examine the affecting social and economic  
66 factors on underground economy in some cities of Sistan and Baluchistan.

67

## 68 2. Concepts, Definitions and Generalities

69

70 Many researchers have tried to present the complete definition for informal economy, never else there are still a lot of  
71 ambiguities about it and there are different understandings for it. There are various understanding but with much  
72 coordination between them.

73 Feige said that despite of determination of importance of underground activities, but there is still considerable  
74 ambiguity about the meaning of this issue. Different authors used various words that the plentifulness of these indicates  
75 commotion in its literature which tries to clear some undiscovered parts of it (Sameti and AlBooSoveilem, 2009).

76 Shakibae (2007) defines shadow economy as an activity that includes production and distribution of all goods and  
77 services that are hidden from the eyes of the authorities knowingly or with other reasons.

78 Which activities are included in the definition of the underground economy affects the interpretation of any estimate  
79 of the extent of this phenomenon. For example, a very narrow definition would include only legal, market transactions that  
80 are not included in measured GDP. A somewhat broader definition would include both legal and illegal market  
81 transactions that are not included in measured GDP. One can also approach the above definitions by considering activity  
82 that is not detected by the tax authorities, rather than that omitted from GDP. Finally a very broad definition of the  
83 underground economy would be one that included all transactions, legal and illegal, market and non-market that are  
84 either intentionally excluded from GDP or omitted from the tax base (Tedds, 2004).

85 The informal sector, which produces legal goods but does not comply with government regulations, is a functioning  
86 part of all economies (Ihrig and Moe, 2003).

87 As a set of economic activities that takes place outside the framework of bureaucratic public and private sector  
88 establishments (Hart, 2008. cited, Elgin and Oyvat, 2013).

89 Definition is all currently unregistered economic activities that contribute to the officially calculated (or observed)  
90 Gross National Product (Schneider, 2005).

91 The System of National Accounts (SNA93) and the European System of National Accounts (ESA95) define the  
92 "Non observed economy", as all product activities that can be classified into the following three areas: (1) Underground  
93 production., (2) Informal production., (3) Illegal production (Dobre and Alexandru, 2009).

94

### 95 2.1 Classification of Underground economy

96

97 Economists provide different classification of informal economy. Some famous and comprehensive classification is done  
98 by Thomas, Feige and Khalatbari.

99 Thomas divided hidden economic activities, which he calls it informal economy, based on some of its attributions.  
100 Therefore, hidden economy (or informal economy) is divided into four household, informal, irregular and legal sectors.

101 Feige classified hidden economy in four categories of illegal, unreported, unregistered and informal economy  
102 through the new institutionalism perspective.

103 Khalatbari divided hidden economy into three sectors of black, self-serving and unorganized economy (Mir  
104 mohammadi, et al., 2007, p. 14).

105 Shadow or underground economic activity is a fact of life around the world, although a large literature exists on  
106 single aspects of the hidden economy, a current comprehensive survey is lacking (Schneider and Enste, 2000).

107 Tanzi (1999, Quotes Fleming, et al, 2000) notes that there cannot be any question that the underground economy  
108 is a real phenomenon with important implications that deserve attention and study." Of greatest concern is that this  
109 activity is unrecorded, and, as such, official national income accounts statistics do not accurately represent the true state  
110 of a nation's economy. Given that these Statistics are employed to generate economic policies; inaccurate figures may  
111 lead to inappropriate policy responses.

112 2.2 *The causes of the underground economy*  
113

114 The reasons for creating the underground economy are function of economic characteristics and situation. These  
115 characteristics are different from each economy to another one. Thus, the reasons of it are different in each situation  
116 (Sameti et al., 2009). The most important factors in the formation of shadow economy are as follow:

117 Tax and social security burdens, Intensity of regulation, Changes in labor market conditions and the employment  
118 system, Public Sector Services, Quality of Institutions, and Tax Morale. That Tax and social security burdens and Quality  
119 of Institutions are the most effective factors (Dell'Anno, 2007., Gomez and Pardo, 2007., Dreher and Schneider, 2009.,  
120 Dreher et al., 2009., Schneider, 2010., Teobaldelli, 2011., Teobaldelli and Schneider, 2012., Kucera and Roncolato,  
121 2008., Torgler and Schneider, 2009., Feld and Frey, 2007).

122  
123 2.3 *The effects of the underground economy to the formal economy*  
124

125 In order to study the effect of the shadow economy on the allocation of resources, several studies integrate underground  
126 economies into macroeconomic models. Develops a theoretical model of the business cycle as well as tax and monetary  
127 policy linkages with the shadow economy. On the one hand, the shadow economy's effect should be taken into account  
128 in setting tax and regulatory policies, and on the other hand, the existence of a shadow economy could lead to  
129 overstatement of the inflationary effects of fiscal or monetary stimuli (Schneider et al., 1989., Adam and Ginsburgh,  
130 1985).

131 Loayza (1996) presents a simple macroeconomic endogenous growth model whose production technology  
132 depends on congestible public services. This model shows that making change in policy parameters and quality of  
133 public institutions lead to an increase in the relative size of shadow economy and result in lower economic growth rate.

134 There are different opinions in contrast with the advocate theories about the negative correlation between shadow  
135 and formal economy.

136 In the neoclassical view, the shadow economy is optimal in the sense that it responds to the economic  
137 environment's demand for urban services and small-scale manufacturing. From this point of view, the informal sector  
138 provides the economy with a dynamic and entrepreneurial spirit and can lead to more competition, higher efficiency and  
139 strong boundaries and limits for government activities.

140 The informal sector may offer great contributions "to the creation of markets, increase financial resources, enhance  
141 entrepreneurship, and transform the legal, social, and economic institutions necessary for accumulation. The voluntary  
142 self-selection between the formal and informal sectors, as described above in microeconomic models, may provide a  
143 higher potential for Economic growth and, hence, a positive correlation between an increase of the informal sector and  
144 economic growth (Nikopour et al., 2008).

145 Some specialists consider that the official activities of the underground economy provides flexibility and adaptability  
146 which it lacks, supplying areas that do not cover them, providing employment to the unemployed and acting as a remedy  
147 in times of recession. Milton Friedman said that the underground economy is a "safety valve" for the formal economy in  
148 crisis (Ramona Mara, 2011).

149  
150 **3. Empirical Foundations**  
151

152 3.1 *Poverty and underground economy*  
153

154 Poverty and underground economy are serious problems with corrosive effects facing many countries. Poverty is  
155 currently one of the most serious problems in the World.

156 As poverty increases in countries of the world, there also appears a strong indication about the increasing rates of  
157 underground economy around the world. One therefore wonders whether there is a kind of linkage between the two  
158 concepts.

159 Poverty has been perceived by many as not just lack of money, food and assets but also as lack of access to  
160 education and health care and lack of security, dignity and independence (Elijah and Uffort, 2007).

161 Sen 1981 asserted that poverty is not only low income, but also deprivation of essential capabilities. The  
162 deprivation itself is a relative concept which can have different definitions in various places and times. Sen believed that  
163 relative deprivation is the core factor of poverty (Khodadad Kashy et al., 2002).

164 Elijah and Uffort (2007) with the goal of analyzing the relationship between poverty rates and size of underground  
165 economy in the developed and developing countries and exploring whether there is a link between them. The results of

166 the descriptive analysis revealed that underground economy and poverty have no geographical boundary. The incidences  
167 of poverty and shadow economy are larger in the poor (developing and transition) countries when compared with the  
168 highly developed countries.

169 Dollar and Kraay (2002) they found that there is no difference between the income of the poor on average and that  
170 in rich countries and that policy-induced growth was as good for the poor as it was for the overall population.

### 171 3.2 *The relationship between unemployment and underground economy*

172 The question of how changes in the unemployment rate affect the size and growth of the underground economy. Not only  
173 from a business cycle perspective but also from the perspective of public funding of welfare assistance programmers  
174 (Bajada, 2005).

175 In the traditional theory of labour supply, individuals can merely spend their time at work and pursue leisure  
176 activities, according to their personal preference. In these models, there is no Differentiation between regular and illicit  
177 work. Becker (1965) extends the problem of efficient time allocation by the problem of deciding between different  
178 occupations. Thus, time is a scarce Good that has to be distributed optimally between work and leisure by the individual.

179 There are serious ambiguities about the trace direction unemployment factor on volume of black economy. In one  
180 hand, with increasing unemployment, the incentives of activity in informal economy increase, but in the other hand, it is  
181 said that unemployment rate is considered as a macroeconomic index and its increase is sign of starting the economic  
182 recession period and demand decrease for labor, in formal and informal activities. So it can expect decrease in black  
183 economy size with unemployment increase. Experimental results indicate that there is reverse relation between  
184 partnership rate and times works in informal part with formal part. one of the other results of these researches is very  
185 large negative elasticity between times work in informal economy and wage rate in governmental part and much mobility  
186 between parts (Sameti and AlBooSoveilem, 2009).

### 187 3.3 *The relationship between education and underground economy*

188 Informal economy is in relation with many factors. These factors which it is in relation with can be seen clearly in the  
189 reasons of informal economy. The factors which are in question can be listed as economic, social, ethical and political.  
190 Besides being affected by these factors, informal economy also affects certain factors. One of the factors which are  
191 mentioned is education (Buehn and Schneider, 2012).

192 The relationship between the level of education and informal economy is dual. While, the decrement of informal  
193 economy as the level of education rises and the decrement of the activities of underground economy through the  
194 decrement of crime rates can enable the dimension of informal economy to decrease, the existence of informal economy  
195 can cause the level of education to decrease especially because of children abandoning their education and doing  
196 informal activities. The fall of Education and the level of quality is one of the important reasons for informal employment  
197 and Including the risks that led to the tendency of people to underground activities due to lack of access to opportunities  
198 and skills will (Ela, 2013., Chen et al., 2002).

## 199 4. **Research Background**

200 Sameti et al (2010) examined the reasons of creating underground economy in Iran using multiply index method. The  
201 results show that unemployment, trade limitation, inflation, tax burden, revenue from natural resources are the most  
202 effective factors on forming underground economy in Iran. Then, using the Granger causality test, the causal relationship  
203 between underground economy and the informal economy has been tested. The relative size of this phenomenon  
204 increased during these 41 years. It started from 6.24 percent of formal economy in 1965 and reached to 5.50 percent in  
205 1967 and 26.15 percent of formal economy in 2005. Average size of the underground economy during this period was  
206 17.54 percent of formal economy. The results show that the underground economy in Iran mostly is the result of  
207 unemployment and trade limitations.

208 Emad Zadeh and Rafi'ei Tabatabaee (2010) in a study as " the analysis of the underground economy and the  
209 effective factors on it in some developed countries" found that in developed countries, age, gender, percentage of  
210 employment in the service sector, the general knowledge, self-assessment of tax system and the percentage of GDP  
211 have reverse relationship with the underground economy and percentage of employment in the agricultural sector, the  
212 marginal tax rate and the inflation rate have direct relationship with the underground economy.

213 Mousaaei and Ahmadzade (2010) examined the relationship between social education and smuggling in



Hormozgan through qualified approach and found that family and peer education are effective factors on smuggling in micro- level and other factors like wealth seeking are effective in mid and macro levels.

Richardson (2006) The purpose of this study is to expand on the work of Riahi-Belkaiou [Riahi- Belkaiou, A. (2004). Relationship between tax compliance internationally and selected determinants of tax morale. *Journal of International Accounting, Auditing and Taxation*, 13, 135–143] and systematically investigate, on a cross-country basis, many of the key determinants of tax evasion identified by Jackson and Milliron [Jackson, B. R., & Milliron, V. C. (1986). Tax compliance research: findings, problems and prospects. *Journal of Accounting Literature*, 5, 125–165]. Based on data for 45 countries, the results of the OLS regression analysis show that non-economic determinants have the strongest impact on tax evasion. Specifically, complexity is the most important determinant of tax evasion. Other important determinants of tax evasion are education, income source, fairness and tax morale. Overall, the regression results indicate that the lower the level of complexity and the higher the level of general education, services income source, fairness and tax morale, the lower is the level of tax evasion across countries. These findings remain robust to a broad range of cross-country control variables, an alternative tax evasion measure and various interactions.

Nikopour and Habibullah (2010) This study attempts to investigate the relationship between shadow economy and poverty by explaining the mechanism through which shadow economy affects poverty via its impact on government size and economic growth, and using the human poverty index (HPI) for developing and developed countries. In order to achieve this objective, the three- way interaction model is utilized using data of 139 developing and 23 developed countries separately during 1999-2007. For developing countries the dynamic panel system GMM and for developed countries, the fixed and random effects method of estimation is used. The results suggest that increasing the shadow economy leads to increase poverty in developing countries while it decreases poverty in developed countries.

Buehn and Farzanegan (2013) Using panel data for more than 80 countries from 1999-2007 this paper studies the marginal effect of education on the shadow economy, particularly considering the quality of institutions. The results show that higher levels of education fuel the shadow economy in an environment of weak political institutions.

## 5. Shadow Economy Measurement

Measuring and evaluating the causes and effects of shadow economy are very significant because it reveals the roots of many economic problems and communication channels of criminal acts against the law. Measurement methods of black economy and its relative issues have been classified in different ways. Some researchers represented different classification due to data collection method, subject and the scope of review. Shadow economy is divided into 2 divisions based on measuring method: based on micro and macro levels and direct and indirect ways (Headquarters Fight Smuggling, Assistance Research and Statistics, 2009., Thomas et al., 1997).

Direct method is based field and survey studies in which questionnaires and interviews are used, and underground economy size is measured through direct and indirect reference (with electronic instruments like telephone, internet) to those who act in this field.

## 6. Estimation Methodology

With the development and application of complex methods such as linier regression, Logit and probit methods in the last decade and use of models based on neural networks, the accuracy of prediction increased to an acceptable level. Logit and probit models are used when dependent variable appears in two modes. The model that is used in this part is logit, which follows logistic regression. In logistic regression, such as multiple regressions, the coefficients of dependent variables are estimated. But their performance is different.

The smallest sum of squares is used in multivariable regression. In this method, the root mean square values between actual and predicted values of the dependent variable have been minimized. Thus, the curve is estimated based on the actual data (Sarai et al., 2011).

$$Li = \ln \left( \frac{p_i}{1-p_i} \right) = Z_i = \alpha + \beta X_i \quad (1)$$

The ratio of  $\frac{p_i}{1-p_i}$  shows the chance of people of tendency to act underground activities and  $Li$  is the Logarithm of chance to linier parameters (Gujarati, 2005, p.708).

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## 6.1 Variables explanation

- Marital status: nominal variable with two options "single" and "married".
- Socio-economic status: in order to measure this item we used 3 variables in 3 levels: individual education, level of spouse education, income level. Education consists of years of formal education that consists of not educated to master degree and more. Monthly income is divided into 5 classifications.
- Unemployment: unemployment means the lack of income for the individual and his family. We can say that unemployment is the cause of crime. In fact, when unemployed person wants to meet needs the crime is increased (Rabyngn and Weinberg, 2004, p. 196).
- Sense of relative deprivation: relative deprivation is a condition in which person is not satisfied, the reason is that the person's expectations of themselves are more. Also, the comparison that person make between himself and others enhance this feeling (Hussein Zadh et al., 2011). To measure this variable, 13 items are included in the questionnaire.
- Family background of underground activities: This variable is measured at nominal level and fitted with the following questions.

Do you have a background of family members and relatives in doing underground activities?

How much your tendency (no tendency) to underground activities is affected by relatives or friends?

- Risk and severity of punishment of underground activities:

When the expected utility of criminal activity is more than the utility of doing activity over the time, the person commits the crime. The probability of a crime is a function of penalty, the probability of conviction and other variables like available income in legal and illegal activities (SoltaniTiran, 1999).

Generally, how much the cost of smuggling is lower, people feel less risk and do this act at lower cost (KhezzZadeh et al., 2010).

- The difference between formal and informal market price:

High rate of tariff cause the price difference between internal and international markets that increase the motivation of importing goods through smuggling. The paperwork for export and import of goods causes costly legal procedure that can be a factor to do smuggling. Such a situation cause legal importers to smuggle in order to prevent losses in competitive market and shorten the path of importing goods (KhezzZadeh et al., 2010).

According to the mentioned variables, 8 hypotheses about tendency to underground activity are as follows:

1. There is negative and significant relationship between income levels and tendency to underground economy activities.
2. There is negative and significant relationship between the level of individual education and their tendency to perform activities in underground economy.
3. There is negative and significant relationship between level of spouse education and activity in underground economy.
4. There is negative and significant relationship between the amount of the penalty for underground activities and tendency to act in underground economy.
5. There is positive and significant relationship between the background of family in underground activities and tendency of people to perform these actions.
6. There is positive and significant relationship between the feeling of deprivation and the tendency of people to carry out activities in underground economy.
7. There is positive and significant relationship between unemployment among people and tendency to perform activities in underground economy.
8. There is positive and significant relationship between the difference between formal and informal market price and the tendency of people to act in underground activities.

## 6.2 Population, sample size and sampling method

This study includes two populations. First group consists of people who act in underground activities and the second group consists of people who do not act in this activities. Two researchers made questionnaires have been used for comparing these two groups. Sample size is 300 that were obtained through Cochran formula in which Z is equal to 1.96 and e 0.07 and  $\alpha$  0.66. Sample size in each group is 150 people.

In this study, purposive and convenience sampling was used. The purposive sampling selects people who have a

lot of information. It is clear that purposive sampling is not designed to meet community credit. In this method, the sample is not significantly representative of population, but it consists of person who has deep understanding of the subject (Gall et al., 1996, P. 365).

### 6.3 Reliability

The Cronbach's alpha is used for determining the reliability of questionnaire items. The value of Cronbach's alpha is 0.644 for feeling of deprivation index which indicates the internal consistency.

### 6.4 Validity

Factor analysis has been used in order to evaluate the construct validity. Factor analysis is a powerful technique that is used in various sciences specially social sciences. This technique not only result in saving but also the researcher can use it to make index and reduce the data to a number of factors (Nazari and Mokhtari, 2009).

KMO statistic that indicates the accuracy of data for factor analysis and generalization of the result is about 0.741. Bartlett's test is 855.912 that confirm the suitability of data for factor analysis (Sangachin et al., 2012).

## 7. Conclusion

Used variables consist of context and economic variables as follows:

Children, F2 (feeling of relative deprivation index), Income, Unemployment, Marriage, Price (the gap between formal and informal market price), Risk (considered penalty for doing underground activities), Tend (children tendency to act in underground activities), Trend (individual tendency to do underground activity under the influence of family background).

**Table 1:** The results of logistic regression

Variables	Coefficients	S.deviation	Prob
c	1.106	0.851	0.193
Children	0.241	0.074	0.001*
F2	-0.438	0.137	0.001*
Income	-0.278	0.131	0.033*
Unemployment	0.202	0.114	0.069**
Marriage	-0.877	0.322	0.008*
Price	0.335	0.123	0.076*
Risk	0.006	0.099	0.951
Trend	-0.421	0.117	0.000*
McFadden R-squared= 0.149			
Log likelihood= -176.91			

**Description:** Symbols \* and \*\* indicate significance levels, respectively, 5% and 10%.

**Source:** Research calculation

Table 1 shows, relative deprivation economically index has negative and significant relationship with tendency to act in underground activities. With an increase in the sense of relative deprivation in terms of economic potential zero group (people who do not active in the underground economy) tendency to group 1 (active participants in the underground economy) was reduced that is not in accordance with the theoretical bases. Without considering the amount of relative deprivation, this people compare themselves with peers and ignoring their abilities lead to the creation of higher relative deprivation. Since the person who acts in shadow economy may be neglected by others. So the possibility of action in underground activity is reduced and other factors such as education, job, gender, married Status and number of children have influence.

Income level has negative relationship with underground economy. With an increase in income level the likelihood of individual tendency to act in underground activity will be reduced. Several factors contribute to a person's activity in shadow economy such as:

Statement of income: suppliers in shadow economy compare their income with their neighbors, want to have a better life, thus, it increases the shadow economy activities. So, the positive correlation seems plausible.

People who need to have more disposable income for use in a particular situation (e.g., construction of houses, celebrations, etc.) are more likely to be involved in the activities of the shadow economy (Schneider et al., 2001).

On the one hand, as illegal activities are hidden from government regulators' view, these items are not reported in collected information. Given that people who engage in this activity do not want to be known, obtaining detailed information about the underground activities particularly income level of actors is very difficult.

The unemployment rate (rate of access to legal jobs) has significant and positive relationship with tendency to underground activities. With an increase in unemployment rate the likelihood of individuals to move from zero group to group 1 (people who act in underground economy) is increased. Accessing to the desired job is one of the basic needs of a person. With an increase of unemployment, the motivation for acting in informal economy is increased. One the other hand, unemployment rate is considered as macro economy index and its increase displays the beginning of recession and reduction of demand for acting in formal and informal economies. Strict regulations and wage issues are the reasons for informal economy mobility.

Price differentiation in formal and informal markets has a positive relationship with tendency of people to act in underground activities. With an increase in price gap the tendency of zero group to group 1 will increase.

The risk and severity of punishment did not have any influence on tendency of people to carry out activities in underground economy in this model.

Used variables in second model include social and cultural variables such as:

F3 (the index of relative social and cultural deprivation), Trend (the tendency of people to act in underground activities under the influence of family background), Education (education level of active or passive people in underground economy), Sped (spouse educational level of active or passive people in underground economy), Background.

**Table 2:** The results of logistic regression

Variables	Coefficients	S.deviation	Prob
c	6.360	1.157	0.000
F3	0.704	0.201	0.000*
education	-0.482	0.231	0.037*
sped	-0.579	0.198	0.003*
Trend	-0.469	0.164	0.004*
background	-0.825	0.396	0.037*
McFadden R- squared= 0.331			
Log likelihood= -90.32			

**Description:** Symbols \* and \*\* indicate significance levels, respectively, 5% and 10%.

**Source:** Research calculation

As it is considered in this model, table 2 shows that relative deprivation index from cultural and social views has positive and significant relationship with people's tendency to act in underground economy. With an increase in relative deprivation index the tendency from zero groups to act in underground activities will increase. Relative deprivation shows individual feeling that lacks competency. The criteria for this person is to reference to others. This index includes family relations, reliability to others, educational situation and accessibility to education facilities.

Education level of the individual and the spouse's education level have negative relationship with the tendency of people to carry out activities. With the increase of educational level the tendency of people to carry out underground activities will be reduced.

The tendency of people to act in underground economy is under the influence of family background and family background has negative effects on people tendency to act in underground activities.

Considering that there are no theoretical backgrounds in this field, data collected, comparing two groups' average and higher educational level of people who are not active display that family background did not have influence on people tendency to act in underground activities.

McFadden statistics in two estimated models are about 0.149 and 0.331 respectively. Louviere (2000) stated that McFadden statistic must be above 0.1 and the amount of it between 0.2 and 0.3 is in accordance with the adjustment

412 coefficient of R2 least squares (OLS) in 0.7 to 0.9 intervals. In consistent with what Louviere has already stated the  
413 results of the model is acceptable (Sharzei and Javidi, 2011).

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## Enacting the HRM Role: What Matters to Line Managers?

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### Abstract

Line managers' performance in enacting the HRM role has been criticized as they failed to meet the expectations of organizational members. Meanwhile, limitations in exploring the development of the line managers' HRM role have been identified in several areas. One of these limitations is the tendency of research to focus on HR specialists view, but failed to place line manager at the centre of the research analysis. To gain a deeper understanding of the causes and outcomes of line managers' HRM role, it is important to gather line managers' experience as a role holder. Drawing on a role theory concept, case studies are conducted at three Malaysian airports to gather in-depth data about line managers' HRM role. 23 interviews were carried out with line managers at the selected airports to understand the challenges they experience in enacting their HRM roles. Line managers' challenges are measured on five factors: desire, capability, competencies, support and HRM policy and procedures. This study revealed that line managers perceived no real challenges hindering them from performing their HRM role. Work environment is a new challenge identified in this study that influence line managers' performance in enacting their HRM role. Importantly, line managers suggested some improvement would assist them in performing better, particularly in terms of sufficient and consistent support from superiors and HR specialists. A clear feedback regarding the implementation of HRM policies and procedures from superiors is regarded as an important tool for line managers in improving their HRM role performance.

**Keywords:** HRM role; line managers; challenges; role theory; Malaysia

### 1. Introduction

Most contributors in the research of the line management involvement in human resource management (HRM) argued that the devolution of HRM activities to line managers (LMs) is an important practice in the modern organizations. The LMs' prominent role is justified through their influence on employee attitudes and behavior (Boxall & Purcell, 2011; Purcell & Hutchinson, 2007). Employee attitudes and behavior are essential to connect HRM with organizational performance. LMs are in the best position to take responsibility for converting HRM policies into practice, and for influencing the direction of work teams to achieve organizational goals (Townsend, Wilkinson, Allan, & Bamber, 2012). As employees are more likely to rely on the actions and support of their LMs, their attitudes and behaviors can be guided to achieve real improvements in unit level outcomes, potentially contributing to overall organizational performance (McConville, 2006; Purcell & Hutchinson, 2007). Unfortunately, for many LMs, their role is confused and uncertain—especially in terms of their coverage and depth of involvement in HRM activities. As a result, LMs' performance has been criticized as they failed to meet expectations of other organizational members, especially by those who are affected with their HRM role.

Limitations in exploring the development of the LMs' HRM role have been identified in several areas. One of these limitations is the focus on HR specialists' views in understanding the requirements to perform the LMs' HRM role. This is likely to be biased as researchers have agreed there is complexity in the relationship between HR specialists and LMs (Larsen & Brewster, 2003). HR specialists' views would best provide information on the intended HRM role from the perspective of the role evaluator as a policy maker, rather than LMs as implementers. LMs' views should receive due consideration as they reflect their understandings of policy maker expectations. Apart from that, most studies about the LMs' HRM role have been conducted in Western countries (Budhwar, 2000; Yusoff, Abdullah, & Ramayah, 2010). Rees and Johari's (2010) review of HRM issues identified this as a gap in HRM literature, especially in relation to important

58 emerging countries such as Malaysia, Indonesia and Thailand. Thus, it is vital to fill this gap, as HRM in Asian countries  
59 may face different challenges to that in Western countries (Varma & Budhwar, 2013). The study of LM involvement in  
60 HRM is limited in terms of scope, as more researchers have focused on the manufacturing sector (e.g. Cunningham &  
61 Hyman, 1995; Whittaker & Marchington, 2003; Yusoff, Abdullah, & Ramayah, 2010). Little attention has been paid to  
62 other sectors, such as service and tourism (Maxwell & Watson, 2006). Thus, exploring what happens in other sectors  
63 may enhance the understanding of the LMs' HRM role development and their contribution in various fields.

64 Understanding the above limitations suggest a study that can overcome the related issues that influence the  
65 understanding of the LMs' HRM role development. These limitations will be addressed in this study in several ways. The  
66 focus of this study is on the challenges faced by the LMs in enacting their HRM role. This study employs a qualitative  
67 research method through a case study and involving a service sector from a non-western country, Malaysia.  
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## 69 2. Literature Review

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71 This section looks at the scenarios of the LMs' HRM role implementation and its relation to the concept of role theory.

### 72 2.1 Challenges to perform the HRM role

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75 Undertaking the HRM role requires LMs to perform multiple roles at once (Renwick, 2003). This includes their role in the  
76 general functional task as well as the HRM task. In addition, LMs also need to act as both supervisor and subordinate.  
77 The experience LMs have as an employee is likely to influence their behavior as a supervisor. Importantly, this  
78 experience shapes their understanding when they undertake their HRM role (McConville, 2006). Since roles have  
79 inflexible structures and are difficult to combine, the diverse expectations of each role may cause conflict for LMs (Lynch,  
80 2007). Studies have found LMs experienced difficulty managing their HRM work when there were other duties that  
81 needed to be completed (Renwick, 2003). Thus, unsurprisingly there was a gap between the intended HRM role  
82 perceived by the members in the organization and the actual HRM role performed by the LMs (Nehles, et al., 2006).

83 A study by Nehles et al. (2006) on the implementation of HRM in four multinational business units used five factors  
84 - desire, capacity, competencies and ability, support, and policy and procedures - to explore the challenges front-line LM  
85 had in performing their HRM role.

- 86 • Desire reflected the willingness of LMs in undertaking the HRM role.
- 87 • Capacity was often associated with the time spent on HRM activities.
- 88 • The LMs' knowledge and skills about HRM activities can determine their competencies and abilities in  
89 undertaking the HRM role.
- 90 • Sufficient support should be in place to ensure the successful implementation of the HRM role by LMs. As LMs  
91 lacked of HRM knowledge and skills, support from HR specialists was needed to give advice and coach LMs  
92 to perform their HRM role.
- 93 • HRM policy and procedures were important for LMs as guidelines to perform their HRM role and to provide  
94 advice to LMs on how they should perform their HRM role. In addition, a clear HRM policy and procedures  
95 was also needed to avoid individual judgments by LMs which could affect the consistency of them  
96 implementing HRM role.

97 In their study, Nehles et al. (2006) identified four factors that hindered effective implementation of the HRM role by  
98 LMs. The only exception to effective LMs' HRM implementation was desire, as LMs in the study reported accepting  
99 responsibility to perform their HRM role. This finding contradicts those of Harris, Doughty & Kirk (2002) and Hope-Hailey,  
100 McGovern, Stiles & Truss (1997), who reported a reluctance of LMs to accept their HRM responsibility as one of the  
101 challenges to devolve HRM role to LMs. Nehles et al. (2006) reported that a key factor that contributed to the exception of  
102 desire as a challenge was the LMs' assumption that they were closer to employees rather than others in the organization  
103 which permitted them to better perform the HRM role.

### 104 2.2 Role theory

105  
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107 Role theory is useful for understanding the causes and outcomes of employee behaviour, specifically in relation to the  
108 role they play (Lopopolo, 2002). Role theory is applicable for understanding the development of a role in the organization  
109 because it covers the structure of developing the role and its association with employment relationship in the  
110 organization. In role theory, a role is developed through the expectations of the organizational members on the



111 requirement to perform the role. It also contributes to providing an understanding of work roles' allocation in the  
112 organization (Biddle, 1986; Broderick, 1999; Lopopolo, 2002). This is achieved through the assumption that each role is  
113 designed for its own purposes in achieving the organizational goals.

114 Although role theory is not isolated from criticisms in its application, researchers believe that the essence of the  
115 role theory is useful to minimize human problems (Biddle, 1986). This can be achieved as role theory considers the  
116 impact of "a role" to the role holder as an individual or a representative of the social group such as an organizational  
117 member. Human problems can be solved as role theory works to explore the interactions between the role holder and  
118 other organizational members who evaluate the role to ensure that the role is enacted in line with the organizational  
119 goals.

120 In understanding the early development of role theory, most researchers referred to the work of Katz and Kahn  
121 (1966; 1978), as they provide the history and concepts applied in the role theory (Wickham & Parker, 2007). Some key  
122 elements of role theory are used in understanding the development of a role and particularly for this article, the  
123 challenges to perform the line managers' HRM role is related to the role compliance and role conflict.

124 Role compliance suggests that in each role, a set of behaviors are expected to be performed by the role holder and  
125 generally described through the job description. Jackson and Schuler (1992) argued role compliance was influenced by  
126 HR policies and the performance objectives set for each position in the organization. Thus, if the employee's position  
127 required them to perform multiple roles at the same time, then these employees may have to deal with different work  
128 requirement for each role. In fact, performing multiple roles was common in the modern organization because  
129 organizations wanted to maximize the contribution of individual employee to achieve organizational goals (Lynch, 2007).  
130 However, when the expectations of one role conflict with the expectations of another role, then the employees may  
131 experience role conflict (Wickham & Parker, 2007).

132 A review by Parker and Wickham (2005) found that factors that contributed to role conflict were perceived  
133 differently by researchers. These factors include participation in decision making, communication networks, internal  
134 control mechanisms, personality types, individual needs and individual approaches to conflict (Parker & Wickham, 2005,  
135 p. 4 & 5). The more employees were involved in the decision making process, their ability to deal with conflict was better  
136 because they had opportunity to channel any dissatisfaction or problem in performing their role. Employees who had a  
137 good relationship with other organizational members especially those who influenced their role development tended to  
138 have more opportunity to discuss the expectations of their role and get perspectives on the requirements to perform their  
139 role. Other factors were related to personal factors that influenced individual perceptions on what was happening around  
140 them. In regards to the situation at the workplace, one author stated that three conditions contributed to the role conflict at  
141 the workplace (Noor, 2004). First, insufficient times to perform all roles where one role took time needed to perform other  
142 roles. Second, the pressure of performing one role caused difficulties for employees to meet the required behaviors of  
143 other roles. Third, different requirements of each role make it difficult for employees to fulfill all requirements.

144 Undertaking the HRM role exposed LMs to role conflict as they were required to perform additional HRM tasks  
145 while maintaining their operational duties. A study of 760 LMs from Hilton hotels throughout the UK found heavy  
146 workloads and short time pressures were two key challenges for LMs undertaking their HRM role (Maxwell & Watson,  
147 2006). Another study undertaken by Nehles et al. (2006) indicated four factors contributed to role conflict among LMs:  
148 capacity, competencies, support and policies and procedures. Results of the four case companies that participated in the  
149 Nehles et al. (2006) study, recorded almost the same result in terms of LMs perceptions about factors that contributed to  
150 the role conflict. However, they suggested company characteristics, task complexities and educational level to be  
151 considered in explaining differences of LMs' perceptions about challenges that influenced their HRM role implementation  
152 success. While both studies gathered LMs perceptions through a questionnaire, their findings were limited as to the  
153 causes of the perceived challenges. Importantly, the existence of challenges in performing the LMs' HRM role suggested  
154 organizations would bear the consequences if the role holder failed to perform the behaviors as expected by members in  
155 the organization. This explains the need to achieve the role consensus between the role evaluators and role holder (Katz  
156 & Kahn, 1978).

### 157 158 **3. Research Methodology**

#### 159 160 **3.1 Participants**

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162 A qualitative research methodology was employed by this research as it serves to achieve a deeper understanding of the  
163 research issue by exploring attitudes, behavior and experiences in a specific context (Dawson, 2006). In addition,  
164 qualitative research is appropriate for this study as it focuses on words rather than numbers (Maxwell, 2005). Exploration

165 towards an in-depth understanding of the research issue is made by using the meanings expressed by participants  
166 involved in the research, to understand why certain events are happening or not happening in the context (Denzin &  
167 Lincoln, 2005). A case study approach through semi-structured interviews was employed because they enabled  
168 participants to give as much information as possible and the researcher to investigate the meaning of responses  
169 thoroughly. Document analysis was used to obtain general information about the airport background and to compare  
170 findings from the interviews. This process involved websites and some documentation such as job descriptions and  
171 organisational chart. Therefore, content analysis was appropriate for describing the content of written documents (the  
172 company documents) and spoken material gathered from interviews.

173 Three out of 39 Malaysian airports participated in the study. Airport structures differed on the basis of airport  
174 category: international or domestic. At the international airport, there were seven functional units, four main units  
175 (operation, engineering, security, and fire and rescue services) and three support units (HR, finance and commercial).  
176 Meanwhile, the domestic airports had five functional units made up of four main units and one support unit. LMs in this  
177 study were the first line supervisors at the lower hierarchical level in the organizational structure to whom individual  
178 employees reported directly, and who had responsibility to the unit head for employees under their supervision. A total of  
179 23 interviews were conducted with LMs. The composition of respondents is provided in Table 1.

180  
181 **Table 1** Participants' demographic backgrounds  
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No.	Factors	Airport X	Airport Y	Airport Z	Total
1.	Gender				
	Male	12	6	3	21
	Female	1	0	1	2
2.	Age				
	30-39	1	0	0	1
	40-49	2	0	0	2
	>50	10	6	4	20
3.	Ethnicity				
	Malay	11	6	4	21
	Chinese	2	0	0	2
4.	Religion				
	Islam	11	6	4	21
	Buddhism	2	0	0	2
5.	Education				
	Secondary school	11	6	4	21
	Certificate/Diploma	2	0	0	2
	Bachelor	0	0	0	0
6.	Tenure				
	<10	0	0	0	0
	10-19	2	0	0	2
	20-29	1	2	0	3
	30-39	10	4	4	18
7.	Unit				
	Unit 1	4	2	1	7
	Unit 2	4	2	2	8
	Unit 3	5	2	1	8
	Unit 4	-	-	-	-

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### 184 3.2 Instrument

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186 LMs' challenges are measured on five factors: desire, capability, competencies, support and HRM policy and procedures.  
187 In addition, participants were given the opportunity to provide responses based on factors that influenced their HRM role  
188 implementation.

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### 190 3.3 Initial document analysis of the airports

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192 The case studies were conducted in the Malaysian airport sector, which comprises 39 commercial airports operated by  
193 one parent company. The parent company was originally established as a government agency and was re-established as  
194 a private enterprise in 1992. These changes meant that the company was no longer the regulatory body responsible for  
195 the airports and aviation industry. Instead, its new focus was on three main activities at each airport: operations,  
196 management and maintenance. Airports in Malaysia cater to airlines servicing 16 domestic and 113 international  
197 destinations. The sector employs approximately 7,000 employees across the 39 airports. The airports consist of five  
198 international terminals, 16 domestic terminals and 18 short take-off and landing (STOL) ports.

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A multiple case study approach was conducted using three airports selected on the basis of airport category and

size. The three airports reflected a range of sizes and functions, and they were differentiated by their connectivity to a number of destinations offered to customers and their size of operation. The case studies comprised one international airport and two domestic airports. The international airport was larger in both size and operation, having a higher capacity to accept large aircrafts and offer connectivity to other countries. The domestic airports were smaller in size and provided services for passengers within the country. They had capacity to receive smaller sized aircraft unlike the international airports.

The core activities of the Malaysian airport sector include management, operation, maintenance and development. The main focus of activities was on customer satisfaction, which included operational efficiency, passenger safety and security, cargo and aircraft operations. The structure of each airport was designed to match its operation. Airport structures differed according to airport category and number of employees, focusing on operational effectiveness and profitability. Thus, the international airport was bigger in size and operation, and have more employees compared to the two domestic airports studied.

Airport revenue came from two sources: aeronautical and non-aeronautical. Aeronautical revenue was gained from activities such as landing fees, aerobridge charges, check in-counter charges, parking fees and passenger service charges. Non-aeronautical revenue was generated from commercial activities offered to customers, including the operation of duty free shops, hotels, parking facilities and commercial space leasing. Aeronautical revenue was the major revenue stream and may influence non-aeronautical revenue. This indicated that the greater the number of aircraft that lands in an airport, then the higher the revenue. In turn, this attracted more businesses and customers to commercial activities. Thus, emphasis was given by the parent company to aeronautical revenue to ensure the quality of services provided to airlines, passengers and contractors, to generate more demand and activity at each airport.

#### 4. Findings

Although LMs mentioned no challenges to perform their HRM role, most of them highlighted two factors to be improved for better performance: support and HRM policy and procedures. Work environment was identified by LMs at Airports X and Y as another factor that influenced their HRM role implementation. It is interesting to note that more issues have been recorded from respondents at Airport X as compared to the other airports. Themes emerged from the interview with LMs at Airport X is shown in Table 2.

Table 2: Comments on challenges from LMs at Airport X

Factors	Comments from line managers
Desire	<ul style="list-style-type: none"><li>• Never view difficulties in performing the HRM role as a burden</li><li>• Take the HRM role as part of the responsibility for the company</li></ul>
Capability	<ul style="list-style-type: none"><li>• Able to manage time to perform all tasks</li><li>• HRM tasks are manageable although situations keep changing</li><li>• Rely greatly on experience</li></ul>
Competencies	<ul style="list-style-type: none"><li>• Rely on experience and observation from previous leader</li><li>• Continuously updated the HRM knowledge to perform better</li><li>• Take initiative to learn and further study to increase knowledge and skills</li></ul>
Support	<ul style="list-style-type: none"><li>• Good support from the head of unit and HR unit</li><li>• Good support from colleagues</li><li>• Get assistance from employees to manage the operational tasks, but never pass the HRM tasks to employees</li><li>• Sometimes the feedback from the HR unit is slow</li><li>• The problem to manage HRM tasks comes from employees themselves</li><li>• The feedback from the HR unit is inconsistent; certain people may get faster feedback compared to others</li><li>• Some of the top management expectations were delivered indirectly or unclear; it is based on LMs own understanding and situations</li><li>• Some of the approaches used to communicate with senior LMs are not suitable</li></ul>

Policy and procedures

- The policies are all good, the only thing is on the implementation part: slow, no budget
- Training policy: the rotation system takes time to get employees to the needed training, insufficient training for HRM
- Lack of infrastructure; some of the policies should not be implemented because there is not enough infrastructure at the site
- Lack of observation; some work designs are not observed, the responsible persons to manage certain areas are not doing their job
- Favoritism; the implementation of the policies are not consistent
- Inconsistent practices; the implementation of the policies differ based on individual understanding
- Communication breakdown; message is not received by LMs when the shift changes
- Transparency in the performance evaluation; clear and consistent processes of assessing employees' performance
- Budget; some of the HR initiatives were postponed due to financial constraints, affected employees' motivation

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The overall explanations of all challenges are described below, including a new factor that has been found to influence LMs in their HRM role implementation.

#### 4.1 Desire

Similar results were reported among LMs between airports in response to the question about desire, as they regarded HRM tasks as part of their responsibility as a LM. This was expressed through their willingness to perform the HRM role and never viewing the role as a burden. For example, LM responded:

Whatever difficulty we face, I know it is my job. I'll give my best to perform my responsibility (LM 13, Unit 2)

More importantly, LMs were not reluctant to accept the HRM role as part of their responsibility because they had observed the same tasks being done by their former LMs. As LMs had assisted their former leaders to perform some HRM duties, they expressed no difficulty in accepting the same duties. Similarly, LMs at all airports expressed their willingness to accept any new task assigned by top management without objection.

#### 4.2 Capacity

LMs at all airports showed the same understanding that undertaking the HRM role did not reduce their responsibilities for the operational tasks. LMs understood they were responsible for two different tasks at one time: operational and HRM tasks. This is expressed through the following statements:

HRM is not a problem for me to handle. I can do it well. Even if I struggle with so many works to do, I know what should be my priority. (LM 10, Unit 2)

Although LMs at all airports expressed their ability to manage time to complete their tasks, the priorities of operational and HRM tasks differed. LMs at Airport X gave the same priority to operational and HRM tasks. Different results were reported among LMs at Airports Y and Z, because LMs from the small units of both airports stated their main priority was operational tasks.

#### 4.3 Competencies

There was a strong agreement among LMs that their knowledge and skills to perform the HRM role are gained through prior experience working in the airport. This was mentioned in relation to their observation and participation in HRM duties prior to being appointed as a LM. Despite a lack of formal training in HRM, LMs suggested that their prior experience had given them enough knowledge to manage employees in the unit.

#### 4.4 Support

Differences were found between airports in terms of support received by LMs. LMs in Airport X had more to say about support than those at Airports Y and Z. The kind of support needed by LMs at Airport X was in terms of feedback and

269 employee attitudes. Slow, inconsistent feedback and difficulty in understanding expectations were identified by LMs at  
270 Airport X as weaknesses of management support, especially from HR specialists. LMs at Airport Z had less issues with  
271 support compared to the other airports.

#### 272 4.5 HRM policy and procedures

273 Findings of the study indicate that the HRM policy and procedures implemented in the airport were unclear in assisting  
274 LMs to perform their HRM role. This was mainly attributed to inconsistent implementation and feedback regarding HRM  
275 policy and procedures among top management. In this respect, LMs mentioned that some of their supervisors and top  
276 management are strictly followed the procedures while others are lenient in practicing the policy. Therefore, LMs  
277 approaches varied depending on their own understanding of the policy, but mainly based on their observation of the  
278 approaches used by their supervisors or former LMs. LMs mentioned:

281 Some LMs don't even care about the guidelines; instead they just give marks for employees' performance  
282 evaluation based on what they think is right. (LM 12, Unit 2)

283 However, the perceptions of HRM policy and procedures differed between airports. LMs at Airport X were most  
284 concerned about the weaknesses in implementation of HRM policy and procedures, and they perceived that this hindered  
285 them in performing their HRM role effectively. In contrast to Airport X, LMs at the other airports had problems with limited  
286 authority in managing the HRM related matters. This is encapsulated through this statement:

287 At this moment, our level was almost the same with our subordinates...that's why it was difficult for us to manage  
288 them...I think power is important in performing the HRM role, not to show off but to gain respect from employees. (LM 18,  
289 Unit 2)

290 While their authority was limited, LMs believed that employees showed more respect to the unit heads compared  
291 to them. According to LMs in Airports Y and Z, this factor had contributed to a situation where the influence of the unit  
292 heads outweighed LMs' influence in managing employee issues.

#### 293 4.6 Work environment

294 Work environment was only mentioned by LMs at Airports X and Y. However, a different emphasis was given by LMs at  
295 each airport. LMs at Airport X related the problem of work environment to insufficient infrastructure and equipment for  
296 new policy implementation. LMs could be seen to have failed in implementing the new system because they could not  
297 really implement it. One LM stated:

300 I remember at one time the HR unit wants to introduce a new way of managing employee leave by using different  
301 color of forms for different type of leave. But we were not provided with the sufficient color paper at the unit. At the end of  
302 the day, all leave records jumbled and we have to use the previous system. It's not that we resist changes, but the  
303 necessary equipment needs to be in place before the new policy can be implemented. (LM 10, Unit 2)

304 LMs at Airport X mentioned that senior management had to ensure that necessary infrastructure and equipment  
305 was in place for effective policy implementation. The pressure would be on LMs, as they were the intermediaries between  
306 top-level management and employees.

307 In contrast, LMs at Airport Y highlighted the lack of standardized equipment used between airports in relation to  
308 work processes and time spent in completing their duties. LMs mentioned the infrastructure used in the domestic airport  
309 differed from that at the international airport and was inferior. LMs said that using old equipment slowed down operations,  
310 reducing time spent on employee issues:

311 At the international airport, they have modern equipment. But here (domestic airport), we still use the old  
312 equipment and that's why our job was slower. (LM 19, Unit 2)

313 LMs believed that if they used the same quality equipment as provided at the international, this would increase the  
314 effectiveness of the airport's operation. This could speed up the completion of some operational tasks, and LMs could  
315 spend more time managing employee issues. LMs expressed the view that a good working environment was important  
316 for employees in the domestic airport and would improve their HRM role performance.

### 317 5. Discussion

320 Nehles et al. (2006) found a positive response among LMs towards accepting the HRM role, although this contradicts  
321 earlier studies, which reported that LMs were reluctant to accept the HRM role as part of their job (Cunningham & Hyman,  
322 1995; Harris, et al., 2002; Hope-Hailey, et al., 2005; Whittaker & Marchington, 2003). However, the devolution of the HRM

role to LMs may be accepted over time and the results of this study add to this perception. More importantly, this is evidence of the devolution of the HRM role to LMs in Malaysian organizations and indicates a transformation from personnel management to HRM in Malaysia. Others have also reported that organizations in Malaysia are beginning to adopt HRM practices (Hashim, 2010; Yusoff et. al, 2010). With their long tenure this suggested that the devolution of HRM to LMs was not new in the Malaysian airport sector.

Findings of the current study also add a new perspective for understanding LMs' attitudes towards the HRM role. Although some researchers have suggested that LMs would give greater consideration to the HRM role through personal or institutional incentives (Harris et al., 2002; Whittaker & Marchington, 2003), this study did not find these factors necessarily persuaded LMs to accept the HRM role. Similar findings by Nehles et al. (2006) also suggested that institutional and personal incentives were not the main factors influencing LMs to understand their HRM role. For example, LMs in these airports did not agree that their understandings of HRM responsibilities were based on job descriptions or performance evaluation indicators. Instead, there was strong agreement among LMs that they were willing to accept the HRM role because they had observed the HRM role of their former LMs.

LMs between airports expressed different kind of support needed to perform their HRM role. LMs at Airport X perceived their involvement in HRM activities to be greater than LMs at Airports Y and Z. This might explain the reason why LMs at Airport X demanded more support to perform their HRM role. The results corroborate the findings of much previous work regarding the importance of support for LMs for their HRM role (Cunningham & Hyman, 1995; Floyd & Lane, 2000; Renwick, 2003; Watson, et al., 2007). Slow and inconsistent feedback from HR specialists was not surprising, as prior studies have reported frustration among LMs not receiving sufficient and consistent support from key members in the organization, including HR specialists (Cunningham & Hyman, 1995; Whittaker & Marchington, 2003).

LMs believed the execution of HRM policy and procedures failed to assist them in performing their HRM role. This related specifically to the difficulty of the organization in creating an alignment between HRM strategies and the view of the organizational members about HRM policy and procedures developed in the organization (Gratton, Hope-Hailey, Stiles & Truss, 1999, p. 27). The execution of HRM policy was based on individual understandings and this resulted in inconsistent feedback given to LMs by their superiors or the HR unit, which caused variation in the implementation of the HRM role between LMs.

Although Nehles et al. (2006) used the same factors to explore LMs' perspectives in performing the HRM role, the use of quantitative data limited their findings for detailed explanation of 'how' LMs enacted their HRM role and 'why' they behaved in a particular way. This study adds to the scant evidence of LMs' experience in enacting their HRM role by providing more prescriptive understanding on LMs' actions, based on qualitative data.

## 6. Concluding Remarks

There is a clear need for improvement in the implementation of HRM policy and procedures to increase the effectiveness of policies in delivering messages about the LMs' role expectations. A well-designed HRM policy may be useful if it is implemented well by superiors as a reference for LMs to perform their HRM role. While the study reported that the airport specific differences contributed to differences in HRM role enactment, this should be considered in the HRM policy development to ensure LMs' contributions can be used to achieve airport goals. Some existing HRM policy and procedures implemented by the parent company were ineffective in aligning LMs' contributions and the company's strategic priorities because they failed to consider these differences. This failure should be highlighted because the misalignment between LMs' understanding and company expectations reflects the ineffectiveness of current HRM policies to convey the right message to employees.

To reduce the misalignment between individual understandings and company expectations, a clear work structure and delegation process should be developed, considering the structural differentiation between airports. Structural differentiation should be highlighted in formulating the work structure, so that LMs in both airport categories have a clear understanding of the specific nature and depth of tasks they are responsible for. Specification and depth of tasks may ensure that LMs are clear about the requirements of their role in the airport and guide their performance to contribute to the company's goals. In particular, the structural differences should reflect the development of employee job descriptions, including LMs. The parent company may consider the strategic priorities they want within airports and differentiate the requirements to perform jobs based on different strategic priorities. This means that the development of job descriptions may include the main priority of the airport operation, so that employees have a clear view of what is expected from them. For instance, as the aeronautical income of the domestic airports may be difficult to increase in the short term, the parent company may encourage the development of initiatives to increase non-aeronautical income, as this was more possible to generate. Indirectly, the understanding of different strategic priorities between airports may improve employees'

motivation, especially those in the domestic airport regarding their contribution to company revenue. Further, this could potentially increase LMs' satisfaction with HRM policy and practices, as they will not make comparisons between what has and has not been done at their airport and another.

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## Significance of Local Taxes in Income Structure of Slovak Municipalities

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### Abstract

Paper focuses on public revenues of municipalities and analyses the importance and significance of local taxes for the Slovak municipalities. Eight municipalities representing the capital cities of higher territorial units in Slovakia were selected. The aim of the paper is to estimate relationship between two tax decentralization measures (local tax income / current revenues and local tax income / total revenues) on one side and number of the citizens, city unemployment and average salary on the other one. We aim to determine and examine the importance and significance of local taxes for the municipalities. Hypothesis: The share of local taxes on total incomes is above 20%. The overall analysis and conclusions were provided for the period 2010-2013. We used three different methods to reach objectives: synthesis of information to give literature background, analytical methods with econometric models to calculate data, and comparison of obtained results. Recommendations of future actions for municipalities are also included.

**Keywords:** local taxes, municipalities, incomes, econometric models.

### 1. Introduction

Local taxes are one of the taxation revenues collected by municipalities in Slovakia. They represent special group of citizen taxation. They are determined by municipalities and they flow directly to their budgets. In Slovakia, we distinguish eight voluntarily local taxes and one compulsory local fee. They all are defined in an Act 582/2004 on local taxes and local fee for communal waste. Municipalities have a free choice depending on their requirements, size, number, and amount of provided public goods and services to implement these local taxes. Local fee for communal waste is the only compulsory local tax set by municipality. Municipalities have also right to administer these taxes, to set tax rates and subject of taxation, or to decide on exemptions from payment. Usually, bigger municipalities adopt all local taxes.

Recently, after decentralisation of competences in 2001 and fiscal decentralisation in 2004 in Slovakia, the significance and importance of local taxes has grown. Municipalities have become more independent from state government and subjective decisions of state representatives. Total local taxes oscillate between 20-25% of all municipality incomes. Local taxes belong together with shared Income tax from natural persons to own incomes.

The aim of the paper is to estimate relationship between two tax decentralization measures (local tax income / current revenues and local tax income / total revenues) on one side and number of the citizens, city unemployment and average salary on the other one. We aim to analyse and determine the importance and significance of local taxes for the municipalities. We stated hypothesis: The share of local taxes on total incomes is above 20%. For our purpose, we selected eight municipalities representing the capital cities of higher territorial units in Slovakia. We picked the period of 2010-2013. The presented analysis is based on some three variants of the panel data models – pooling model (PM), fixed effects model (FEM) and random effects model (REM). We analysed the development of local taxes within focused period, compared obtained data with both current and total incomes, and finally we confronted obtained results with stated hypothesis and gave further recommendations to analysed municipalities.

Paper is divided into five chapters. Chapter 2 provides information on objectives and research methods used to prove/decline stated hypothesis. In general, we provided synthesis of relevant expert and scientific literature sources from domestic and foreign literature. In Chapter 4, we applied the econometric models, analytical methods and comparison of obtained data. Literature overview and present state of problematic are part of Chapter 3. We identified up-to-date



57 definitions, characteristics and opinions on local taxes and their position and role in income structure of the Slovak  
58 municipalities. The analyses and discussions of local taxes development in selected municipalities and for selected  
59 period are part of Chapter 4. Final conclusions and recommendations for municipalities are involved in Chapter 5.  
60

## 61 2. Objectives and Research Methodology

62  
63 The aim of the paper is to estimate relationship between two tax decentralization measures (local tax income / current  
64 revenues and local tax income / total revenues) on one side and number of the citizens, city unemployment and average  
65 salary on the other one. We stated hypothesis: The share of local taxes on total incomes is above 20%. In order to fulfil  
66 given objective we used the following methods:

- 67 1. Synthesis of information and available data to offer literature overview of focused topic and present state of  
68 problematic. We collected information from scientific and expert domestic and foreign literature sources, the  
69 Slovak Statistic Office, from budgets and internal financial statements of selected municipalities, web portal of  
70 the Slovak municipalities, as well as from the Internet sources.
- 71 2. Analytical methods were applied in Chapter 4. We analysed data from budget incomes in order to calculate  
72 the development of local taxes in 2010-2013. We chose eight Slovak municipalities representing the capital  
73 cities of higher territorial units. Data were collected from final accounting closing reports and thus they express  
74 real obtained financial sources.
- 75 3. We calculated local taxes and summed the incomes from all kinds of local taxes collected by municipalities.

76 The share of local taxes on current revenues was calculated:

$$\frac{\text{income from local taxes}}{\text{total current revenues}} \quad (1)$$

77  
78 The aim is to determine the significance of local taxes for current revenues and current spending.

79 The share of local taxes on total revenues was calculated:

$$\frac{\text{income from local taxes}}{\text{total revenues}} \quad (2)$$

80  
81 The aim is to determine the significance of local taxes for the municipality and to confirm/decline stated hypothesis.

- 82 4. The presented analysis is based on some three variants of the panel data models – pooling model (PM), fixed  
83 effects model (FEM) and random effects model (REM). The general linear relationship is defined as follows:

$$y_{it} = \alpha + \beta^T x_{it} + \mu_i + \lambda_t + \epsilon_{it} \quad (3)$$

84 where  $y_{it}$  is a discussed decentralization measure as dependent variable,  $x_{it}$  is a vector of explanatory variables  
85 (number of citizens, city unemployment and average salary),  $\mu_i$  and  $\lambda_t$  represent individual error components and  $\epsilon_{it}$  is  
86 idiosyncratic error independent of regressors  $x_{it}$ . Indices  $i$  and  $t$  specify city and time, respectively. If individual error  
87 components are statistically insignificant, PM provides unbiased and efficient estimation. On the other side, in case the  
88 individual error components are correlated with any of the explanatory variables, then PM and REM provide biased  
89 estimations. In this case, the FEM specification is needed. REM is most appropriate, if there are statistically significant  
90 individual components but uncorrelated with any of the explanatory variables. In order to distinguish the above given  
91 regimes, we applied the Poolability F test of the statistical significance of the individual components. To decide between  
92 the REM and FEM, we use the Hausman (1978) testing methodology based on consistency of the fixed and the random  
93 effects models.  
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95 Analysis was done in the R (R Development Core Team, 2014) using package plm (Croissant et al., 2013).

- 96 5. Comparison of obtained figures, data, and shares of local taxes on both current and total municipalities'  
97 incomes. Analysis of correlation of local taxes with current and total incomes. Provided comparison and  
98 analysis of correlation will enable us to prove or decline stated hypothesis.  
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## 100 3. Literature Overview

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102 Act 582/2004 on local taxes and local fee for communal waste defines following eight voluntarily local taxes and one  
103 compulsory fee:

- 104 • property tax,
- 105 • tax for dog ownership,
- 106 • tax for using of public space,
- 107 • tax from accommodation,

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- tax from vending machines,
  - tax from selling automats,
  - tax for entry and stay with motor vehicle in historic part of the city,
  - tax for nuclear facility,
  - fee from communal waste as compulsory local tax.

113 The virtues of the local taxes that have given rise to their importance have been long recognised by public finance  
114 scholars. As Brunori, Green, Bell, Choi, and Yuan (2006) point out, the local taxes have been praised by the intellectual  
115 leaders in the public finance field as the ideal source of revenue for local governments. And there is virtual unanimity  
116 amongst these and other scholars as to the virtues of the taxes. That leading scholars have touted the virtues of the local  
117 taxes have led to widespread endorsement of the taxes by public finance professionals. As public finance experts  
118 recognise, the local taxes revenue has consistently grown over the years. As importantly, from a political perspective, the  
119 local taxes revenue grows without the risks associated with raising rates.

120 Slemrod (1995) set several reasons for the success of these taxes:

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1. The property tax remains an important source of revenue for local governments in large part because it has always played that role. The historical dominance of the tax was attributable to the fact that there were no alternatives to financing local government. Just fiscal decentralisation provided in 2004 in Slovakia, brought further opportunities for municipalities to collect own sources and thus to increase own independence from state government.
  2. The property tax has long provided a stable and reliable source of revenue for local governments. Local governments rely on the tax because, unlike all other local option taxes, the base of the tax cannot, for all intents and purposes, be moved. Property tax rates are rarely raised to meet the public service demands of the citizens. Indeed, property tax revenue often grows faster than the public service demands of local citizens. According to Sokolow (1998), the property tax is the principle source of fiscal flexibility for local governments.
  3. Sheffrin (1999) points out that the administration and compliance with the property tax is relatively easy and thus inexpensive. For government, the tax base is easily identifiable. And while values change, the number of acres, parcels, and buildings are easily ascertainable by most local government administrators. Another virtue from the government's perspective is that taxpayers cannot easily hide or move property. The property tax is thus difficult to evade. Youngman (1999) argues that industrial property taxation is also politically attractive and thus likely to continue because officials and the public view the business taxes as "victimless" because they fall on corporations or are exported.
  4. The property tax has endured because it is conceptually attractive. Property tax revenue is raised locally to support local public services. That connection arises because the services provided by local governments benefit the owners and renters of the property within the jurisdiction. Fischel (2001) agrees that the property, the taxes, and the services are all linked. That is why local governments pursue policies that protect and increase the value of property located in their jurisdictions, particularly the value of residential property.

143 We agree with the opinion of Sotolář (2004) that reasons why state transfers its significant competence in the area  
144 of local taxes on municipalities relies on their rationality, effectiveness, suitability, and logic. As Neubauerová (2009)  
145 states that although there are some countries transferring the revenues from income or consumption taxes to local  
146 budgets, in general the local and property taxes remain the most frequent ones administered by municipalities. She  
147 emphasises their positive characteristics: comparing to income taxes they influence the labour effort the least.

148 Šíroký (2008) notices the stable and easily defined and identifiable revenue of local taxes. He identifies the  
149 following principles of local taxes: (1) local governments must have a competence and authority to implement or to  
150 postpone the local taxes; (2) local governments must be obliged to decide on tax rate, tax base, subject of taxation, tax  
151 payers, and on tax exemptions; (3) local taxes must be originally administered and directed to municipal budgets without  
152 any opportunity of national government to withdraw any revenues; (4) local taxes must result from local sources such as  
153 local property situated within the municipality jurisdiction.

154 Taxes with stable tax base should be the revenues of local budgets. At once, these taxes should be difficult to  
155 avoid, tax evasions should be minimised, and the whole taxation revenue should remain in municipal budgets.

156 Frees, E. W. (2004) focused on models and data that arise from repeated measurements taken from a cross-  
157 section of subjects which is referred as panel data. Croissant, Y.; Millo, G. (2008) described estimation of linear panel  
158 model in R.

159 Maličká et al. (2012) used panel data analysis to measure the influence of the fiscal decentralization on public debt  
160 in the member states of the European Union. Geys, Revelli (2009) investigated the economic and political determinants

of the local tax mix using panel data.

#### 4. Analysis of Local Taxes in Selected Municipalities

The Chapter 4 deals with the analysis of significance and importance of local taxes for Slovak municipalities. For our purposes, we chose municipalities of Bratislava, Trnava, Trenčín, Nitra, Žilina, Banská Bystrica, Prešov, and Košice. We obtained required data from the internal accounting statements of municipalities as well as from their budgets. We calculated indicators in the way described in Chapter 2 – Objectives and Research methodology.

##### 4.1 Description of municipalities

The Chapter 4.1 gives a brief description of selected municipalities. We provided readers with basic demographical and economic indicators. As seen from Table 1, Bratislava as the capital city of Slovakia is the most economically developed municipality. The second biggest one is Košice situated in the Eastern Slovakia. The remaining capital cities of higher territorial units are approximately the same concerning the economic fundamentals (with Prešov exemption) and number of inhabitants (with exemption of Trenčín).

**Table 1:** Characteristics of selected municipalities

Municipality	Inhabitants (thousand)	Acreage (km <sup>2</sup> )	Average unemployment (%)	Average salary (€)
Bratislava	414	367,58	5,20	1 220
Trnava	67	71,54	7,22	865
Trenčín	57	82	8,65	857
Nitra	81	100,50	9,84	839
Žilina	85	80,03	10,07	863
Banská Bystrica	79	103,37	9,86	818
Prešov	92	70,4	18,15	756
Košice	241	244	11,25	880

**Source:** Statistic office and internal municipality financial statements.

##### 4.2 Analysis of local taxes in 2010 – 2013 in selected municipalities

In Chapter 4.2 we analyse the development of local taxes in selected Slovak municipalities and their share on both current and total incomes.

Table 2 summarises obtained financial sources from all local taxes the municipalities adopted. Data were collected from municipalities' final closing reports.

**Table 2:** Development of local taxes in selected municipalities (in €)

Year Municipality	2010	2011	2012	2013	Index 2013/2010 (%)
Bratislava	52 258 516	52 587 200	56 416 907	56 519 197	108.15
Trnava	8 831 951	9 109 275	10 329 961	10 740 924	121.61
Trenčín	6 469 479	6 620 606	7 601 768	7 775 730	120.19
Nitra	9 965 011	10 594 269	11 328 585	11 288 277	113.28
Žilina	8 697 816	8 845 117	11 657 256	12 804 140	147.21
Banská Bystrica	7 997 954	8 278 508	9 844 778	10 603 518	132.58
Prešov	6 908 733	6 947 742	8 862 709	8 738 894	126.49
Košice	30 286 583	31 846 471	31 230 708	36 686 786	121.13
<b>Average Index 123.83</b>					

**Source:** Own calculation on a basis of municipality budgets and closing reports.

There are two most important local taxes for Slovak municipalities: property tax and fee for communal waste. They contribute to overall incomes from local taxes by more than 90% (property tax is the highest financial source for

municipalities). As seen from Table 5, in almost all municipalities the income from local taxes has constantly grown within the analysed period. The few exemptions can be found in municipality of Košice in 2012 (slight decrease), and in Nitra and Prešov (2013), respectively. These increases in local tax incomes were caused mainly by increased tax rates from property taxes and tax from communal waste, slightly from increased population, as well as from improved economic fundamentals. Although we also noticed increased tax rates in other taxes, they did not bring any significant income to municipalities. Despite of constant increase in property tax rates, there is still free space for their potential growth and for strengthening of their share within the income structure. And that is what municipalities have successfully done: Index 2013/2010 in final column of Table 2 expresses the growth rate and significance of income from local taxes for them. The highest growths were noticed in Žilina, Banská Bystrica and Prešov. City of Košice also increased local tax rates significantly in 2013 in order to fulfil gap in incomes. Obtained data point out to strengthen significance of local taxes for municipality representatives.

These data are expressed in absolute numbers, though. We see the rise of the importance of local taxes for municipalities as they contribute to widen scale of provided public services. The higher income from local taxes municipalities receive, the bigger volume of public services they offer. But what these figures do not say to us? The purpose of the paper was not to show sole development of local taxes. The aim is to show how important they are for municipalities in order to become independent from state decisions and to decrease own indebtedness. For these purposes, we also calculated and analysed the share of local taxes on both current and total revenues.

**Table 3:** Share of local taxes on current revenues in selected municipalities (in %)

Year Municipality	2010	2011	2012	2013	Average share
Bratislava	28.62	26.51	39.11	26.44	30.17
Trnava	24.88	24.54	26.32	26.23	25.49
Trenčín	24.18	23.22	25.34	24.77	24.76
Nitra	25.24	25.19	25.26	24.80	25.27
Žilina	17.77	19.03	23.84	25.68	21.58
Banská Bystrica	21.34	20.84	23.16	24.16	22.38
Prešov	14.13	14.47	17.43	16.65	15.67
Košice	27.11	26.67	26.29	28.53	27.15
<b>Total Average Share</b>	<b>24.06</b>				

**Source:** Own calculation on a basis of municipality budgets and closing reports.

The second step was to analyse the share of local taxes on current revenues. Current revenues consist of both taxation and non-taxation revenues. Slovak municipalities receive two kinds of taxation revenues: shared Income tax from natural persons (comprising 60-65% of current revenues) and local taxes. Non-taxation revenues are represented by items such as administrative fees, property rental income, received interests, fines, and many others.

Table 3 shows that local taxes have stable position within the current revenues and are important income source for municipalities. According to absolute numbers in Table 2, local taxes intent to grow every year and thus indicate the same behaviour and attitude of municipality representatives towards significance of local taxes. After calculating the share of local taxes on current revenues we found more differences. In cities of Bratislava, Trnava, Trenčín, Nitra, and Košice the share of local taxes on current revenues oscillates around or above 25% what confirms the need of local taxes and their importance for local budgets. On the other hand, the share of local taxes on current revenues in other three remaining cities (Žilina, Banská Bystrica and Prešov) is below 25% what means that municipalities are more dependent on shared income tax and state subsidies in financing of current spending. Representatives of these three municipalities realise the necessity of own revenues and therefore they increased property tax as well as communal waste rates in order to strengthen their budgets. We see that the share of local taxes also grew in 2012-2013 in other three cities.

Intention to increase both absolute number of local taxes and their share on current revenues is highly recommend.

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**Table 4:** Share of local taxes on total revenues in selected municipalities (in %)

Year Municipality	2010	2011	2012	2013	Average share
Bratislava	19.01	18.88	26.73	24.55	22.29
Trnava	19.37	21.81	20.08	23.08	21.09
Trenčín	18.72	16.32	18.64	21.56	18.81
Nitra	14.65	17.99	20.13	17.68	17.61
Žilina	13.95	11.86	23.29	24.76	18.47
Banská Bystrica	18.58	19.94	18.23	22.08	19.71
Prešov	12.53	12.46	15.84	16.07	14.23
Košice	20.52	20.68	21.98	19.08	20.57
<b>Total Average Share 19.10</b>					

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**Source:** Own calculation on a basis of municipality budgets and closing reports.

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Table 4 illustrates the share of local taxes on total municipality incomes. From given data we should be able to confirm or decline our hypothesis. It is not easy to make strict conclusion, though. Total incomes consist not only from current ones, but also from capital incomes and the one from financial operations such as received bank loans or transfers from municipality funds. Municipalities receive capital incomes or bank loans to build new infrastructure or to reconstruct and modernise the persisting one. And that is what happened in some analysed municipalities within 2010-2013. Bratislava increased its indebtedness by accepting bank loans in order to support huge reconstruction of the municipal ice-hockey stadium because of the IIHF World Championship held in Slovakia in 2011. So did Žilina. They received state loans to purchase land for the automobile factory in 2010-2011. The same occurred in Košice: they obtained EU and state grants over 70 mills. € for reconstructing and renovating the cultural facilities connected with the European Capital of Culture 2013 title. All these capital spending meant that the share of local taxes on total revenues dropped despite of their constant growth in absolute numbers and even despite the growth of their share on current revenues. It is caused by higher capital inflows to the budgets. On the other hand, municipalities with lower indebtedness and capital spending noticed significant growth of the share of local taxes on total revenues. That clearly indicates that they have become more important for municipalities. As the average share of local taxes on total revenues exceeds 20% we can point out to their importance.

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Our panel seemingly suffers by the significant correlations between the explanatory variables, which can cause the multi-collinearity problem inducing large standard errors of the estimated regression coefficients; however the coefficient of determination achieves relatively high values. Therefore, we introduce the estimated Pearson correlations given in Table 5. The highest correlation was indicated in the case of the relation between number of inhabitants and average salary. Average salary is highly correlated with unemployment, too. That is why we exclude the salary variable in further analysis.

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**Table 5:** Correlation Matrix

	<i>inhabitants</i>	<i>unemployment</i>	<i>salary</i>
<i>inhabitants</i>	1.000 ***	-0.399 **	0.830 ***
<i>unemployment</i>	-0.399 **	1.000 ***	-0.638 ***
<i>salary</i>	0.830 ***	-0.638 ***	1.000 ***

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Note: \*\*\*, \*\*, \* denote significance levels on 1, 5 and 10 percent respectively.

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Figure 1 shows evolution of the dependent variables across cities. There is noticeable rise over time in both variables.

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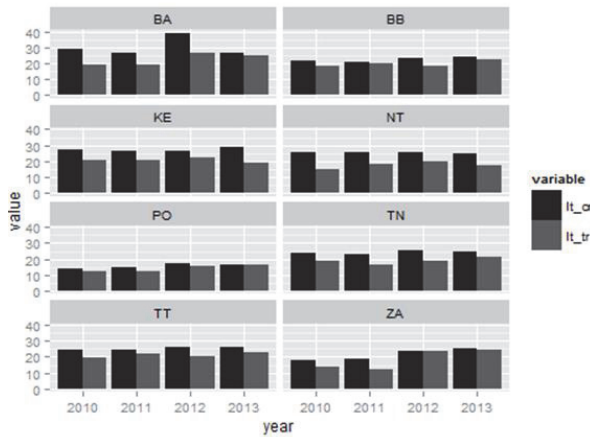


Figure 1: Evolution of dependent variables across cities

Note: It\_cr is share of local taxes on current revenues and It\_tr is share of local taxes on total revenues.

We estimated four linear panel models with both dependent variables share of local taxes on current revenues and share of local taxes on total revenues.

Table 6: Estimated coefficients for dependent variable share of local taxes on current revenues

	Fixed effects overparameterized model (1)	Pooling parsimonious Model (2)	Fixed effects parsimonious model (3)	Random effects parsimonious model (4)
	Estimate	Estimate	Estimate	Estimate
<i>intercept</i>	-	0.29645***	-	0.30715***
<i>No. inhabitants</i>	0.00003***	0.00001**	0.00001***	0.00001***
<i>unemployment</i>	-1.29490***	-0.79681***	-0.91170***	-0.89583***
<i>salary</i>	-0.02557*	-	-	-
R-Squared	0.77844	0.60932	0.74578	0.72553

Note: \*\*\*, \*\*, \* denote significance levels on 1, 5 and 10 percent respectively. Poolability test for individual cross-sectional effects using fixed effects model predicts that all coefficients, excluding the intercepts are equal for individual effects (F=0.2664) and time effects (F=0.3347). F test for individual effects suggests statistically insignificant difference among individuals (F=1.9895). On the other side, F test for time effects indicates statistically significant difference among individual time components (F=5.8396\*\*\*). Parsimonious FEM uses time dummies. Overparameterized FEM (1) contains full vector of independent variables including *salary*. Parsimonious models (2), (3), (4) exclude *salary* as a regressor. Hausman test (Chi-squared=0.4676) favors application of the parsimonious FEM (3).

Estimate of the regression coefficient of the number of inhabitants' variable is positive. It means that it has positive impact on share of local taxes on current revenues. Negative sign by the estimated regression coefficient of unemployment means that higher unemployment implies local tax income reduction.

The same analysis was realized for dependent variable share of local taxes on total revenues. Estimated regression coefficient for number of inhabitants is not statistically significant in that case. The best model (3), according to Hausman test, predicts negative impact of unemployment on share of local taxes on total revenues.

**Table 7:** Estimated coefficients for dependent variable share of local taxes on total revenues

	Fixed effects overparameterized model (1)	Pooling parsimonious Model (2)	Fixed effects parsimonious model (3)	Random effects parsimonious model (4)
	Estimate	Estimate	Estimate	Estimate
<i>intercept</i>	-	0.22180***	-	0.23337***
<i>inhabitants</i>	0.00000	0.00000	0.00000	0.00000
<i>unemployment</i>	0.48595*	-0.42161**	-0.54288***	-0.52895***
<i>salary</i>	0.00380	-	-	-
R-Squared	0.44628	0.27235	0.47351	0.44364

Note: \*\*\*, \*\*, \* denote significance levels on 1, 5 and 10 percent respectively. Poolability test for individual cross-sectional effects using fixed effects model predicts the same results for both effects, for individual effects (F=0.9203) and time effects (F=0.3355). F test for individual effects suggests statistically insignificant difference among individuals (F=1.8237). On the other side, F test for time effects indicates statistically significant difference among individual time components (F=7.2431\*\*\*) as well as in the previous analysis. Parsimonious FEM uses time dummies. Overparameterized FEM (1) contains full vector of independent variables including salary. Parsimonious models (2), (3), (4) exclude salary as a regressor. Hausman test (Chi-squared=0.4098) favors again application of the parsimonious FEM (3).

Realized model regressions showed that both variables number of inhabitants and unemployment have effect on share of local taxes on current revenues. On the other hand, there is not statistically significant effect of number of inhabitants on share of local taxes on total revenues, which is also less sensitive to unemployment as share of local taxes on current revenues. FEM is most appropriate model in both cases as reported by Hausman tests. These models have the highest R-Squared, too.

## 5. Discussions and Recommendations

It would be dubious from us to argument on importance of local taxes for municipalities without having known the reality. Without being informed what is hidden behind the numbers. On one hand, we see the growing importance of local taxes for analysed municipalities: the share of local taxes on total incomes has grown within 2010-2013 in all municipalities. Those municipalities not investing huge capital confirm our hypothesis. On the other hand, high capital inflows mixed together with bank loans caused decreased share of local taxes on total incomes despite of their constant growth expressed in absolute numbers. Thus, in municipalities with the share of local taxes on total incomes below 20% we must reject our hypothesis.

Local taxes represent one of the important revenues for municipalities. As we see from provided analysis, the municipalities increased tax rates in order to strengthen own revenues and the budget structure. Incomes from local taxes serve mostly to cover current expenses. As seen from Table 2, their constant growth indicates the importance of local taxes for municipalities and vital financial source to provide widen volume of public services. In almost all analysed municipalities, the share of local taxes on current revenues exceeds 25% what demonstrates their growing importance for municipalities.

We point out to strong positive correlation between the development of local taxes and current revenues. We noticed increased current revenues when local taxes increased as well. But we cannot say that they increased in the same way. Since current revenues consist mostly from shared Income tax from natural persons (up to 60-65%), they use to follow the shift upwards of the income tax transfer from state budget.

Finally, we confirm our hypothesis in municipalities which did not invest huge capital state or EU grants or bank loans to renew the infrastructure, to reconstruct or modernise sport, cultural, and social facilities. In those municipalities, the share of local taxes on total incomes was higher than 20%. We decline our hypothesis in municipalities investing huge capital expenditures and receiving bank loans. The share of local taxes on total incomes is below 20%. Despite the fact that share of local taxes on total incomes is below 20%, they still remain significant source of own revenues and their increase is recommended and expected. Municipality of Prešov is the only single one to have the share below 20% during the analysed period. According to development of both absolute local taxes and the share of local taxes on total incomes in 2010-2013, we anticipate their increase in future periods.

We found positive correlation between the development of local taxes and total incomes as total incomes increased when the amount of local taxes grew in municipalities not investing huge capital or receiving bank loans. We found negative correlation between the development of local taxes and total incomes when total incomes decreased in municipalities investing huge capital or receiving bank loans despite the growth of local taxes. Although there is a

350 correlation, these two categories did not shift in the same way.

351 Proposed municipalities' budgets for 2014-2015 confirm our recommendations for municipalities to keep on  
352 increasing the local tax rates. As mentioned in upper text, there is still free space to do so. The property taxes increased  
353 in Slovakia within 2004-2014 by 156% but they still remain below the OECD and V4 countries' average.

354 The easiest way to increase the share of local taxes on total incomes is to decrease a comparison base: especially  
355 capital inflows and bank loans. But this progress would be misleading. It is not possible and it even would go against the  
356 basic principles of municipalities functioning and existence. Their main task is not only to maintain but also to build new  
357 and modernise the old property. It is impossible without capital investments. Therefore, the municipalities must focus on  
358 income structure and ways to increase it without influencing importance of the expenditure side.

## 360 6. Conclusion

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362 In paper we focused on local taxes and their significance for Slovak municipalities. We analysed the development of local  
363 taxes in 2010-2013 in selected Slovak municipalities as well as their share on both current and total incomes. The aim of  
364 the paper was to prove the hypothesis: The share of local taxes on total incomes is above 20%. We found different  
365 results for the municipalities and it is not possible to make clear single conclusion and confirmation. Final statements  
366 depend on decision of municipality representatives to invest to capital extensive infrastructure. Discussed conclusions  
367 and recommendations for municipalities are part of Chapter 4. Stated goals were fulfilled.

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# Implications of Accounting Information System Implementation in SMEs: A Study on Retail Business in Vlore Region

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## Abstract

Due to the functions of AIS are realizing to the company, is evidenced that this system is playing a very important role in the management of operations and activity of the company, what makes AIS based more in computers and very necessary required from Albanian businesses including SMEs particularly in recent years. So, in this article is described exactly the implementation effort of AIS in SMEs that operates in business retail sector, also bringing in this way the testimony that despite of fact if SMEs have or not preliminary a manual accounting information system, they anyway display the need for accounting information ensured in standard or formal way. The main contribution of this study is that has generated facts and information that the implementation of AIS software in SMEs of retail sector in Albania is accompanied with many implications, which of course should be investigated also in other study contexts, before this proposal to be test in a quantity authentic study.

**Keywords:** information systems, AIS, software implementation, small and medium enterprise, retail business.

## 1. Introduction

*Without big data analytics, companies are blind and deaf, wandering out onto the Web like deer on a freeway.*  
Geoffrey Moor

According to European Commission report (2014) is emphasized that "SMEs<sup>1</sup> are very important for the Albanian business economy, accounting for 81 % (EU average: 67 %) of employment and generating about 70 % (EU average: 58 %) of added value. Micro firms are particularly prevalent among SMEs dominate three sectors in terms of added value and employment: accommodation, wholesale and retail trade and construction" (pg 1).

Rapid developments of information technology have influenced for good also in the accounting firm itself, its processes and of course the quality of the information that it offers, which is the purpose of the accounting information systems, to guarantee in this way a qualitative information for its users and as a result likely for a good decision. Furthermore, besides the equipments that will support the accounting computerization of an enterprise, part of information technology will be software applications or productions which will help in data processing and in generation of reports and information, starting from operational reports that have processed the data of the transactions of the business up to accounting and management reports, saving all these inputs and outputs in a single location. However, a key factor in implementation of information technology is the conception of this process as a project, but is a missing culture in SMEs what can be due to obstacle all of this process.

However, we cannot fully consider AIS effectiveness and success if we are not aware that the information is a very important business resource beside other company resources. Thus, for example Hall (2011) explains that every day in the company should circulate a large amount of information as to internal or external users which are interested toward

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<sup>1</sup> Referring to SMEs classification in this study by Commission Recommendation 2003/361/EC of 6 May 2003, and by law No.8957, date 17.10.2002, "For small and medium enterprises".

54 the company. Exactly in figure 1 is indicated the flow of this information as in bottom – up direction, so from the business  
55 operations referring here to main activities of production, sales, distributions etc. to three management levels according to  
56 the need that they have for the information.



57  
58

59 **Figure 1:** Internal and external flow of information. Source: From “Accounting Information System”, by Hall, J.A., 2011,  
60 pg.4.

61  
62

## 63 2. Literature Review

64  
65

66 According to Lester and Tran (2008) an increasingly important factor for the survival and future of the company is  
67 undoubtedly the information technology. Information technology evidenced from word processing applications, those of  
68 networking, internet use, e-commerce, etc making in this way the information technology an important factor in the today  
69 world economy development. Dedrick, Gurbaxani, and Kraemer, (2003) have defined information of technology closely  
70 linked with using of computer and telecommunication equipments and their other elements such as hardware, software  
71 and other services. According to Rao, Metts, and Monge, (2003) companies' investments in information technology  
72 include activities such as payroll, human resources, accounting, supply chain management, and other functions. But  
73 despite these it seems like small enterprises are less orientated towards innovation of information technology compared  
74 to big companies which have the compulsory and as a result also with profitably investment in IT (Stimmel, 200; as cited  
75 in Lester & Tran, 2008).

76  
77

78 According to Lester & Tran (2008) a problem of the small business in the IT investment remains the need for  
79 available resources (Pool, et al., 2006).

80  
81

82 Moreover, information and planification complexity and system of control is one of the main factors for failure or  
83 success of the company mainly when the company grows and is more complex in the organization (Churchill & Lewis,  
84 1983). As a result growth of the company requires that these information systems to be implemented before the growth  
85 starts and the company owner manager to be also ready to decentralize the organization and to delegate responsibilities.

86  
87

88 So, small business through information technology applications and automation of the processes and its operations  
89 to ensure collection and access of qualitative information will achieve to transform all the company (Dedrick, et al., 2003).  
90 However, according to Lester, et al. (2003) besides other variables a more decisive indicator of life cycle phase of the  
91 company would be complexity of procedures of information processing itself (as cited in Lester & Tran, 2008).

92  
93

94 According to Salehi, Rostami and Mogadam (2010) accounting means the functioning of the service that request to  
95 ensure to the information users quantitative information, but from another aspect AIS means an information system  
96 created to perform accounting process and functions. So, an AIS processes mainly financials data and transactions to  
97 ensure and offer to user's sufficient information to accomplish planification and control functions of the business.  
98 (Romney et al., 1997:2). An accounting information system can perform in a manual or automated way through the usage  
99 of information technology, however, despite this an AIS perform, collect, enter, process, store, and report data and  
100 information” (Salehi, Rostami and Mogadam, 2010, pg. 187). Based on the general definition of information system as a  
101 whole of the related components that are working together to collect, store and disseminate data for the purpose of  
102 planning, control, coordination, analysis and decision making, in this sense an AIS is the whole of the related components  
103 that are put together to collect information, raw data or ordinary data and transform them into financial data for the

purpose of reporting them to decision makers (Salehi, Rostami and Mogadam, 2010, pg. 187). Regardless of these definitions the oldest system in business if we would refer to these information systems has been Management Information System. This system includes two different concepts such as "management" and "information" by highlighting unquestionable importance of information for management activities in business, so Management Information System includes many subsystems, where exactly in the whole Accounting Information System itself is one of these subsystems and even the earliest (Salehi, Rostami and Mogadam, 2010, pg. 187). Anyhow, effective establishment of such information system, so of an AIS is undoubtedly connected with more other specific organizational characteristics such as organizational culture, level of strategic planning and the information technologies (Salehi, Rostami & Mogadam, 2010, pg. 187), so in this sense even the quality of financial information of the company itself will depend on the quality of configuration AIS itself, referring here on main functions of an AIS which are: "collecting and recording data about the activities and transactions; planning; processing the data and turning it into information to be used in decision-making for planning, application and control activities; and carrying out the necessary controls in order to protect the business assets" (Salehi, Rostami & Mogadam, 2010, pg. 188).

Precisely because of these functions AIS have an important role for the management of the operations and activity of the company, which makes these applications based on computer more needed and required from Albanian businesses including SMEs especially recent years, despite this approach very prevalent in the world long time ago. And also if we will refer to the Albanian reality currently consciousness of the managers for the importance of this systems many organisations are placed in front of the need of implementation of an AIS even if obligated because of the need of control, adapted with clients and consumers or because of the competition for optimization of their processes, such as SMEs, larges business and public administration as well.

Although, implementation of an AIS can be a project with a high cost in the developed countries it looks like in Albania is not like this in relation with profits that come to the business from this system, but absence of the conscious for all the factors that influence in the success of this implementation in Albanian companies is making it harder this adaptation despite the need of the companies for an AIS. According to Salehi, Rostami and Mogadam (2010) the studies also testify for other implications in relation with implementation of AIS for example Flynn (1992) has testify that only 20% of information systems are used in effective way, while for other part this application can bring a negative effect, testifying for the importance that has the effective implementation of an information system. Exactly Flynn (1992) explains that the effectiveness of AIS can be received providing management information to assist concerned decisions with regard to the successfully managing of corporations" (Salehi, Rostami & Mogadam, 2010, pg. 188). So, according to Corner (1989) the effectiveness of AIS "can be evaluated as added value of benefits", while Gelinas (1990) defines the effectiveness of AIS "as a measure of success to meet the established goals" (Salehi, Rostami & Mogadam, 2010, pg. 188). As a conclusion researchers have estimated fulfillment of mission of an AIS through the successful usage of it referring here fulfillment and completion of needs of its users mainly internal but also external. However, if we would refer studies in this field it seems that there are different methods of effectiveness of AIS in business (Salehi, Rostami & Mogadam, 2010)

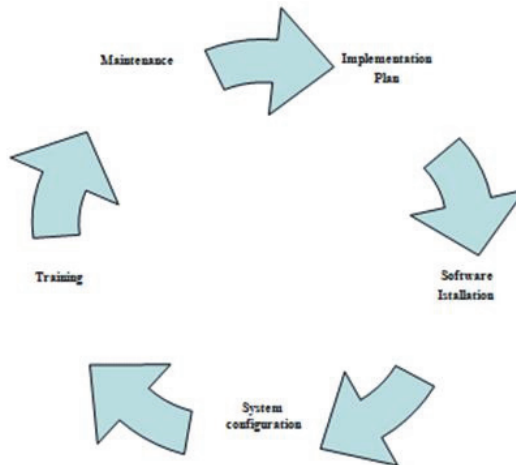
### 3. Methodology of Study

The plan of accounting software implementation is a very important project because otherwise the company would invest in late period's time, energy and additional money. Impact of information systems (or ERP) on financial performance of companies requires time and studies evidence a period of several years (Poston & Grabski 2001), so a good planification of the implementation of the process of accounting software to avoid unexpected expenses and to avoid miss communication through administration of business is needed.

The plan of implementation of accounting software should be first step of the process and in this phase are specified the steps that should follow for the effective implementation of accounting software.

Specification and clarification of the information which should pass from the old system even from the manual in the new one is very important to realize wit success implementation of AIS in function of business necessities even the companies do not show careful in this phase this will be accompanied with additional cost.

But also the planning of assets is another very important moment of the implementation plan, so is necessary that the business to plan which actual computer equipments and what is needed further and to identify capabilities of their human resources.



**Figure 2:** Conceptual cycle of accounting software implementation

The article aims to evidence implications during AIS implementation in retail business in Vlore region. To enable generation of the facts and to conclude in study proposal, this study through a qualitative approach has explored empirical data of 20 interviews directed to 20 owner- manager in 20 retail businesses in Vlore region. On study focus have been companies of retail sector with high sale level, long life and commercial activity over 5 years, which occupy an important weight regarding the market and their commercial activity in the companies of this sector in Vlore region.

The research problem of this study with focus on AIS implementation is that:

Retail business in Vlore region do not plan with careful the implementation of AIS process bur request to solve only emergency problems and this is accompanied with additional costs in medium and long terms and influence in its quality and effectiveness of this system. Usage with effectiveness of AIS asks also great abilities and qualified personnel of the business.

#### 4. Findings and Discussions

Study's results for the implementation of accounting software in retail business Vlore region are clearly presented by pointing the necessity for improvement in steps and activities of implementation.

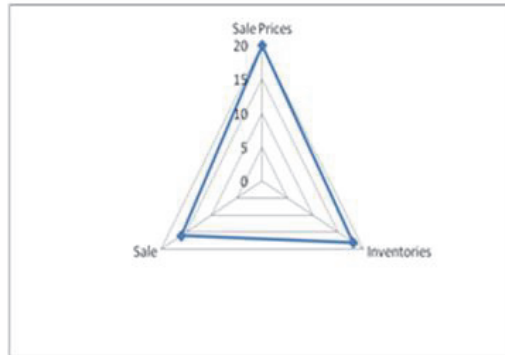
The first step in the implementation cycle is the implementation plan of AIS. Precisely in relation to this phase, owner – managers of the businesses included in the study are interviewed regarding: "Which were the reasons that you decided to implement an AIS"?

According to the data showed out the fact that according to them the main reasons for the planning of implementation of automated AIS were measuring and control of inventory, invoicing and registration of daily sales and automated configuration of sales prices. Long list of sales prices is testified that is one that is one of the main reasons for implementation of AIS, which appeared as a worry even for sales personnel especially in cases when purchasing and selling price of the articles vary significantly from period to period. So, memorizing of long lists of selling prices was presented as a problem for all owner-managers of the companies included in the study, influenced this also from the sector itself where they operate being that they show a big number of products.

Identification and inventory measurement situation in real time is another worrying problem for businesses. These commercial activities posses large warehouse and in many cases are problem control and measurement of inventory situation in real time. Between 20 retail businesses around 18 of them raise as a very important problem the issue of stocktaking in real time of warehouse and time when should order for supply and purchasing conditions.

Registration and measurement of daily sales of commercial businesses and reconciliation with cash is ranked as third reason that businesses are encouraged in their decision for implementation of accounting software. Until the moment of implementation of software operated with the principle of cash accounting where frequently cash receipts were equivalent to daily sales, but the problem hampered for sales with delayed payments and in relation with accounts

185 receivables, so in 20 retail businesses in around in 16 of them this problem is ranked as another reason for decision of  
 186 implementation of accounting software.  
 187



188  
 189

**Figure 3:** The main reasons of AIS implementation by Retail Business Sector in Vlora Region

**Source:** Study research data.

191

192 Second result generated from the study is related to the usage of AIS implementation plan by retail business firms,  
 193 exactly second question directed to retail business was “Have you done an implementation plan of AIS before the start of  
 194 its implementation process?”  
 195

196

**Table 1:** Planning the implementation plan of AIS by Retail Business Sector in Vlora Region.

197  
 198

	Yes	No
AIS implementation plan before the start of the process	6	14

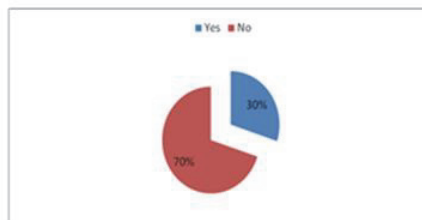
199

**Source:** Study research data

200

201 A considerable part of commercial companies do not have an implementation plan for AIS. Only 30% have an  
 202 implementation plan, while 70% of them do not draft and concept such a plan, despite the importance it has for the  
 203 success of AIS itself.  
 204

205



206

**Figure 4:** Planning the implementation plan of AIS by Retail Business Sector in Vlora Region.

**Source:** Study research data

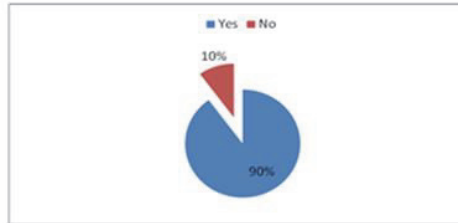
209

210 Absence of draft and preliminary conception of an implementation plan from these businesses is very worrying, because  
 211 being that short and medium terms of retail businesses are faced with other expenses and it creates distrust climate  
 212 between retail businesses and software vendors. At the same time is added inefficient time of work spent from software  
 213 vendors. Lack of an implementation plan of AIS is estimated and proves the lack of businesses' objectives or at least  
 214 estimation with seriousness of businesses objectives from retail firms.

215

In connection with a very another important aspect of implementation of AIS, regarding the investment budget in  
 216 accounting software, results that 90% of firms have forecast and plan in the beginning only monetary cost of the software,

217 and later they were obligated to change hardware, which brought excess of financial value also paying additional services  
 218 or yearly maintenance contracts stimulated from the necessities of changing hardware after the software installation.  
 219 Delayed purchasing of new hardware brought for software vendors additional working hours, while for business itself  
 220 brought the need of returning of the working processes behind old techniques of manual operations because of the  
 221 required time which requested replacement of and transferring of AIS data in new hardware.  
 222

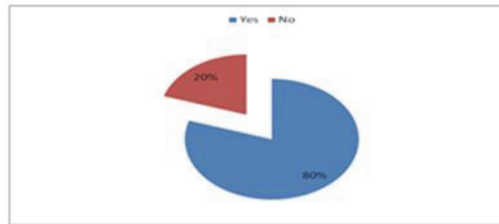


223  
 224  
 225 **Figure 5:** Planning the cost of AIS software by Retail Business in Vlora Region

226 **Source:** Study research data  
 227

228 Organisative structure of retail business is another important characteristic investigated during the study, precisely the  
 229 question that investigates around this characteristic of the firm is “if installation of AIS is accompanied with a changing of  
 230 actual working processes and duties in firm.”

231 Despite their organization level of the firm, studied businesses had already a functional organisative structure, but  
 232 in the moment of implementation of AIS was necessary a reconfiguration of organisative structure in 80% of the cases.  
 233



234  
 235  
 236 **Figure 6:** Reorganization of the organizational structure by Retail Business in Vlora Region

237 **Source:** Study research data  
 238

239 And precisely in 8 of these businesses experienced reconfiguration of staff, so in 50% of them came out the need for  
 240 increasing the number of personnel and moreover the qualified one with good abilities on AIS, being that they will use an  
 241 accounting software to do their work. While in 12 retail businesses (where in 8 of them were done structure and  
 242 personnel reorganization and 4 other where there was not reorganization) was necessary the training of all personnel that  
 243 already would perform tasks and a part of firm’s operation through innovator system supported in usage of technology.

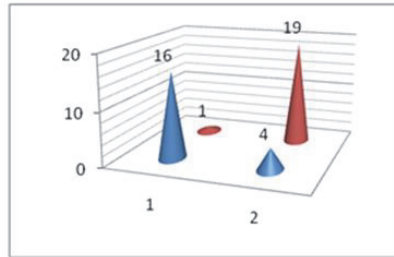
244 However, the process of reconfiguration was done as necessity during implementation of AIS and was not planned  
 245 before, even not considerate as a process continued from owner-managers but only as a moment orientation, despite  
 246 that organization of the business and furthermore organisative structure should be constantly in adaption with activity and  
 247 transaction of the firm, ways which developed with implementation of AIS itself.  
 248

249 **Table 2:** Reorganization of the organizational structure by Retail Business in Vlora Region  
 250

	Yes	No
Reconfiguration of the processes of work and tasks from the beginning	16	4
Continued improvement and fit of organizational structure	1	19

251 **Source:** Study research data  
 252

253 Regarding also the reorganization from the study results that only 5% of the business continued analyze of working  
 254 process and in later periods so after implementation of AIS, aiming constantly improvement and adaption of processes  
 255 and works in function of firm's objectives.  
 256

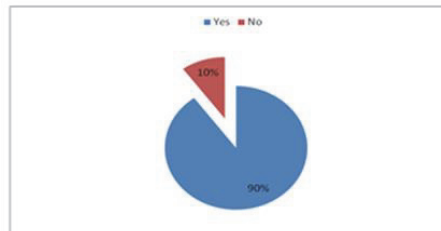


257  
 258 **Figure 7:** Redesign of processes in continuation by Retail Business in Vlora Region  
 259 **Source:** Study research data  
 260

261  
 262 A very important part of implementation plan is analyzing of hardware that retail businesses use.

263 Question directed to owner-managers of this business regarding this very important aspect for all processes and  
 264 activities that firm does is "if the firms use existing hardware or purchase new hardware for implementation AIS software",  
 265 which seems that presents interesting results.

266 Around 90% of retail businesses look like do not invest in new hardware for installation and implementation of AIS  
 267 using exactly the existing one.  
 268



269  
 270 **Figure 8:** Use of existing hardware for AIS implementation by Retail Business in Vlora Region  
 271 **Source:** Study research data  
 272

273  
 274 Hardware of these businesses was preliminary tested from software vendors and around 50% of them had resulted not  
 275 appropriate for installation and implementation of AIS. However, regardless tenacity of owner-managers for usage of  
 276 existing hardware which would affect the effectivly of AIS, software vendors accepted installation and implementation of  
 277 AIS in old hardware for not prevented the sales process of software.

278 From the data of the interviews was witnessed that in the beginning productivity of AIS was rated satisfactory, but  
 279 later it looked like the speed of software work on answer time to perform selling transaction and accounts receivables  
 280 because of amortization of hardware was low.

281 So, around 44.5% of firms which used existing hardware for implementation of AIS because of low speed were  
 282 obligated to substitute existing hardware within a year.  
 283

284 **Table 3:** Use of existing hardware for AIS implementation by Retail Business in Vlora Region  
 285

	Yes	No
Firms use existing hardware	18	2

286 **Source:** Study research data  
 287

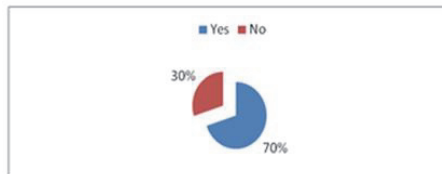
288 The second step is AIS installation. This is a process that is realized both by the local retail store of software vendor as  
289 well as by the software company itself. Problems of installation of AIS software in this study are important as a step or  
290 phase of implementation process of AIS. Both the local software retail store and the software company analyze in  
291 continuation their processes, tasks and activities of AIS implementation to reduce unnecessary processes and working  
292 hours or days.

293 So an issue raised in the study is related to preliminary test of AIS and from the data collected results that around  
294 70% of retail businesses have preliminary tested application of AIS, and also this process is requested from them.

296 **Table 4:** Testing of AIS by Retail Business in Vlora Region

	Yes	No
Testing AIS	14	6

298 **Source:** Study research data



301 **Figure 9:** Testing of AIS by Retail Business in Vlora Region

302 **Source:** Study research data

303 Testing of AIS in reality means a request from retail business itself to see and preliminary estimate functioning and  
304 application of AIS software across their transaction and accounting processing. In many cases the process of testing is  
305 evaluated as a security and guarantee that retail businesses requiring estimating before taking decision of buying AIS  
306 software.

307 Third step of AIS implementation in retail business is software configuration. The question that is raised regarding  
308 this subject is "Who has done implementation of the software, firm's staff or software vendors", has testify that all studied  
309 businesses or 100% of them have followed the same way as it is describe as following.

310 Configuration process of AIS in this firms is configurated in two phases, where in first phase is done configuration  
311 of AIS as per firms request itself and this process is realized by the local retail software vendor.

312 **Table 5:** Configuration of AIS by Retail Business in Vlora Region

	Yes	No
Configuration of AIS	16	4

313 **Source:** Study research data

314 The other important phase of configuration has been identification and collection of preliminary data of firm transactions  
315 which after are registered in AIS files. This operation is realized from the staff of the firm itself during the process of  
316 implementation of the software.

317 In this phase in the same time is dedicated importance also to preliminary information organizing, cleaning from  
318 details and unnecessary qualities and careful transferring of it in AIS files.

319 The fourth step of AIS implementation in retail business is staff training. Regarding staff or personnel of the firm  
320 that would use and would interact with AIS, from firm side is made possible that training of the personnel to be done  
321 before starting of the process of implementation of AIS. In the training were included existing staff and the new one which  
322 added during configuration of organisative structure of these firms. Although some of staff members preliminary knew  
323 other accounting software, anyway they were optimists in the choice made because of the reason of advantage of this  
324 AIS software and above all because of the support that offered software vendor.



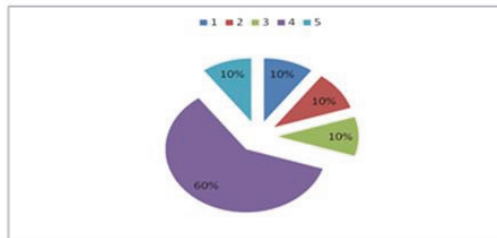
The fifth step for implementation of AIS in retail business is software maintenance. Regarding this subject look like has not missed support of local software vendors gave to these businesses concerning with software maintenance. To explore this subject the question directed to owner-managers consist on "How sufficient has been support of local software vendors given for the maintenance of software?" measuring this scale with a Licert item from 1-5 (from lower to higher) the result of which are summarized in table7.

**Table 6:** Support and maintenance by local software vendor, Retail Business in Vlora Region

	1	2	3	4	5
Support and maintenance by local software vendor	2	2	2	12	2

**Source:** Study research data

Around 10% of businesses estimate on the average very good, 60% of the businesses evaluate very good and 10% estimate excellent support of local selling point. In this way only 10% estimate poorly and 10% weak. The result of 20% with evaluation under average is enough discutable because a part of current staff in the beginning of implementation do not have capability and competence to use AIS.



**Figure 10:** Support of sale local point, Retail Business in Vlora Region

**Source:** Study research data

Software maintenance provided to these retail businesses as consisted in the form of maintenance service with request of client2 or guaranteed through maintenance contracts. Regarding software maintenance and support contract it is an agreement between AIS software vendor and customer with the maximum term of duration by one year, but the maintenance agreement is signed in the end of three months of software guarantee period. One-year Service Agreement gives firms a priority in caring of problem solving that come as a result of various defects during software use. However despite the fact that the annual agreement is associated with an annual cost, it should be simply considered as a necessary fee required obtaining the guarantee of fast and qualitative software maintenance service.

## 5. Conclusions

It appears that rapid development of technology have significantly influenced and firms of developed countries what appears in their trend for evaluation of working processes in enterprises of all sizes without excluded also SMES, changing mainly the processing transaction process and also influencing in the processes of information accounting system of the enterprise.

Because of a very important role that AIS has for the management of operation and activity of the firm, did these applications very important for Albanian SMEs especially recent years, despite these information systems are spread over the world long time ago.

However implementation of AIS results to be a high cost project for developed countries look like Albania such implementation is not expensive in proportion with business profits generated from application wit effectiveness of this information system, but the lack of consciousness from Albanian SMEs and particularly of owner-managers for all factors that influence in the success of this implementation is making harder this process and maybe more expensive and less effective.

What is clear from study results about implementation in retail business is the fact that through implementation of

376 AIS software businesses intend to solve only specific problems which are accumulated and are made obstacle for the  
377 normal flow of their operations, so owner-managers in the moment that decide to implement an AIS for their transaction  
378 cycle do not analyze a full plan to precede the effective implementation of accounting software. In these problems that  
379 businesses hurry up to solve through accounting software which more important are stock review, sale prices, or daily,  
380 weekly and monthly estimation of sales.

381 However, what I suggest and prove based on the experience and findings of this study is importance that has the  
382 large study of implications and other factors that influence in implementing of accounting software in SMEs of retail sector  
383 in Albania, for the fact itself that identification and evidence of firm forecast not only problems in effectiveness of AIS, but  
384 testify further other complexities in firm organizing which also witnesses also for phase or life cycle of firm itself.

385 Also, in many cases seem like the firms have acute shortage of knowledge for necessary hardware for  
386 implementation of AIS. Businesses hesitate in investment for hardware and the money spent for hardware are evaluated  
387 as excess cost, also accounting and financial wisdom and knowledge between owner-managers in retail business  
388 significantly vary.

389 Lack of vision for planning hardware brings problems in working speed of AIS and increase spent time for  
390 processing of many transactions mainly sale process, causing dissatisfaction to the clients and firms itself. At the same  
391 time in short-term periods firms obligated to invest again in hardware equipments.

392 The plan for AIS implementation is skipped by the firm plans and so this process is planned from local software  
393 vendor itself before the project starts, so businesses should concept as an advantage that the vendor offers, even though  
394 they still hesitate in following and execution of an implementation plan. Culture of these firms is a key factor that influence  
395 in negative translation of implementation plan with the initiative of the vendor, representing it as seller initiative to realize a  
396 bigger value of selling from this project.

397 Another hypothesis which should be considered in future studies is related to the attitude that AIS vendors hold  
398 regarding the standards of their clients' hardware before AIS implementation.

399 Precisely regarding this subject is recommended that marketing and sales personnel of software companies should  
400 spend more time with their clients to inform and to make them more conscious regarding the importance and standards of  
401 hardware where should be implemented AIS software, should be orientated stronger and develop more marketing  
402 functions and not to focus only to final selling process.

403 Forecast of monetary values for the implementation plan process of accounting software is another problem of  
404 retail business which also shows for problems in financial management practices regarding the planification in the  
405 business.

406 At the same time implementation of AIS influence also in the reorganization of many working processes in  
407 businesses, even though look like few businesses continue to analyze working processes even on AIS post-  
408 implementation period.

409 Existence of a local retail and service store is very important for effective implementation of AIS from businesses,  
410 because after the business culture this is evaluated as guarantee for readiness of maintenance service and later support.

411 Also, other hypothesis and proposals for future studies should be raised about:

- 412 ● Influence of AIS in organizing of processes, activities, operations and works of the firm.
- 413 ● Trend of the firm for not changing.
- 414 ● Division of the functions of AIS implementation project between software companies and local software  
415 vendors
- 416 ● The significance of the spread of local software vendors for AIS Implementation in SMEs in Different regions
- 417 ● With separating of the duties, responsibilities, authority and information circulation in businesses.
- 418 ● Centralized decision and style of owner-managers decision of SMEs what looks as a problem that appears in  
419 this study regarding the main role of owner-managers in taking decision for implementation of AIS in firm?

420 This research is organized through a qualitative research approach, and as such has its limitations as following:

- 421 ● The study is orientated only in one sector and precisely in retail business and as not reflected and explored  
422 other sectors of business which have also implemented AIS software for practice and activity of their  
423 businesses.
- 424 ● Also the regional character raises another limit of the study including only firms that operate in Vlore region. .
- 425 ● Questionnaire is distributed in a limited number of retail businesses because of its qualitative approach,  
426 although firms included in the study are healthy representatives of this sector from selling volume and function  
427 duration point of view of them in the market.

428 However, this study is also important because of:

- 429
- 430
- 431
- 432
- 433
- 434
- 435
- Highlight the reality of using AIS in specific regions and open the road to extensive studies.
  - Hack through discussions on the importance, implications and value of the implementation of AIS in business.
  - Awareness business administrators for the importance of AIS implementation plan.
  - Push out other studies about the implementation and impact of AIS in small and medium enterprises, especially in developing countries, and moreover in Albania where the studies around this field are in their genesis and are IT perspective and not from accountant's perspective.

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# Implementing Competition Law in Patent License: Issues and Challenges for Malaysia

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## Abstract

Patent license is established when the patent owner allows the other party to exercise rights granted under the patent grant based on the terms specified in the patent license contract. However, there is no standard form of patent license contract and hence, parties are left with their own discretion to decide the terms to be included in the patent license. The freedom to include terms in the patent license led parties to expand their rights via inclusion of anti-competitive provisions in the patent license. Thus, competition law authority plays its role in determining whether terms included in the patent license affects competition process. In fact, patent license is expected to comply with regulations set by the competition law authority if it contains provisions which are anti-competitive in nature. This research evaluates the legal mechanisms employed by the Malaysia and EU competition authority in order to establish whether the mechanisms have adequately address issues relating to competition law in patent license. It also seeks to identify problems surrounding the patent license contract and explores how it affects the competition law. The findings indicate that while Malaysia has the basic legal mechanism to implement competition law in patent license, which is Competition Act 2010, but review of the Competition Act 2010 and additional legal mechanisms such as Guidelines are necessary to cater the needs arising from the patent license.

**Keywords:** patent license; competition law; Malaysia; Competition Act 2010; legal issues; EU

## 1. Introduction

Patent license refers to the transaction being made between the licensor and licensee concerning rights to be granted to the licensee by the licensor relating to invention owned by patent owner. It usually exists in the form of a written contract, known as license agreement (Hodkinson, 1987). Patent license adopts the characters of a contract namely, it may be made oral or written, enforceable and parties to the contract will be subjected to liabilities and responsibilities (Bielefield & Cheeseman, 1999). In fact, Malaysia requires a patent license to be reduced in written form and signed by the parties (Section 41(2) of Patents Act 1983).

In relation to patent license, there is absent of specific form of patent license contract. Patent license is tailored to the needs of the parties although certain provisions are commonly included in patent license (Power, 1971). The absence of a standard form of patent license provides freedom to the parties to include terms in the patent license contract depending on agreement between them. According to Bowes, the freedom to include provisions in the patent license is to ensure maximum benefit to the parties involved in the patent license as well as the public (Bowes, 1977).

Nevertheless, such freedom led parties to extend rights beyond the patent grant (Diggins, 1955), via inclusion of restrictions terms imposed by the licensor towards the licensee in the patent license. Such restrictions may exist in the form of provisions relating to royalties, territorial restriction, price restriction and patent use restriction (Rupert, 1980). These provisions are sometimes used by the parties to create anti-competitive effect in the competition process (Anderman & Schmidt, 2011). As a result, all contractual restrictions are subject to the rulings of competition legislations in the event it contravenes provisions relating to prohibited business practices underlined by the competition law (Leslie, 2009).

Maskus and Lahouel were of the opinion that licensing restrictions have been widely abused due to few concrete guidelines in existence among developing countries to assist in the area of intellectual property license (Maskus & Lahouel, 2000). One of the suggestions in relation to this problem is to examine practices adopted by various countries when dealing with competition law in the field of intellectual property (Raju, 2013). It is also suggested that a proper legal mechanisms must be in place to ensure effective implementation of competition law (Nguyen, 2010). EU experienced different phases in the evolution of competition law towards intellectual property licensing (Anderman & Schmidt, 2011)

57 which as a result requires EU to adopt various legal tools to accommodate the implementation of competition law in  
58 licensing area. Thus, the following sections examine the legal mechanisms employed by the EU and Malaysia  
59 competition authority in implementing competition law in patent license. This article proceeds to lay down issues relating  
60 to patent license affecting competition law in Malaysia and provide options to overcome the arising issues in patent  
61 license related competition law in Malaysia.

## 62 2. The European Union Approach in Patent License

63 This section looks at the various legal mechanisms employed by the EU competition authority in implementing  
64 competition law for patent license.

### 65 2.1 Basic legislation on competition law

66 In EU, the most important piece of legislation regulating competition law is The Treaty of the Functioning of European  
67 Union (TFEU), formerly known as European Community Treaty (EC Treaty). The TFEU came into being as a result of  
68 ratification of Lisbon Treaty which replaces the EC Treaty. The TFEU under Article 101(1) and 102 provides main  
69 regulations on competition law in general to be applied throughout the European region. According to Article 101(1) of the  
70 TFEU, it provides:

71 The following shall be prohibited as incompatible with the internal market: All agreements between undertakings,  
72 decisions by associations of undertakings and concerted practices which may affect trade between Member States and  
73 which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in  
74 particular those which:

- 75 (a) Directly or indirectly fix purchase directly or indirectly fix purchase or selling prices or any other trading  
76 conditions;
- 77 (b) limit or control production, markets, technical development, or investment;
- 78 (c) share markets or sources of supply;
- 79 (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a  
80 competitive disadvantage;
- 81 (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations  
82 which, by their nature or according to commercial usage, have no connection with the subject of such  
83 contracts

84 Article 101(1) of the TFEU above provides rulings relating to anti-competitive agreement whereas Article 102  
85 prohibits conducts which amounts to abuse of dominant position. Article 102 of the TFEU provides:

86 Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of  
87 it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States.

88 Such abuse may, in particular, consist in:

- 89 (a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;
- 90 (b) limiting production, markets or technical development to the prejudice of consumers;
- 91 (c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a  
92 competitive disadvantage;
- 93 (d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations  
94 which, by their nature or according to commercial usage, have no connection with the subject of such  
95 contracts.

96 In relation to patent license, paragraph 7 of the Guidelines on the Application of Article 101 of the Treaty on the  
97 Functioning of the European Union to Technology Transfer Agreements (2014/C 89/03) (the Guideline) expressly  
98 provides that although intellectual property law grants exclusive rights of exploitation, it however does not confer immunity  
99 on the intellectual property rights from being intervened by the competition law. This indicates that patent license is  
100 subject to the scrutiny of competition law although it is not expressly mentioned by the provisions in the TFEU.

### 101 2.2 Implementation of competition law in patent license

#### 102 2.2.1 Patent license is granted block exemption

103 In EU, although no blanket immunity is given by the competition law in the field of intellectual property, yet, patent license

is granted block exemption under the Commission Regulation (EU) No.316/2014 on the Application of Article 101(3) of the Treaty of the Functioning of the European Union to Categories of Technology Transfer Agreement (TTBER). The TTBER has its basis in the Patent Licensing Block Exemption Regulation which was announced in 1984 and was followed suit by Know How BER (556/89) in 1989. These block exemption regulation were then replaced with a single block exemption known as TTBER (240/96). The TTBER (240/96) continues to be revised and update and the current TTBER in force is TTBER (316/2014) and the Guideline.

The TTBER grants automatic group exemption to patent license so that it will not be subject to Article 101(1) of the TFEU. According to Article 2 of the TTBER, Article 101(1) of the TFEU shall not apply to technology transfer agreement. Technology transfer agreement has been defined by Article 1(1)(c) of the TTBER to mean:

- (i) A technology rights licensing agreement entered into between two undertakings for the purpose of the production of contract products by the licensee and/or its subcontractors
- (ii) An assignment of technology rights between two undertakings for the purpose of the production of contract products where part of the risk associated with the exploitation of the technology remains with the assignor.

According to Article 1(1)(b), technology rights refers to the know how and the following rights, or a combination thereof, including applications for or application for registration of those right, which, among others include patents.

The TTBER operates on the presumption that although license agreements are caught by Article 101(1) TFEU, these agreements however fulfill the conditions for exemptions set under Article 101(3) of the TFEU, namely;

- (1) The agreement contributes to improving the production or distribution of goods or to promoting technical or economic progress;
- (2) The agreement allow consumers a fair share of the resulting benefit;
- (3) The agreement does not impose restrictions which are not indispensable to the attainment of the above objectives;
- (4) The agreement does not afford parties to the agreement the possibility of eliminating competition in respect of a substantial part of the products in question.

However, in order for a patent license to shelter under the TTBER, contracting parties are to observe their market shares and to avoid hardcore restrictions in the patent license. The market share limits requirement under the TTBER requires parties to determine their market share limits based on their relationship, i.e whether parties are competitors or non-competitors. The fact that parties exceed the market share limits does not render the agreement to be caught under Article 101(1) of the TFEU (Para 43 of the Guideline). In fact, they will be assessed within the actual context in which competition would occur in the absence of the agreement (Para 11 of the Guideline) and individual assessment will be carried out to determine the anti-competitiveness of the patent license (Para 43 of the Guideline). It is only when parties include hard core restrictions in the patent license that the patent license will be presumed as falling under Article 101(1) of the TFEU (Para 43 of the TFEU).

### 2.2.2 Specific guideline for patent license

In EU, the existence of the TTBER is supplemented with a guideline known as The Guidelines on the application of Article 101 of the Treaty on the Functioning of the European Union to Technology Transfer Agreements (2014/C 89/03) (the Guideline). The Guideline elaborates on matters relating to the application of TTBER to technology transfer agreement and also manner in which technology transfer agreement need to be assessed under Article 101(1) and 101(3) of the TFEU in the event technology transfer agreement falls outside the ambit of the TTBER.

## 3. Malaysian Approach in Implementing Competition Law in Patent License

### 3.1 Basic legislations on competition law

The main legislation in force pertaining to the implementation of competition law in Malaysia is Competition Act 2010. The Competition Act 2010 is a national legislation on competition which came into effect in 2012. In addition to the main legislation, there are certain guidelines which have been issued by the Malaysia Competition Commission (MyCC) for the purpose of assisting in implementing competition law in Malaysia namely, Guidelines on Market Definition, Guidelines on Anti-competitive Agreements, Guidelines on Complaints Procedure, Guidelines on Abuse of Dominant Position, Guidelines on Financial Penalties and Guidelines on Leniency Regime.

The Competition Act 2010 is silent on the application of its provisions to matters relating to intellectual property especially with regards to patent license. Hence, by way of implication, it can be inferred from the following provisions that

165 patent license is not excluded from the ambit of competition law.

### 166 3.1.1 Activities of "commercial nature"

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168 According to Section 3 of the Competition Act 2010, the Competition Act 2010 applies to commercial activity conducted  
169 inside and outside Malaysia. By virtue of Section 3(4) of the Competition Act 2010, it provides that commercial activity  
170 means any activity of a commercial nature but does not include the following:

- 171 (a) Any activity, directly or indirectly in the exercise of governmental authority;
- 172 (b) Any activity conducted based on the principle of solidarity; and
- 173 (c) Any purchase of goods or services not for the purposes of offering goods and services as part of an economic  
174 activity.

175 In relation to patent license, it is an exercise of rights in the field of commercial. Section 37(1) of the Patents Act  
176 1983 provides that exercising exclusive rights under the patent only confine to acts done for the purpose of industrial or  
177 commercial. Therefore, patent license is a form of commercial activity being exercised by patent owner in relation to  
178 patent owners' exclusive rights.

### 179 3.1.2 Patent License is a form of 'agreement'

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181 Section 2 of the Competition Act 2010 provides that the term 'agreement' as indicated by the Competition Act 2010  
182 includes the followings:

183 Any form of contract, arrangement or understanding, whether or not legally enforceable, between enterprises, and  
184 includes a decision by an association and concerted practices.

185 The elaboration on the term 'agreement' provided by Section 2 of the Competition Act 2010 concludes that  
186 'agreement' may be in the form of formal or informal arrangement between parties regardless of whether such  
187 arrangement is made in oral or written.

188 In Malaysia, patent license is concluded via 'written contract signed by the parties' (Section 41(2) of the Patents  
189 Act 1983). Thus, patent license comes within the ambit of 'agreement' as mentioned by Section 2 of the Competition Act  
190 2010.

### 191 3.1.3 Exclusion under Competition Act 2010

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193 In order to identify matters which are excluded from the application of the Competition Act 2010, Section 3 (3) of the  
194 Competition Act 2010 identifies commercial activities which are not govern by the Competition Act 2010.

195 According to Section 3(3) of the Competition Act 2010, the commercial activity regulated by the communication  
196 and energy sectors listed in First Schedule of the Competition Act 2010, namely, Communications and Multimedia Act  
197 1998 (Act 588) and Energy Commission Act 2001 (Act 610) are under the supervision of their respective legislations.  
198 Effective from 1<sup>st</sup> January 2014, the Federal Government gazetted Petroleum Development Act 1974 (Act 144) and the  
199 Petroleum Regulations 1974 (PU (A) 432/1974) to be added in the list of First Schedule of the Competition Act 2010.

200 In addition to the excluded commercial sectors provided under the First Schedule of the Competition Act 2010, the  
201 Competition Act 2010 also provides other exclusion under its Chapter 4 via Section 13 of the Competition Act 2010.  
202 According to Section 13 of the Competition Act 2010, it provides that prohibitions mentioned in Part II of the Competition  
203 Act 2010 shall not apply to matters provided in the Second Schedule of the Competition Act 2010. This indicates that anti-  
204 competitive practices, which comprises of anti-competitive agreements and abuse of dominant position will not apply in  
205 the following situation:

- 206 (a) An agreement or conduct to the extent to which it is engaged in an order to comply with a legislative  
207 requirement;
- 208 (b) Collective bargaining activities or collective agreements in respect of employment terms and conditions and  
209 which are negotiated or concluded between parties which include both employersd and employees or  
210 organizations established to represent the interests of employers or employees;
- 211 (c) An enterprise entrusted with the operation of services of general economic interest or having the character of a  
212 revenue-producing monopoly in so far as the prohibition under Chapter 1 and Chapter 2 of Part II would  
213 obstruct the performance, in law or in fact of the particular tasks assigned to that enterprise.

214 None of the above provisions expressly indicates that patent license is an excluded subject matter under the  
215 Competition Act 2010. Thus, it signals that patent license is within the regulatory regime of the Competition Act 2010.

219 3.2 *Implementation of competition law in patent license*

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221 3.2.1 *Patent license is subject to common rules to be applied to other kinds of agreement*

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Patent license is expected to avoid from contravening the prohibitions set by the competition law under the Competition Act 2010 which are participating in anti-competitive agreement under Section 4 and abuse of dominant position under Section 10 of the Competition Act 2010. According to Section 4(1) of the Competition Act 2010 which provides for anti-competitive agreement, it states that:

*A horizontal or vertical agreement between enterprises is prohibited insofar as the agreement has the object or effect of significantly preventing, restricting or distorting competition in any market for goods or services.*

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The explanation regarding the application of Section 4 of the Competition Act 2010 is assisted by the Guideline on Anti-Competitive Agreement which provides clarification on the terms used in the Competition Act 2010 relating to anti-competitive agreement, characteristics of prohibited horizontal and vertical agreements, other kinds of agreements which subject to the ruling of anti-competitive agreement, exemptions from anti-competitive agreement, notifications for guidance and non-application and exclusions under the Competition Act 2010.

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By virtue of paragraph 4 of the Guideline on Anti Competitive Agreement, the Malaysian Competition authority endeavor to issue a separate guideline applicable to matters relating to intellectual property and franchise agreement (Para 4 of the Guidelines on Anti Competitive Agreement). Hence, for the time being, the existing Guideline on Anti-Competitive Agreement applies to patent license.

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Parties to patent license agreement are also expected not to abuse their dominant position as they can be caught under Section 10(1) Competition Act 2010. According to Section 10(1) of the Competition Act 2010, it provides:

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An enterprise is prohibited from engaging whether independently or collectively, in any conduct which amounts to an abuse of a dominant position in any market for goods or services.

Lists of situation which may amount to abuse of dominant position are provided under Section 10(2) of the Competition Act 2010 which are :

- (a) directly or indirectly imposing unfair purchase or selling price or other unfair trading condition on any supplier or customer;
- (b) limiting or controlling production, market outlets or market access, technical or technological development or investment to the prejudice of consumers;
- (c) refusing to supply to a particular enterprise or group or category of enterprises;
- (d) applying different conditions to equivalent transactions with other trading parties;
- (e) making the conclusion of contract subject to acceptance by other parties of supplementary conditions which by their nature or according to commercial usage have no connection with the subject matter of the contract;
- (f) any predatory behaviour towards competitors; or
- (g) buying up a scarce supply of intermediate goods or resources required by a competitor, in circumstances where the enterprise in a dominant position does not have a reasonable commercial justification for buying up the intermediate goods or resources to meet its own needs.

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In this case, implementation of Section 10 of the Competition Act 2010 relating to abuse of dominant position in patent license area is assisted by the Guidelines on Abuse of Dominant Position and Guidelines on Market Definition. Manners in which dominant position are established is elaborated by the Guidelines on Abuse of Dominant Position which in most circumstances are indicated by the market shares of an enterprise. As in the case for Guidelines on Anti-Competitive Agreement, Guidelines on Abuse of Dominant Position and Guidelines on Market Definition also provides general rulings which applies to all types of arrangement even though empirical assessment is needed for market power associated with intellectual property (Anderman & Schmidt, 2011).

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3.2.2 *Patent license is subject to individual assessment prior to obtaining exemptions under the Competition Act 2010*

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Although licensing activities are mostly pro-competitive since it is able to create competition on the downstream market (Peeperkorn, 2003) yet, patent license in Malaysia is still subject to the requirements under Section 5 of the Competition Act 2010 to determine whether such patent license is pro-competitive. The patent license is required to fulfill the four cumulative requirements which are as follows:

- (a) significant identifiable technological, efficiency or social benefits directly arising from the agreement is present;



- 273 (b) without the agreement having the effect of preventing, restricting or distorting competition, the benefits could  
274 not have been reasonably provided by the parties to the agreement;  
275 (c) the detrimental effect of the agreement on competition is in proportion to the benefits granted; and  
276 (d) the agreement does not permit the enterprise involved to remove competition completely regarding a  
277 substantial part of the goods or services.

278 Hence, patent license is expected to demonstrate that it possesses the above requirements prior to obtaining  
279 exemptions from Section 4 of the Competition Act 2010.  
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## 281 4. Findings and Discussion

### 282 4.1 Comparative approach between EU and Malaysia on the implementation of competition law in patent license

283 The above discussion indicated that EU and Malaysia do not exclude the application of competition law in patent license.  
284 EU is aware that patent license comes under the umbrella of competition law in the event that patent license is used as a  
285 tool to hinder competition in the market while in Malaysia, patent license is not listed as one of the excluded subject  
286 matter in the Competition Act 2010.  
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288 Although both jurisdictions demonstrate that competition law applies to patent license, yet EU and Malaysia differs  
289 in the manner in which competition law is implemented in patent licence. EU presumed that technology transfer  
290 agreements provides economic efficiencies and therefore granted block exemption (Para 41 of the Guideline). It is until  
291 and unless such patent license includes hardcore provisions that it is presumed to be infringing Article 101(1) of the  
292 TFEU (Para 43 of the Guideline).  
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294 In Malaysia, on the other hand, there is no presumption that patent license is pro-competitive. In fact, there is  
295 absent of recognition of the pro-competitive effect of patent license under the Malaysian Competition Act 2010 as well as  
296 the guidelines. Hence, patent license in Malaysia is subject to individual assessment, which implies that in case of anti-  
297 competitive agreement, the patent license needs to be assessed individually based on Section 4 and Section 5 of the  
298 Competition Act 2010. For that purpose, general guidelines applicable to all kinds of agreements are used to cater the  
299 needs to assess patent license under Section 4 and Section 5 of the Competition Act 2010. These Guidelines provides  
300 general application of the competition law to all kinds of agreements.  
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### 302 4.2 Options and recommendations for Malaysia

303 The comparative approach between EU and Malaysia has led to the following recommendations, namely to grant block  
304 exemption to patent license in Malaysia and to introduce a specific guidelines to be applied to matters relating to patent  
305 license. Patent license deserves to be ruled under a specific guideline since varieties of provisions in the patent license  
306 are complex in nature (Nielsen, 2011). In fact, it has been expressly indicated by the Malaysian competition authority  
307 under paragraph 4 of the Guidelines on Anti Competitive Agreement that there will be a specific guideline to be used for  
308 matters relating to intellectual property (Para 4 of the Guidelines on Anti-Competitive Agreement) but such guideline is yet  
309 to materialised.  
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## 311 5. Concluding Remarks

312 The discussion above has set forth the path for implementing competition law in patent license for Malaysia. The EU  
313 experienced in this matter has no doubt provides clear indication that implementing competition law in patent license  
314 requires additional legal mechanisms apart from the existing legislations. According to Maskusand Lahouel, there is  
315 urgent need to develop procedures to ensure that there is no delay on the implementation of competition law in the field  
316 of intellectual property (Maskus & Lahouel, 2000). Perhaps, it is high time for Malaysia to consider practices exercised by  
317 other jurisdictions relating to the implementation of competition law in the field of patent license.  
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# Veracruz Economic Dynamics in the Long Run: Continuities, Changes and Ruptures

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## Abstract

The aim of this paper is to provide a quick glance of Veracruz's economic dynamics between the last decades of the 19th century and the early years of the 21st. It is based on a great variety of secondary sources (books, articles, government briefs and official documents) as well as economic censuses and state's statistics. The main processes of development and specificities that each economic model adopted are described and continuities, changes and disruptions about Veracruz economy along more than a century are identified. The analysis allows us to confirm that Veracruz has lost relevance in the national economic scene. From being the first state economy in the country, it lost its preeminence during the period of the import substitution industrialization, been replaced by states of large industrial development such as Nuevo Leon, Mexico State and Mexico City. Since then it has continued to decline up to 2009 ranking sixth place nationally after the states above mentioned as well as Jalisco and Campeche.

**Keywords:** Veracruz state, economics dynamics, 20<sup>th</sup> century.

## 1. Introduction

The economic development of a country or region is molded according to past experiences and upon these, new ones are built. Therefore, to understand the current situation of Veracruz, it is important to know how different economic sectors have behaved over time.

### 1.1 Objectives and methodology

The aim of this article is to provide an overview of the main features that the economic development of Veracruz has adopted from the *Porfiriato* to the first decade of the 21<sup>st</sup> century. For this purpose we've divided the paper in three sections corresponding to each of the economic models: the primary export model, the import substitution industrialization and the neoliberalism. At last, continuities, changes and disruptions about Veracruz economy along more than a century are identified.

The materials about Veracruz twentieth century, especially those related to its economic development, are scattered and fragmented in several studies on specific activity sectors (oil, sugar industry, tourism) or to determinant, historical periods as the Mexican Revolution, workers' or agricultural struggles, etc.

Under this scenario, the methodology of this paper is based on documentary research mainly from secondary sources such as books and articles, as well as primary sources including government briefs and official documents, economic censuses and state's statistics. From these, a long-term vision has been built which we present in three periods corresponding to the economic models by which México has gone: the primary export model, the model of import substitution industrialization (ISI) and the neoliberal model. In the end, it is a reflection on the continuities, changes and ruptures observed throughout its history.

## 2. Background

### 2.1 The primary export model (1880-1930)

The inclusion of Mexico in the international division of labor took place in the last quarter of the nineteenth century, and it coincided with the long period (33 years) when Porfirio Díaz ruled the country. Mexico was incorporated into the international economy as a raw material supplier, acquiring at the same time, many of the manufactured goods in foreign markets, consumed by a small elite with high purchasing power. This development model, known as primary export, prevailed until the 1930's when the effects of the 1929 crash showed the vulnerability of the national economy and its dependence on the outside (see Cárdenas, 1995 and Villarreal, 1997).

During the *Porfiriato* the foundation for the industrialization of the country were established, with large investments in railways, electricity and other utilities which created a basic infrastructure for economic growth. Particularly important was the construction of the first Mexican railroad between Mexico City and the port of Veracruz launched in 1873, which stimulated commerce and industry. The possibility of bringing raw materials and move the production (textiles, sugar and products elaborated from tobacco) into the Republic enabled Veracruz to be one of the leading industrial states of the country.

Between 1875 and 1930, an industrial plant based on the production of non-durable consumer goods was formed: textiles and processing of agricultural products such as sugar cane, coffee and tobacco products. However, they constituted enclave economies with very few (or none) production chains.

The textile industry excels, whose background goes back to 1836 when the Cocolapan was installed in Orizaba, the first cotton mill and cotton fabrics (whose original owner was Lucas Alamán). Between that year and 1852 three more factories of the same type were installed in Xalapa and during the second half of the nineteenth century it had a boom characterized by its advanced technology that placed it as the spearhead of national industrialization.

The largest textile factory in Veracruz and the country for a long time was founded in 1892 in the region of Orizaba: the Río Blanco. The owners of large companies were foreigners, mostly French (known as *barcelonetes*). Originally they had accumulated capital by trading in Mexico, and in the late nineteenth century they came to invest in the industry, creating gigantic and ultra-modern, for that time, cotton textile mills.

On the other hand, agriculture was undoubtedly the largest source of state wealth, because of both its products linked to an exporting agro-industries sector (sugar cane and coffee) as well as the production for local consumption market (basic grains and livestock). One of the first industries established was the processing of the sugarcane, crop that in Veracruz goes back to colonial times, when the first mills (note 1) were mounted (see Chávez and Florescano, 1965). The basic period of growth of Veracruz sugar industry occurred between 1900 and 1911. Production was multiplied six fold due to demand in the world market as a result of the destruction of the mills of Morelos during the Revolution. From 1913 Veracruz was positioned as the main national sugar producer and by 1922 contributed with 42.5 percent of the country's sugar (Bartra *et. al.*, 1993).

Meanwhile, coffee cultivation was being expanded in the central area of the entity from the second half of the nineteenth century. Also destined for export and its main investors were foreign: german, english and american.

Cattle raising (also practiced since the colonial period) had two moments of expansion: one in the first decade of the twentieth century and another in the 1920s, spurred by the lack of coverage of domestic demand by the end of the Revolution due to the crisis in the northern livestock, as well as external demand (Olvera, 1981, p. 14).

In the late nineteenth and early twentieth century the oil industry began to gain importance, controlled by foreign companies: british, american, german, and belgian. During those years Veracruz had a dual economy: firstly an industry linked to foreign markets (sugar, coffee and cotton textiles) and another focused on immediate consumption to meet the needs of the local population (food and jute textiles). The revolutionary struggle hardly changed the economic dynamics that had been going on since the last quarter of the nineteenth century. It was not until the late twenties when the situation began to change.

The 1929 crisis severely affected export industries and in a special way to the textile industry. The drastic reduction in foreign demand highlighted the vulnerability of the domestic industry showing the first signs of depletion of this economic model. The next decade would be the turning point that marked the shift to a new economic model based on import substitution industrialization

The first agricultural and industrial censuses of the Republic were rose in 1930 and realize the status of these sectors in 1929. Such censuses clearly show the poverty and backwardness of the industry. Most of the companies were craft workshops, family companies and small manufacturing plants, and the few large-scale enterprises were located in agricultural regions and mining and oil areas (Ramos, 1975 and Amezcua, 1981).

The essential part of life in Veracruz took place in the countryside. By 1930, 71.47 percent of the total population lived there, and its daily existence revolved around its production. 75.5 percent of the economically active state population was engaged in the agricultural sector.

Nationally, Veracruz contributed with 9.61 percent of agricultural production, 10.70 percent of the value of cattle, 8.7 percent of forest production and 15.78 percent of the value of poultry and apiaries. At that time, 8.32 percent of Mexicans were living in the entity; therefore, extra production was much higher than local needs (Olvera, 1981). Table 1 shows the major crops of the state and the percentage of its value in Veracruz and nationally.

**Table 1.** Percentage of value of agricultural production in Veracruz and its contribution to national production (selected products), 1930

Product	Percentage value of the state's agricultural output	Percentage value of the state output to national level
Corn	32.33	9.63
Coffee	20.30	41.78
Sugar cane	16.88	22.98
Banana	8.07	33.38
Vanilla	3.72	97.57
Bean	3.10	10.73

**Source:** Cattle and Agricultural Census 1930 (quoted by Olvera, 1981).

The exportable commodities and agro-industries were mainly four crops that accounted for 72.61 percent of the value of agricultural production of the state: corn and beans, the basics, coffee and sugarcane, the agro-industries. The last two were traded worldwide. Since 1921, the sugar industry was in crisis, which worsened in 1929 with the fall in prices, accompanied by a global overproduction. Coffee suffered similar pressures in the late twenties.

Despite its importance, a very small proportion of the territory of Veracruz was destined to agriculture. Forests occupied nearly 32 percent of the total area, the third of which remained unused (the state contributed 8.7 percent of timber production in the country).

The agricultural sector was characterized by the concentration of land ownership. Common lands (known as ejidos) represented only 10 percent of the working surface. The speculative-strategic ownership stand out, linked to oil production and handled mostly by foreigners. Next to it was equally remarkable the properties owned by cattlemen who occupied besides natural grasslands, large potential agricultural areas.

On the other hand, in 1930, Veracruz was the first federal entity because of the value of its industrial production (just behind Mexico City), with 44.5 percent of workers registered in the census in big industry, in only 0.5 percent of establishments. This proportion was much higher than the national average in general and Mexico City and Nuevo Leon in particular.

The most powerful proletariat and the bourgeoisie of the country were in Veracruz, from the point of view of the concentration of production, capital and employment. Veracruz was the only entity that had three large establishments (more than 1,000 workers each) with a total of 6,497 workers. The biggest factory of the time throughout the country was the Minatitlan refinery, where 3,400 workers toiled.

Veracruz industry was essentially a set of big companies, giants for its time, with little importance of small and medium industries (Olvera, 1981, p. 33). The proportion of medium industries of Veracruz was less than others states; in contrast, the number of family workshops was much higher. This is indicative of a high degree of polarization of manufacturing production divided into a few large establishments and a multitude of small workshops producing for the local market.

In 1929 the industrial structure of Veracruz was characterized by an enormous development of five industrial branches: cotton textiles, sugar, coffee processing, oil refining and beer. All these, modern industries were operated by foreign capital and three of them traded abroad: coffee processing, sugar mills and refineries.

Most of the oil was exported crude, unrefined, so basically all this activity had an exporter character. The other two branches were integrated into the domestic market: cotton textiles and beer. They were immediate consumption goods for the national population. Table 2 shows the state's total and relative national importance of industrial production in 1930.

The 1929 census recorded 3,802 establishments in Veracruz (7.8 percent of the national total), employing 31,199 workers (11.6 percent of the national total).

158 Only 122 establishments (3.2 percent of the total) could be considered proper industrial (small, medium and large  
159 industry) and nevertheless they employed 20,834 workers, 72.67 percent of those registered in the census.  
160

161 **Table 2.** Relative importance of the main industries in the industrial production of the state and country, 1930  
162

	By output value		By number of workers		By number of establishments		By investment		By salary	
	State	Country	State	Country	State	Country	State	Country	State	Country
State total	100	11.23	100	11.62	100	7.78	100	10.98	100	12.57
Cotton mills	23.91	23.61	21.4	20.83	0.26	1.92	26.65	23.38	39.68	27.34
Sugar, alcohol, sugar mills	18.26	34.94	13	26.13	0.89	22.22	24.74	30.62	12.21	36.77
Oil refineries	11.99	96.82	7.9	94.74		66.66	10.69	64.65	15.56	97.62
Coffee processing	10.56	56.82	3.6	39.24	4.9	52.28	1.91	28.27	1.83	48.14
Beer	10.4	24.43	1.6	20.18	0.1	13.33	6.37	26.44	3.13	15.01
Power plants	3.54	5.25	2.5	9.24	1.8	9.9	10.38	5.11	5.41	8.25
Corn mills	3.26	7.51	1.03	5.54	7.15	7.33	0.42	5.46	0.97	8.15
Bakeries	3.17	9.04	2.27	9.3	9.83	10.75	1.74	6.91	2.9	9.63
Cigars and cigarettes	1.97	5.65	1.55	12.4	0.65	18.11	1.14	3.6	2.01	10.79
Jute mills	1.56	39.96	1.9	34.74	-	25	2.13	44.34	1.69	32.6
Grain mills	1.3	2.47	-	1.21	-	0.27	0.78	1.77	0.22	2.42
Mechanics workshops	1.1	3.67	1.81	3.61	1.92	7.41	0.93	4.04	3.63	4.29
Sweetener "piloncillo" and liquor "aguardiente"	1	14.2	31.52	26.3	30.45	28.22	1.79	17.97	1.34	27.96
Soap	0.93	4.2	0.19	3.32	0.31	3.64	0.93	4.23	0.33	3.78
Wood shops	0.81	5.26	1.35	6.71	7.39	6.05	0.57	5.18	1.7	7.46

163 **Source:** I Industrial Census 1930 (quoted by Olvera 1981).  
164  
165

166 The workers of the big industry were 13,914, 44.5 percent of those registered in the census, who were concentrated in  
167 just 19 establishments, with an average of 732 workers per establishment. They were five cotton textile factories, four  
168 sugar factories, a refinery, a brewery, a power plant, a jute textile factory and five large mills.

169 The quintessential industrial city at the time was Orizaba and foreign bourgeoisie owned practically all the great  
170 industry of Veracruz, except for some mills and sugar factories. These were mainly French and British.

171 According to data from the 1930 Industrial Census (quoted by Olvera, 1981), small industry was not numerous. It  
172 employed 1,839 workers (5.9 percent of the census) and it was very dispersed in 56 manufacturing establishments with  
173 an average of 32.8 workers each. They were mainly agro-industries: 16 mills, ten sugar factories and five coffee  
174 processing, which occupied a seasonal proletariat.

175 The craft workshops employing two or three workers were mills, bakeries, corn mills, very tiny coffee processing  
176 and other business of food industry mainly for the local market. They were altogether 1766 establishments (46.4 percent  
177 of total), with only 4,068 workers (13.1 percent). According to the author, in this level, industrial census should have  
178 already lost a lot of coverage.

179 Finally, family workshops, in which no wage labor was occupied, 1,262 workers (33.29 percent of total) were  
180 recorded, but probably there would be many more. Added to this, the high degree of concentration of Veracruz industry  
181 was remarkable: in only 6.15 percent of industrial establishments (about 240) 74.35 percent of the production value was  
182 generated, 70.33 percent of total capital was invested, 47.5 percent of the workers were occupied and 72.41 percent of  
183 the wages and salaries were paid. Only 47 industrial establishments explain 95 percent of the quantitative level of all  
184 variables. There were nine spinning factories and cotton fabric factories, 19 sugar factories, a refinery, 17 coffee  
185 processing and a brewery. In these, the industry of the region was concentrated (Olvera, 1981).

186 It is possible to observe a specialization in five branches: coffee and sugar, textil industry, oil and nondurable  
187 goods (nixtamal mills, bakeries, cigars and cigarettes, jute textil factory, grain mills, a sweetener called "piloncillo" and a  
188 liquor known as "aguardiente"), being the latter destined to the local market and in the vast majority produced in small  
189 industries or in handcrafting workshops.

190 Regarding oil, by 1930 Veracruz accounted for more than 90 percent of national production. By then part of the  
191 extracted crude was processed at three refineries, being Minatitlan (which concentrated 2,459 of 2,778 workers employed  
192 in refineries) the most important. It belonged to the *Compañía Mexicana de Petróleo El Águila*. The main products  
193 extracted from crude were oil, lubricants, naphtha and paraffin. However, the inputs required for refining came from

194 abroad and sometimes had higher value than crude itself.

195  
196 **2.2 Import substitution industrialization**

197  
198 The import substitution model was the dominant economic policy in Mexico since 1940 when industrialization was erected  
199 as a way to achieve development (see Ortega, 2011).

200 While this process of industrialization progressed, the state of Veracruz remained within the same pattern of  
201 development based on agricultural and extractive activities and therefore its industry did not evolve at the same rate than  
202 the country (Ramos, 1975, p. 29). It was a crucial period in the national and local history characterized by high population  
203 growth, transition from a rural to a predominantly urban society, and domestic industry development.

204 Veracruz was a major attraction area for migrants because of the significant level of development involving oil  
205 industry activity, port operations and some factories; subsequently as a consequence of demands derived from this  
206 activity combined with other services such as tourism and commerce (INE, 2007, p. 3).

207 In 1940, the largest city in terms of population was Orizaba, still under the impulse that the textile industry in the  
208 region had. Its decline was evident in the next decade from which the port of Veracruz experienced an unprecedented  
209 growth that continued throughout this period.

210 At first, this dynamism can be explained by the harbor expansion at the juncture of the Second World War and  
211 commerce activities and related services. Later, by the establishment of industries such as Tubos de Acero de México  
212 S.A. (TAMSA) in the fifties which have been catalysts for the region.

213 However, this growth was not necessarily followed by a similar economic development. A loss of the relative  
214 national importance of Veracruz was observed, particularly in sectors as industrial which previously headed.

215 Between 1930 and 1970, the number of industrial establishments in Veracruz fell down from 8.32 percent in 1930  
216 to 5.34 percent in 1970, compared to the total establishments in the country. This brought about the relative decline on  
217 the number of employed persons, the invested capital and total gross production.

218 Veracruz, which was the second state in terms of establishments, labor, investment and industrial production  
219 (immediately after Mexico City) in 1930, became the fifth or sixth, depending on the chosen indicator, in 1970 (Amezcuca,  
220 1981 p. 87).

221 This loss of relevance of Veracruz in the national economy is observed in the declining of its contribution to Gross  
222 Domestic Product (GDP) from 7.67 percent in 1940 to 3.91 percent in 1970, meaning a 48 percent decrease (Amezcuca,  
223 1981, pp. 86 - 87).

224 Since 1940, the transformation industry in Veracruz was relegated to the background, and the importance of the  
225 entity at national level derived from the role that had oil production, and this was relative because by the end of this  
226 period other states began to stand out.

227 As the country industrialized, the regional capital accumulation continued its same traditional dynamics centered  
228 on non-durable consumption goods, in the mining and oil sector.

229  
230 **Table 3.** Percentage of Gross State Product (GSP) to Mexico's GDP, by activities and sectors, 1940-1970

Activities and sectors	1940	1950	1960	1970
Agriculture	10.12	9.48	11.53	17.27
Cattle industry	16.13	6.82	9.99	15.64
Forestry	32.88	2.54	3.18	3.49
Fishing	37.18	13.39	19.73	18.69
Primary sector	13.44	8.48	10.97	16.48
Oil	90.00	85.00	75.00	62.59
Oil industry	1.01	0.02	2.60	5.66
Electricity	16.65	13.33	16.73	9.04
Construction	3.31	2.18	2.95	4.57
Transformation industry	7.67	4.02	4.28	3.91
Secondary sector	13.19	11.12	11.23	9.46
Commerce	5.71	2.40	2.12	2.04
Transportation	7.48	4.93	6.64	9.89
Services	6.4	5.05	5.75	6.37
Tertiary sector	6.11	3.57	3.89	4.26
Total	9.92	6.97	7.66	7.94

231 **Source:** Regional Economic Statistics of the State of Veracruz, 1940-70 (quoted by Bravo, 1972).

232 As shown in Table 3, from the 1950s Veracruz started to lag. Its contribution to GDP falls relative to the prior decade from  
233 9.92 percent in 1940 to 6.97 percent. The most significant drop is observed in the primary sector whose share decreased  
234 47 percent (from 13.44 percent to 8.48 percent) and in the tertiary, 41.5 percent (from 6.11 percent to 3.57 percent); while  
235 the secondary sector reduced its contribution to the national assembly by 16 percent, when passing from 13.9 percent to  
236 11.12 percent.

237 From the data presented in Table 4, it might be concluded that this state becomes industrialized when the  
238 percentage share of secondary activities increased in the gross national product. But when we analyze by sectors, we  
239 find that this impact is due solely to the increase in share percentage of oil, which exceeds the percentage decrease in  
240 the transformation industry. This decline stems from the lack of private sector industrial investment and definitive closing  
241 of old spinning and weaving factories.

242 **Table 4.** Internal structure of the Gross State Product (GSP) of Veracruz, 1940-1970 (percentages)  
243  
244

Activities and sectors	1940	1950	1960	1970
Agriculture	12.91	19.87	18.59	18.67
Cattle industry	14.69	6.92	7.81	9.52
Forestry	2.61	0.24	0.15	0.10
Fishing	0.38	0.37	0.48	0.27
Primary sector	30.59	27.40	27.03	28.56
Extractive industries	0.55	0.01	0.76	1.30
Oil	22.74	33.87	30.9	26.55
Electricity	1.55	1.73	2.63	2.20
Construction	0.73	0.99	1.35	2.25
Transformation industry	14.41	11.86	12.89	13.50
Secondary sector	39.98	48.46	48.53	45.80
Commerce	14.88	9.02	7.16	5.9
Transports	2.86	3.43	4.25	6.26
Services	11.69	11.69	13.03	13.48
Tertiary sector	29.43	24.14	24.44	25.64
Total	100.00	100.00	100.00	100.00

245 **Source:** Regional Economic Statistics of the State of Veracruz, 1940-1970 (quoted by Bravo, 1972).  
246  
247

248 The main Veracruz transformation industries in 1950 were sugar mills, coffee processing and breweries, very similar to  
249 1930. By 1960 its participation in Gross State Product (GSP) increased from 11.86 percent to 11.89 percent reaching  
250 fourth place in all sectors of Veracruz. This phenomenon is the result of industrial investments in the state, especially in  
251 non-traditional items among which the steel, including the launch of TAMSA in 1954; and new food industries.

252 Regarding the characteristics of the manufacturing sector, most of the establishments were as small, that it can be  
253 thought that they were established to meet local demand, in the region and in many cases, the city where they were  
254 located: corn mills, bakeries, tortilla factories, and to a lesser extent, soft drink bottlers, garment, furniture stores, tire  
255 shops and construction materials, representing more than two thirds of the total establishments in 1970 (Ramos, 1975, p.  
256 45).

257 Regarding the agricultural and livestock production, it significantly exceeded the proportion of inhabitants, which  
258 indicates that Veracruz contributed with agricultural inputs to the domestic market.

259 Tertiary activities which hardly suffered any modification in terms of percentage contribution to gross state product  
260 regarding the previous decade, did change their sectorial structure, ranking first place in these activities the services  
261 sector, which recorded a percentage increase, going from 11.69 percent to 13.48 percent. Throughout this period, oil was  
262 gradually decreasing its share in GSP due to intensive resource exploitation outside the limits of the state, mainly in the  
263 continental shelf and Tabasco State.

### 264 2.3 Economic dynamics between 1940 and 1970

265 Before ISI, Veracruz occupied a very important place in the national economy, perhaps because of the scarce  
266 industrialization of the country, its low urban concentration and its high economic dependence from abroad. These  
267 deficiencies that the national economy had by 1940, gave Veracruz a comparative advantage towards the rest of the  
268  
269



country.

Since the early twentieth century, agricultural and extractive activities were the most important in the state. The exploitation of these activities contributed to the development of a large number of small and mid-size urban areas as well as an acceptable communication system. New industries were established, mostly, small business to fulfill the local population needs or to serve the demands of the agriculture and extractive sectors.

Finally, larger firms were established to exploit some of the natural resources: food processing companies (sugar mills); smelting industries; companies using perishable raw materials (fish, seafood or fruit packing) and industries that process mineral resources, such as chemical and petrochemical industries (Ramos, 1975, p. 56).

During the ISI, the state specialized in the production of raw materials for the export sector: mainly sugar and coffee in agriculture, and sulfur in mining. This specialization also covered domestic demand where oil and cattle industry were the main lines. This features an economic imbalance of Veracruz that can be noticed in three levels:

- A) A regional imbalance between Veracruz and the rest of the country;
- B) An interregional imbalance between the major economic areas of the state: Tuxpan, Poza Rica, Coatzacoalcos-Minatitlan, Veracruz and Córdoba-Orizaba, and the rest of the entity.
- C) A critical economic dualism between the most dynamic sectors -oil and agriculture-, and the rest of Veracruz economy (Bravo, 1972, pp. 44-45).

#### 2.4 1975: A temporary boom

As the seventies went by, mining and transformation industry in Veracruz began to rise, followed and perhaps driven by the growth in oil production, electricity and construction (note 2).

This industrial (note 3) "boom" in the state of Veracruz is explained by the national and international situation of the seventies: The shortage of oil pushed up its prices, determining an increase in oil revenues which made affordable and profitable the opening and exploitation of new wells and technological modernization (Amezcuca, 1981, p. 89). Meanwhile, the economic policy of the federal government devoted more attention and priority to regions of the country with proven oil reserves.

Parallel to the crisis overcome supported by oil, the Mexican government and the national bourgeoisie sought to reorient the country's industrial plant to the production of capital goods. The intention was to create a heavy industry of its own, that would give more dynamism to the capital accumulation in Mexico. The establishment of such industry was particularly promoted at places nearby the commodities: energy, sulfur, iron, or close to ports and exit points, characteristics both of Veracruz.

Already since 1970 the national public investment earmarked up to 75 percent of its budget to boost the oil and petrochemical industry settled in the state. Regarding a heavy, industrial plant, complementary or independent from oil, in 1970 the regional development had a slight increase along with the establishment and expansion of 39 companies with an initial capital of 2,000 million pesos in industries such as "Fertilizantes Fosfatados", "Metalúrgica Veracruzana", "Aceros Fortín", "Fibras Acrílicas", and so on, which produced for heavy industry (Amezcuca, 1981, p. 90).

This process of emergence of heavy industry was accompanied by a modernization of the old Veracruz industry based on the production of non-durable consumption goods as textiles or food processing. These industries extended their facilities in response to the rise of regional demand due to the increasing urban population.

By 1975 the most dynamic branches of production in Veracruz were iron ore mining, non-metallic minerals and other non-metallic mineral products which mainly provided the raw material: sulfur, iron, silica, etc. for local and national heavy industry. These branches coexisted with those relatively new and that reflected most the industrial shift of the state: a) chemical products derived from petroleum and coal (secondary petrochemicals), including fertilizers, oils, industrial gases, etc.; b) basic metal industries, including casting of metal products, metal containers, metal structures, galvanizing, etc.; c) machinery and equipment, comprising production and repair of metal furniture, manufacture of mechanical equipment, and tractors; d) chemical products; e) beer production; and f) manufacture and repair of machinery and tools (Amezcuca, 1981, p. 97).

Unlike what happened in other states, Veracruz had many more medium and small establishments and few major industries. Data from the Industrial Census in 1975 show that of 6,016 existing industries in that year, 61.5 percent were family units. The medium industry hardly represented 1.68 percent of the total, with 103 units and the big industry 1.21 percent, hardly 74 units. Family units, craft workshops, small and medium industries, together contributed 98.62 percent of the industrial establishments, but only 12.8 percent of total gross production. While large industry with 1.25 percent of establishments generated 87.12 percent of both, production and added value.

## 2.5 Switching to neoliberalism

The same way than in 1929, the crisis of 1982 led the country to rethink its economic model, now under neoliberal precepts. Among other measures, economy would gradually be opened, liberalizing financial markets and minimizing state intervention in the economic sphere.

Throughout the ISI, an important state-owned industry was created, especially in priority sectors for economy such as oil, electricity and steel. In 1984 the state of Veracruz had 57 state-owned companies, which were mainly located in the cities of Veracruz (26 percent), Coatzacoalcos (23 percent) and the rest along the state (Pimentel, 1986, p. 286).

The main produced goods were: chlorine and caustic soda, lime, cement and shipbuilding (shrimpers, tugboats, tuna boats, patrols and barges), steel products, sugar, alcohol and crystallized honeys. As for the services provided we find air transportation of passengers and cargo, the spread of cultural programs on television, maritime transportation and storage and shipment of products derived from sugar cane, among the most important (Pimentel, 1986, p. 286).

In the decades of 1980s and 1990s, the withdrawal of the federal investment in key sectors of the economy in Veracruz caused the closure of many companies, affecting regional economies and causing massive unemployment. The restructuring of *Petróleos Mexicanos* (Pemex) and the resizing of the oil economy, as well as the closing of *Fertilizantes Mexicanos* (Fertimex), led to a severe reduction in employment (note 4).

After 1980, Veracruz lost its relative importance as a producer of oil and gas. In turn, its contribution to national GDP continued decreasing. According to Rodríguez (1996, 2003), Veracruz contributed 20 percent of total jobs that the domestic manufacturing industry lost between 1985 and 1988.

The change of economic strategy meant a tremendous shock to Veracruz economy. In agriculture, opening of markets, liberalization of prices and transformation of systems of land ownership, have precipitated a massive and renovated population exodus from rural areas to urban centers. As a result, the primary sector on the one hand has become a major supplier of labor to other sectors of the economy but on the other, is failing as a provider of food for a growing urban population as well as of raw materials for processing industries (Acosta, 2005, p. 273). Figure 1 shows the marked decline in state production with respect to national, especially since the 1990s.

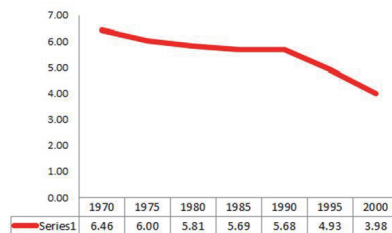


Figure 1. Percentage of Veracruz GSP compared to national, 1970-2000

Source: INEGI, *Sistema de Cuentas Nacionales* (data quoted in García, 2011)

Since then, manufacturing industry has consisted of nine productive branches whose participation has been very unequal. In the decade of 1990, only three of them concentrated 90 percent of the total value of manufacturing production in the state. The branch of food products, beverages and tobacco participated with 44.8 percent of total, the primary metals industry with 24.3 percent and the chemicals manufacturing industry with 20.7 percent. The other branches participate marginally: paper production, printing and publishing with 4.9 percent; the non-metallic mineral products 4.3 percent and that of textiles and apparel 0.2 percent (Secretaría de Desarrollo Económico, 2005, p. 21).

Between 1985 and 1993 the industry in Veracruz closed 16,000 positions in its most dynamic branches, and of large scale, such as petrochemical, pharmaceutical, metal structures, iron and steel, chemicals, textiles, beverages, sugar, preserves, coffee and tobacco products. Furthermore, the lack of investment flows to industrial activities, constraint the ability to provide jobs for surplus labor force released by the primary sector. As a result, the industry sector failed in its expectations of becoming the driven force of economic development.

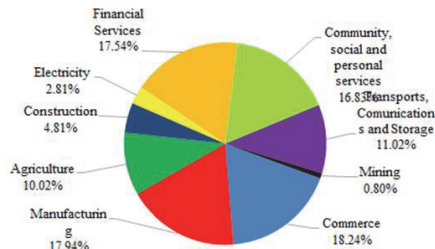
The recession continued almost until the next crisis in 1994. The comparative advantage that the devaluation of the peso represented in 1994, helped boost exports from the region, although this occurred in three specific areas: iron and steel industry (particularly TAMSA company), chemical industry (the case of fertilizers, inorganic chemicals and plastics) and agro-industries, especially the export of coffee (Rodríguez, 2003). Despite the growth of exports in those sectors, in Veracruz around one million economically active people were unemployed in 1996.

370 At the beginning of XXI century, the economic dynamics of the state was determined by 257,623 economic units,  
371 mainly distributed in commercial activities (45 percent); non-financial private services (29 percent) and manufacturing  
372 industry (15 percent).

373 Manufactured products in recent years have had a declining behavior. Since 1997, when the value of  
374 manufacturing output fell two percent, negative growth rates were consecutively recorded. This behavior caused that from  
375 1996 to 2004 the value of production fell 5.5 percent, which contrasts with the national increase of 28.5 percent  
376 (Secretaría de Desarrollo Económico, 2005, p. 23).

377 As figure 2 shows, the most important productive sectors for the value of their production were: in first place,  
378 commerce with 18.2 percent of total state production; then the manufacturing industry with 17.9 percent; the financial  
379 services sector with 17.5 percent and community, social and personal services, with 16.8 percent.

380



381

382 **Figure 2.** Veracruz. Production by sector (2002)

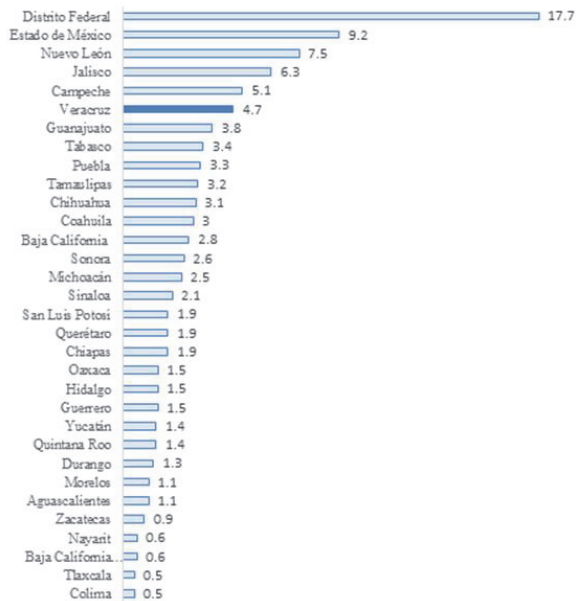
383

384 **Source:** Secretaría de Desarrollo Económico, 2005

385

386 In recent years the tertiary sector has been the most dynamic of the economy in Veracruz. However, this increasing  
387 participation is not focused on activities that can generate employment multiplier effects and increase the potential  
388 productivity of human resources, such as those related to teleinformatics and telecommunications. Instead, productivity is  
389 focused on activities related to tourism and commerce. In 2010 Veracruz was the third most populous state in Mexico and  
390 the fifth largest economy. As seen in the figure 3, that year, it contributed with 4.7 percent of GDP.

391



392

393 **Figure 3.** State Participation in Gross Domestic Product (year 2009)

394

**Source:** INEGI (2010).

394 In recent years, the secondary sector of the economy (including hydrocarbons) was increasing its importance: while in  
395 2003 it contributed 30 percent of Gross Territorial Product (GTP), by 2010 contributed almost 38 percent. In more recent  
396 years, the growth drivers of Veracruz are related to increased public investment in sectors such as energy (oil, gas and  
397 electricity), infrastructure (roads, water and sanitation, building) as well as private investment in areas such as industrial  
398 manufacturing, housing, real estate development, tourism, retail and logistic services.

399 The three major branches have maintained a strong growth dynamic in recent years: the metal industry with an  
400 increase of 46.1 percent and food, beverages and tobacco with 14.6 percent, while the production value of the chemicals  
401 subsector fell 34.9 percent from 1995 to 2004 (Programa Veracruzano de Desarrollo Económico y Portuario 2011 – 2016.  
402 Gobierno del Estado de Veracruz/Secretaría de Desarrollo Económico y Portuario, 2011).

403 The commercial sector has shown a positive trend, although it has been slowing down compared with increases of  
404 transportation and tourism. Since 1990, the hotel industry of Boca del Rio has registered important qualitative and  
405 quantitative changes, derived from the arrival of national and international hotel chains that have modified the structure of  
406 the lodge features in the city.

407 Under the current economic model, exportations and foreign direct investment (FDI) have taken on a new and  
408 determinant role. Export activity of the state of Veracruz grew 32.6 percent between 1999 and 2002. Export structure  
409 shows up a deep concentration on only two types of products: smelting and manufactured products of iron and steel, and  
410 organic and inorganic chemicals products. As for foreign investment, 261 companies with FDI are located in the state (0.8  
411 percent of a total of 30,939 societies with foreign participation registered in the country).

412 The economic activity branches that have benefited from the inflow of foreign investment have been, in order of  
413 importance: the electrical industry with 39.5 percent, basic industry of iron and steel with 35.1 percent, chemicals  
414 manufacturing 23 percent, transformation and milling of cereals and other agricultural products 11.3 percent, the  
415 provision of professional, technical and specialized services 7.2 percent, manufacturing and / or assembly of transport  
416 equipment and its parts with 4.1 percent, manufacturing and / or assembly of machinery and equipment for specific tasks  
417 2.8 percent, and wholesale of food, beverages and tobacco products 1.2 percent of the total (Secretaría de Desarrollo  
418 Económico, 2005, pp. 39-40).

419 Most of the companies of foreign origin in the state are located in the manufacturing sector (32 percent); 28.4  
420 percent in commerce; 28 percent in services: community and social; hotels and restaurants; professional, technical and  
421 personal, services to the agriculture, cattle industry, construction, transport, financial and commerce. This means that  
422 only three types of economic activities concentrate 88.5 percent of all foreign companies in the state. This same pattern  
423 of concentration of investment is observed in geographical terms, since 62.5 percent of all businesses are in the  
424 metropolitan area of Veracruz-Boca del Rio.

### 425 3. Conclusion

426  
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428 The brief description we have done of the economic evolution of the entity since the late nineteenth century - during the  
429 Porfiriato - up to the beginning twenty-first century, allows us to confirm that Veracruz has lost relevance in the national  
430 economic scene. From being the first state economy in the country, it lost its preeminence during the period of the ISI,  
431 been replaced by states of large industrial development such as Nuevo Leon, Mexico State and Mexico City. Since then it  
432 has continued to decline up to 2009 ranking sixth place nationally after the states above mentioned as well as Jalisco and  
433 Campeche (See Figure 3).

434 Despite its decline, Veracruz has maintained a position among the top six states that contribute most to GDP.  
435 Today, it's most important sectors have diversified and include industry, energy, commerce, tourism and agro-industries.  
436 Thus, it is possible to find some continuities, changes and ruptures in remarkable sectors and economic activities, as  
437 shown below.

438 As for continuities, certainly the most outstanding and that can be traced to the colonial period, is the importance of  
439 the primary sector, particularly cattle industry and the cultivation of sugarcane. These activities represented in 2009 only  
440 5.69 percent of gross state product, despite of it several products top domestic production.

441 Stockbreeding (especially bovine) brought to the continent by the Spaniards, is an activity that stands to date as  
442 the main national producer contributing 14.6 percent of the total raw meat (INEGI n/d).

443 It's also distinguishable another traditional activity that arrived with the conquerors from Spain: the cultivation of  
444 sugarcane. Veracruz produces a third of the national total (33 percent). In the early twentieth century, coffee production  
445 was added to these primary activities. The state stands second in the country, with a contribution of 22 percent nationally.

446 In addition to the mentioned above, another of the continuities can be found in the tertiary sector that in 2009  
447 accounted for 58.49 percent of GSP in Veracruz. At the beginning, the centrality of this sector was in commerce, having

448 the port and the activities associated to it, a prominent place. However, the composition of the tertiary sector has  
449 undergone a series of qualitative changes among which the increase of services excels.

450 Commerce stopped being the most relevant sector in tertiary activities to give way to an increasingly growing  
451 importance of services, particularly: 1) Transportation and logistics (mostly associated to port activity); 2) financial and  
452 real estate services; and 3) tourism services.

453 Another remarkable change was the emergence of tourism in the 1960s, which began to stand out as a relevant  
454 economic activity, especially since the mid- nineties with the economic liberalization that allowed the arrival of the large  
455 hotel chains.

456 From the 1920s, another change in state economic composition emerged with the growing importance of the oil  
457 industry, being Veracruz for several decades the main oil producer in the country. Today ranks third nationally  
458 contributing just 3.6 percent, well below Campeche and Chiapas.

459 The presence of refineries in Veracruz area led to the false impression that the transformation industry was  
460 relevant in the state. However, removing this item, manufacturing was quite poor. This situation has changed over time,  
461 particularly since the second half of the twentieth century with the arrival of TAMSA to Veracruz. Although of late  
462 development compared to the national experience, manufacturing has gained importance and now represents almost 14  
463 percent of production in Veracruz, non-negligible proportion considering that at country level, this represents 17.5 percent  
464 of GDP (INEGI, 2009).

465 As for ruptures, without doubt the most outstanding is the disappearance of the textile industry which after  
466 practically being the pioneer of industrialization in the country in the nineteenth century, moved to Puebla and other states  
467 in the early twentieth century.

468 Another remarkable fact about breakups refers to the loss of relevance of Veracruz in forestry, decreasing from 33  
469 percent at a national level to less than 3.5 percent. This is explained, in large part by the deforestation caused by the  
470 lumber industry but also by the expansion on cattle industry as well as agriculture.

471 With its continuities, changes and ruptures, Veracruz economy faces a major challenge: to boost capitalist  
472 development in the region to overcome the widespread economic backwardness, in order to put the local producers in  
473 conditions to take advantage of trade opening and leave behind precarious conditions on which most of the production  
474 takes place. Particularly in the agricultural sector, where a significant percentage of farmers are engaged in domestic  
475 subsistence production.

476 There's still a lot to be achieved. Understanding the features of Veracruz long run economic development enables  
477 us to identify trends and opportunities to regain the prominent place it deserves on the national stage.

478

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480

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482

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520 **Notes**

521  
522 Note 1. The mills elaborated especially panela which was the sweetener of popular consumption since refined sugar was  
523 an export product; also used to produce liquor. It was not until the fall in world sugar prices that it became a product for  
524 the masses (Bartra et al., 1993).

525 Note 2. There are disparities in the quantities provided by different authors so it is not possible to perform time  
526 series of the variables except for the 1940-1970 periods (whose quantities were calculated at the Economic and Social  
527 Studies Center, Faculty of Economics at Universidad Veracruzana). In another study, data are presented for the years  
528 1970, 1975, 1980, based on information provided by INEGI (Statistical Yearbook of Veracruz, 1984), or the Industrial  
529 Census of 1975. This may explain the differences between one table and another.

530 Note 3. An example of this "boom" is the fact that 83 percent of the electricity consumption in 1975 was held in the  
531 industrial sector, 10 percent was residential use and 4 percent of the commercial sector (Pimentel, 1986, p. 314).

532 Note 4. Only in the oil industry 24,000 jobs were lost between 1988 and 1993 (Anguiano, 2005).

# Perceived Organizational Crisis Preparedness of Corporations in Stock Exchange of Thailand 100 (SET 100 index)

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## Abstract

This study examines perceived organizational crisis preparedness of corporations listed in Stock Exchange of Thailand 100 index, and compares the differences on organizational characteristics among these companies. Samples of 300 employees in six companies in different industries listed in SET 100 were purposively selected to participate in this study by using non-probability sampling approach. Thirty items of self-administrated questionnaires were equally distributed to these six companies. The total of three-hundred questionnaires was returned with completion. The descriptive statistics were used to analyze the level of perceived organizational crisis preparedness, and to compare mean differences of independent variables on perceived organizational crisis preparedness. The results showed that the total mean score of perceived organizational crisis preparedness of respondents were "high." The limitations and further recommendations were also discussed.

**Keywords:** Crisis Preparedness, Crisis Management, Stock Exchange of Thailand, SET 100

## 1. Introduction

To become a successful company in a highly turbulent environment in today's business world, a company must have an ability to cope with uncertainties or unusual situations when occurred. Ability to deal with crises depends on the company's readiness and preparation when confronting with crisis. Though various studies have attempted to examine the promptness of crisis management in different settings (Chong & Nyaw, 2002; Ocal, Oral, & Erdis, 2006; Fowler, Kling, & Larson, 2007; Najafbagy, 2011; Johansen, Aggerholm, & Frandsen, 2012), there is still a few research focusing on prevent preparedness, which is necessary to measure the crisis management process and results (Promsri, 2014). In particular, a study of organizational crisis preparedness in Thailand is limited, and needs to be explored especially companies listed in Stock Exchange of Thailand 100 index (SET 100). Stock Exchange of Thailand has indexed the most effective and efficient corporations based on the following criteria: the period of registration in a stock market (required at least six months), market value and capitalization, the ratio of free-float (at least 20%), etc. Companies listed in Stock Exchange of Thailand 100 index are technically robust in terms of financial performance and profitability. To achieve these goals, listed companies in SET 100 index must be able to manage their organizational resources effectively and efficiently regardless of the types of situations companies confront. To ensure that companies listed in SET 100 index have sufficient capabilities to deal with unusual circumstance, organizational crisis preparedness are needed to be measured. Moreover, the previous research indicated that demographic and organizational factors including respondent's gender, respondent's position in organization, number of employees, respondent's employment state, level of education, work experience (years), type of industry, and education in crisis management, had influenced on companies' crisis preparation and management (Chong & Nyaw, 2002; Fowler, Kling, & Larson, 2007; Johansen, Aggerholm, & Frandsen, 2012). Therefore, this study aims to examine perceived organizational crisis preparedness of corporations listed in SET 100, and to compare the differences on organizational characteristics among these companies.

### 1.1 Research Questions

1. What is level of perceived organizational crisis preparedness of corporations listed in SET 100?
2. What are differences on perceptions of organizational crisis preparedness of corporations listed in SET 100 in terms of basic characteristics of the organizations?

56 **2. Literature Review**

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After reviewing related concepts and research on crisis management, this present study developed the conceptual framework that was consistent with the research objectives. The variables appeared on conceptual framework were created based on the literature review, as shown in Table 1. Independent variables were developed based on the works of Chong and Nyaw (2002); Fowler, Kling, and Larson (2007) and Johansen, Aggerholm, and Frandsen (2012). Independent variables included 'Respondent's gender', 'Respondent's position in organization', 'Number of employees', 'Respondent's employment state', 'Level of education', 'Work experience (years)', 'Type of industry', and 'Education in crisis management.'

Perceived organizational crisis preparedness was determined as dependent variable in this study. Perceived organizational crisis preparedness were described the understanding, confidence, and familiarity of organization's preparation based on employees' perceptions. This variable was developed based on the works of Fowler, Kling, and Larson (2007); Dinkin (2007); and Bernstein (2012).

**Table 1.** Research variables

Variables	Brief description	Authors	Dependent (D)/ Independent (I)
Organizational and Demographic Variables	-Respondent's gender -Respondent's position in organization -Number of employees -Respondent's employment state - Level of education - Work experience (years) - Type of industry -Education in crisis management	Fowler, Kling, & Larson (2007) Chong & Nyaw (2002) Johansen, Aggerholm, & Frandsen (2012)	Independent Independent Independent
Perceived Organizational Crisis Preparedness	Perceived organizational crisis preparedness are described the understanding, confidence, and familiarity of organization's preparation based on employees' perceptions.	Fowler, Kling, & Larson (2007); Dinkin (2007), Bernstein (2012)	Dependent

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**3. Methodology**

A survey research design was used to answer the research questions in this study. The research design of this study involved a comparison of perceived organizational crisis preparedness of companies listed in SET100.

*Independent variables* of this study were gender, position in organization, number of employees, respondent's employment state, level of education, work experience (years), type of industry, and education in crisis management.

*Dependent variable* of this study was perceived organizational crisis preparedness.

**3.1 Sampling Plan**

Participants consisted of a total of 300 employees from six companies in six different industries listed in SET 100. According to the criteria of Stock Exchange of Thailand, the industry was divided into eight different industries including agricultural industry, financial industry, property and construction industry, resource industry, service industry, consumption industry, industrial industry, and technological industry . However, there were a few companies in consumption and industrial industries listed in SET 100 index, and after contacting the companies in these two industries, they denied to participate in this study. Therefore, there were only six industries including agricultural industry, financial industry, property and construction industry, resource industry, service industry, and technological industry left for data collection. This study was used purposive sampling to select the companies due to the availability and accessibility of the companies. To improve the sample representativeness, questionnaires were distributed based on organizational size. Large organization with more than 1,000 employees received 50 copies. In this study, most of purposively selected companies listed in SET 100 were large corporations. Thus, each company was sent 50 copies of questionnaire equally. The researcher and the research assistant contacted the HR managers of each company in a different industry to distribute the questionnaires to employees. To ensure that each company could return all completed 50 copies to the researcher, the instruction of doing a questionnaire was explained to the HR managers of each company before they



distributed the questionnaires. Overall, the total of 300 questionnaires of each company in six different industries was returned to the researcher by posted mail with completion.

### 3.2 Data Collection

Data were collected in six large corporations in six different industries including agricultural industry, financial industry, property and construction industry, resource industry, service industry, and technological industry. Questionnaires were equally distributed to HR managers of each company by mail. To ensure the receipt of questionnaires, HR managers of each company were contacted to recheck whether they had received the questionnaires yet. Prior to the questionnaire completion, the researcher and research assistants contacted the representatives of each company to explain the purpose of the study and confirmed the rights protection of subjects. Participants were asked to complete the questionnaire by assessing their degree of agreement based on their perceptions towards organizational crisis preparedness. The researcher asked HR managers of each company to check the completion of each returned questionnaire and the research assistant rechecked again before processing data analysis. Collected data were analyzed using only descriptive statistics to answer two research questions as the non-probability sampling was used.

### 3.3 Instrumentation

A perceived organizational crisis preparedness scale was developed based mainly on a 21-item crisis/ disaster preparedness scale created by Fowler, Kling, and Larson (2007) with their permission. Their scale covered five key areas of crisis including secondary terrorist attack, natural disaster, major terrorist attack, accidental disaster, and workplace violence. Additionally, the relevant concepts of organizational crisis preparedness from Dinkin (2007) and Bernstein (2012) were included as additional items in a modified scale. A rationale of adding additional items was to ensure that some dimensions such as training and support of external agencies were included as part of organizational crisis preparedness. Additional items included item#22-30, according to Table 2. A total of 30-item for a perceived organizational crisis preparedness questionnaire was finalized and tested for validity and reliability. To ensure the meaning of each item when translated into Thai language, a reversed translation was done by a professional translator. In addition, the index of item-objective congruence (IOC) was used to evaluate the content validity of each item of the scale. A total of five experts in related fields were asked to evaluate the score for each item. The IOC score of more than 0.5 was acceptable. For this instrument, there was no item received a score less than 0.5.

A final version of perceived organizational crisis preparedness scale comprised of 30-item with a 4-point rating scale (1-4). Participants were asked to rate each item of scale to the extent in which each characteristics described them properly. The rating scale of perceived organizational crisis preparedness scale were 1 = "strongly disagree", 2 = "disagree", 3 = "agree", and 4 = "strongly agree". This instrument had a Cronbach's alpha of 0.94, which was highly acceptable. Criteria used to interpret mean scores was determined by calculating the interval class as follows: maximum score – minimum score/ number of levels. Thus, the mean scores interpretation can be categorized to 4 levels as follows:

- Mean scores between 3.26 – 4.00 = strongly agree (Vey high)
- Mean scores between 2.51 – 3.25 = agree (High)
- Mean scores between 1.76 – 2.50 = disagree (Low)
- Mean scores between 1.00 – 1.75 = strongly disagree (Very low)

## 4. Findings

As of 300 questionnaires distributed to six companies in different industries listed in Stock Exchange of Thailand 100 index (informally called SET 100), all of them were returned with completion. The Demographic and Organizational characteristics provided information about the background of each respondent. Personal and organizational factors of sample respondents showed that more than a half of respondents were female (57%). The majority of respondents' employee position was nonmanagement (74%). For number of employees, the largest group of respondents stated that their companies had more than 6,000 employees (64.2%). Regarding organizational size, some employees may be confused while filled out this question as they might have thought about the total number of employees of the holding company or the total number of employees in their working companies under the management of the holding company. For employment state, the majority of respondent was employee (80.3%). Personal and organizational factors of sample respondents presented that the largest group of respondents was educated in "undergraduate degree" level (63.3%). Almost a half of respondents had approximately 1-10 years of working experience (48%). For type of industry, as each

151 company had 50 employees completed the survey questionnaire, the number of each industry was therefore equal, which  
152 was about 16.7% out of a hundred. For education in crisis management, most of respondent was provided education  
153 about crisis (74.3%).

154  
155 **Table 2.** Mean and Standard Deviation for Perceived Organizational Crisis Preparedness (n=300)  
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	Mean	S.D.	Level	Ranking
1) I am very familiar with our company's evacuation plan	3.11	.614	High	17
2) My organization has provided each employee with a basic emergency preparedness kit (e.g., flashlight, smoke mask, etc.)	3.22	.584	High	6
3) The security at my workplace is adequate.	3.24	.610	High	4
4) If a crisis occurred at my organization, I am familiar with the plan for how family members can get information on the status (e.g. safety) of their relatives.	3.00	.649	High	25
5) In the event of an emergency or disaster, I am familiar with my organization's plan to continue operations from another location.	2.94	.767	High	29
6) All organization suffered a serious crisis; I would still have my job.	3.07	.766	High	22
7) If my organization suffered a crisis, I would still be covered by my organization's employee benefits (e.g. health insurance, etc.)	3.24	.631	High	3
8) Security at my workplace has been significantly increased since the anti-government demonstration occurred.	3.19	.563	High	9
9) I know where the nearest fire extinguisher is to my desk/ workstation.	3.11	.632	High	14
10) If a crisis and evacuation occurred at my organization, I am familiar with our plan on how to communicate with my fellow employees from scattered or emergency locations (such as cell phone numbers, websites, or e-mail lists).	3.07	.635	High	24
11) Most of our employees are familiar with my organization's crisis/ disaster plan.	2.97	.696	High	27
12) As part of our emergency plan, customers and suppliers would be able to contact us for information.	2.97	.633	High	28
13) If my organization suffered a crisis/ disaster, I would have the data I need to do my job backed up at a remote site.	3.10	.711	High	18
14) My organization offers to pay to have volunteer employees trained in basic life support techniques, such as CPR, first aid, etc.	3.11	.619	High	16
15) My organization has contingency plans in place so our customers would be covered if we suffered a disaster.	3.21	.552	High	7
16) I know where the nearest emergency exits are to my desk/ workstation.	3.29	.588	Very High	2
17) My organization's emergency plan has been coordinated with local agencies, such as the fire department, hospitals, etc.	3.22	.596	High	5
18) All organization members are required to rehearse portions of our crisis plan, for example, evacuation.	3.29	.633	Very High	1
19) It would be easy for a potentially threatening nonemployee to gain access to my workplace.(R)	2.93	.882	High	30
20) If organization suffered a serious crisis, I would still get paid until we could reopen.	2.99	.812	High	26
21) Every employee knows what his or her job is when certain types of crises occur.	3.10	.620	High	20
22) All employees would be provided orientation or refresher training relating to crisis management.	3.10	.669	High	19
23) My organization's current plan is regularly updated based on changes in the organization as well as by periodic brainstorming session about vulnerabilities.	3.15	.583	High	12
24) My organization's current plan was prepared by professionals in related fields of crisis/ disaster.	3.20	.561	High	8
25) My organization considers the external effect of crisis that may affect the organization.	3.17	.591	High	11
26) My organization conducts training and simulation about crisis for all employees	3.12	.693	High	13
27) My organization has a backup for all data when crisis occurred.	3.17	.617	High	10
28) Employees would be provided knowledge about crisis/ disaster through the internet and intranet system.	3.09	.691	High	21
29) My organization collaborates with internal agencies for developing activities that relate to crisis preparedness.	3.11	.623	High	14
30) My organization has a handbook of crisis/ emergency management plan and all employees know where to get this information.	3.07	.648	High	23
<b>Total</b>	<b>3.11</b>	<b>.397</b>	<b>High</b>	

157  
158 To answer research question # 1, Table 2 showed the summary of the results of perceived organizational crisis

159 preparedness of respondents from six companies in different industries listed in SET100. The total mean score of  
 160 perceived organizational crisis preparedness of respondents were "high" (M =3.11, S.D. = .397). To consider each item  
 161 from the highest mean scores to the lowest mean scores, the findings indicated that item#18 "All organization members  
 162 are required to rehearse portions of our crisis plan, for example, evacuation" was perceived in a very high level (M = 3.29,  
 163 S.D. = .633). The second highest mean score was item#16 "I know where the nearest emergency exits are to my desk/  
 164 workstation" (M =3.29, S.D. = .588). For the lowest mean scores, the findings showed that item#19 "It would be easy for a  
 165 potentially threatening nonemployee to gain access to my workplace" was perceived "low" (M = 2.93, S.D. = .882). The  
 166 second lowest mean score was item#5 "In the event of an emergency or disaster, I am familiar with my organization's  
 167 plan to continue operations from another location" (M = 2.94, S.D. = .767).  
 168

169 **Table 3.** Compare Mean Differences among Demographic and Organizational Characteristics Variables for Perceived  
 170 Organizational Crisis Preparedness (n = 300)  
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Demographic and Organizational Characteristics Variables	Mean	S.D.
<b>Gender</b>		
Male	3.10	.392
Female	3.12	.402
<b>Position in Organization</b>		
Top Manager	3.52	.307
Middle Manager	3.34	.425
First-line Manager	3.13	.468
Non-management	3.06	.363
<b>Number of Employees</b>		
Less than 2,000	2.79	.238
2,000-4,000	3.10	.496
4,000-6,000	3.08	.320
More than 6,000	3.11	.412
<b>Employment State</b>		
Executives	3.32	.423
Employee	3.06	.374
<b>Level of Education</b>		
Lower than Undergraduate Degree	2.97	.345
Undergraduate Degree	3.06	.374
Graduate Degree	3.32	.407
<b>Work Experience</b>		
1-10	3.10	.383
11-20	3.09	.415
More than 20	3.20	.392
<b>Type of Industry</b>		
Agricultural Industry	3.27	.336
Financial Industry	2.91	.241
Property and Construction Industry	3.54	.433
Resource Industry	2.98	.338
Service Industry	3.10	.141
Technological Industry	2.88	.377
<b>Education in Crisis Management</b>		
Provided	3.21	.382
Not Provided	2.82	.286

172 To answer research question # 2, Table 3 showed mean differences among demographic and organizational variables for  
 173 perceived organizational preparedness of employees in six companies in different industries. Results found that female  
 174 (M = 3.12, S.D. = .402) had a slightly higher perception of organizational crisis preparedness than male (M = 3.10, S.D. =  
 175 .392). For position in organization, top manager (M = 3.52, S.D. = .307) had higher perception of organizational crisis  
 176 preparedness than middle manager (M = 3.34, S.D. = .425), first-line manager (M = 3.13, S.D. = .468), and  
 177 nonmanagement (M = 3.06, S.D. = .363), respectively. For number of employees in a specific organization, respondents  
 178 who worked at the organization that had more than 6,000 employees (M = 3.11, S.D. = .412) had higher perception of  
 179 organizational crisis preparedness than smaller size companies. For employment state, findings indicated that executives  
 180

(M = 3.32, S.D. = .423) had a higher perception of organizational crisis preparedness than the employee (M = 3.06, S.D. = .374). Further, respondents who held graduate degree (M = 3.32, S.D. = .407) had higher perception of organizational crisis preparedness than respondents who earned undergraduate degree (M = 3.06, S.D. = .374) and below undergraduate degree (M = 2.97, S.D. = .345), respectively. For work experience, results found that employees with more than 20 years of working experience (M = 3.20, S.D. = .392) had higher perception of organizational crisis preparedness than employees with 1-10 years of working experience (M = 3.10, S.D. = .383), and employees with 10-20 years of working experience (M = 3.09, S.D. = .415), respectively. To compare mean differences among employees in six companies for different industries, results showed that respondents who worked in property and construction industry (M = 3.54, S.D. = .433) had higher perception of organizational crisis preparedness than agriculture industry (M = 3.37, S.D. = .326), service industry (M = 3.10, S.D. = .141), resource industry (M = 2.98, S.D. = .338), financial industry (M = 2.91, S.D. = .241), and technological industry (M = 2.88, S.D. = .377). In addition, the findings indicated that employees with education in crisis management (M = 3.21, S.D. = .382) had a higher level of perceived organizational preparedness than employees without education in crisis management (M = 2.82, S.D. = .286).

## 5. Conclusion and Discussion

For research question #1, results showed that the total mean score of perceived organizational crisis preparedness of respondents were "high." To consider each item from the highest mean scores to the lowest mean scores, the findings indicated that item#18 "All organization members are required to rehearse portions of our crisis plan, for example, evacuation" was perceived in a very high level. The second highest mean score was item#16 "I know where the nearest emergency exits are to my desk/ workstation." This finding was consistent to Promsri (2014) who found that the employees in a paper packaging company perceived item#18 as the highest mean score. This means that purposively selected companies listed in SET 100 in six different industries had the rehearsal like evacuation as part of their crisis management and preparation. For the lowest mean scores, the findings showed that item#19 "It would be easy for a potentially threatening nonemployee to gain access to my workplace" was perceived "low." The second lowest mean score was item#5 "In the event of an emergency or disaster, I am familiar with my organization's plan to continue operations from another location. Overall, the results of perceived organizational crisis preparedness showed the readiness of six organizations listed in SET100 to cope with crisis events as the total score was in "high" level. This may be because these organizations had a big market capitalization and large assets, and they needed to ensure that they had had crisis management plan in place for before crisis, during crisis, and after crisis to handle with crisis properly and effectively. Moreover, based on the findings, it seemed that most organizations attempted to rehearse their employee to be ready for confronting with crisis incidents. These findings were consistent with Promsri's (2014) findings.

For research question #2, findings found that female had a higher perception of organizational crisis preparedness than male. Top manager had higher perception of organizational crisis preparedness than middle manager, first-line manager, and non-management, respectively. This was consistent with the findings of Fowler, Kling, and Larson (2007), which indicated that the top management had a higher perception of crisis preparedness than typical employees. Furthermore, respondents who worked at the organization that had more than 6,000 employees had higher perception of organizational crisis preparedness than smaller size companies. These findings were inconsistent with Fowler, Kling, and Larson (2007) who found that organizations employed more than 500 employees showed the highest perception of crisis preparedness. This was because these two studies were conducted in the different context in terms of type and size of company. Also, executives had a higher perception of organizational crisis preparedness than the employees. This finding was consistent with Promsri's (2014) findings as he found the significant differences between executives and employees. This study examined the perception of employees of a packaging company in Thailand towards organizational crisis preparedness. This study showed that executives of a packaging company had a greater perception on organizational crisis preparedness than employees. Besides, this present study also found that respondents who held graduate degree had higher perception of organizational crisis preparedness than respondents who earned undergraduate degree and below undergraduate degree, respectively. Additionally, results found that employees with more than 20 years of working experience had higher perception of organizational crisis preparedness than employees with 1-10 years of working experience, and employees with 10-20 years of working experience, respectively. However, all of these respondents perception with different working experience towards crisis preparation in the organization were in "high" level, which means that different working experience of respondents did not affect the perception on organizational crisis preparedness. This finding supports the findings of Promsri (2014) as he found no significant differences of perceived organizational crisis preparedness among employees who had the different years of working experience. The finding of this study was inconsistent with Najafbagy's study (2011), which reported that the older managers were

accustomed to crisis management, and took crisis events and incidents more critically than younger ones. Among six companies in different industries, results showed that respondents who worked in property and construction industry (M = 3.54, S.D. = .433) had higher perception of organizational crisis preparedness than agriculture industry, service industry, resource industry, financial industry, and technological industry. This finding was new knowledge in this field, and needed to be explored more in the further study. In addition, the findings indicated that employees with education crisis had a higher level of perceived organizational preparedness than employees without education crisis. This finding was consistent with Promsri's findings (2014), which indicated significant difference between employees for education in crisis, which employees with education crisis had a higher level of perceived organizational preparedness than employees without education crisis.

## 6. Limitations and Recommendations for Future Research

There were some limitations in this research. As this research used a small sample size in different companies in different industries listed in SET100 index using non-probability sample, the results of this study were unable to generalize to other companies or industries listed in SET100. This impacted on the external validity of this study. Thus, to strengthen external validity of the study, the sampling technique must have been changed in the further study to ensure the representativeness of respondents. Some variables such as the number of employees might be deducted for the future study since they may cause some confusion for the respondents. The further study should expand the sample size, and focus on the specific companies in the same industry or various companies in the different industries to compare the differences of perceived organizational crisis preparedness. Inferential statistics must be used to analyze the differences of organizational crisis preparedness among the chosen organizations to find the significant differences between the variables. Besides, even though the validity and reliability of scale measurement in this study were highly acceptable, the exploratory factor analysis and confirmatory factor analysis must be used to reconfirm and remove some variables, and group the dimensions of organizational crisis preparedness. Furthermore, other variables relating to organizational characteristics should be considered for the further study. The comparative study of two or more corporations in the same or different industries about perceived organizational crisis preparedness should be investigated in the future. This would help understand the readiness of each corporation in terms of crisis management and preparedness.

## 7. Acknowledgement

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# The Efficacy of Energy Production and Economic Growth in Aggregate Energy Consumption: A Panel Data Evidence from Selected OIC Countries

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## Abstract

This paper examines correlated variables of energy resources and growth, and their contribution in aggregate energy consumption. Its main objective is to identify the efficacy of energy, as well as to find out to which extent an economy is based on energy in order to extrapolate whether it is highly linked to energy-based industries or not. For this purpose, an empirical model is regressed for the logarithmic annual stationary data of selected OIC countries over the period 1991-2010. The results reveal that the GDP growth in Saudi Arabia has led to reduced levels of aggregate energy consumption, and does not for the UAE in the short-run. Moreover, the economies of Malaysia and Libya are highly linked to energy use especially natural gas in the long-run. And vice versa for Algeria and Indonesia in which the crude oil and natural gas production are not statistically significant.

**Keywords:** crude oil, natural gas, electricity, panel data, energy use efficiency.

## 1. Introduction

During the last two decades, the introduction of high levels of competition in the crude oil, electricity and natural gas sectors of several OIC member countries has raised the general question of the efficiency of these sectors (Konac 2004). Therefore, the increasing attention given to energy issues in OIC countries and their policies for achieving a better use is a major reason of this paper via examining the effect of energy production on the aggregate energy consumption over the period from 1991 to 2010.

A number of research papers related to energy sector have attracted many economists and policy makers in recent times due to its role in determining levels of economic growth particularly in producing oil countries. In this paper, we considered three components of energy supply; crude oil, electricity, and natural gas, and we added the per capita GDP variable. The main question is; what is the association between these variables and energy consumption? However, this study is an attempt to investigate how much the production of different energy sectors will affect aggregate energy consumption in oil countries like Saudi Arabia, Libya and the UAE, and other economies such as Malaysia, Indonesia and Algeria, which gas sector represents a main source of energy. Accordingly, our analysis is seeking to extrapolate the energy policy of these economies and its impact in this context. Analysing of diagnostic tests of data of this study combined into three samples, each one represents two countries due to their geographical location. Where, Saudi Arabia and the UAE as GCC, Libya and Algeria as NA, and Indonesia and Malaysia as EA. The main purpose for that is to analyse them as samples of various geographical areas of selected OIC member countries, while the econometric model will be estimated for each country by using a fixed panel data technique.

## 2. Review of Literature

Many studies which addressed the relationship between the energy and economic performance are varied notably due to the different economic structures of the countries studied. As well as, the period of these studies. It is also differentiated because of the differences of level of economic development. The majority of these studies have found a positive linkage running from different energy sectors to GDP. However, we will consider some literature which is commonly cited by many scholars in order to shed light on the mainstream of energy studies. (Costantini and Martini 2010) showed an empirical study for not stationary and co-integrated panel data with a large sample of developing and developed countries. (Kwakwa 2011) and (Siddiqui 2012) for the causal linkage between energy consumption and economic growth by using modern panel unit root technique. While the study of (Loganathan and Subramaniam 2010) represents that

56 energy consumption in Malaysia is on sustainable limits, as well as it stated a bidirectional co-integration effect between  
57 total energy consumption and economic performance.

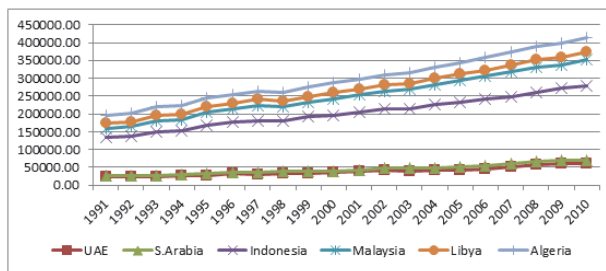
58 In addition, other studies are inferred a positive association between energy use and economic growth using  
59 different methods. For instance, (Gbadebo and Okonkwo 2009, Fatimah Kari and Ahmed 2014) found a positive linkage  
60 between economy and energy consumption in Nigeria and GCC countries. These evidences have also been found in  
61 other studies like (Sari, Ewing et al. 2008) and (Kaplan, Ozturk et al. 2011) which analyses the positive role of energy  
62 towards economies of many countries.

63 Although there are studies that pursued many methods, few studies have explicitly examined the association  
64 between energy consumption and its production using the disaggregate panel data approach for selected OIC countries.  
65 However, the disaggregate data allow for comparison of the relative strengths of the relationship with an energy source.  
66 Accordingly, our approach is on investigating the link between the aggregate energy consumption and the disaggregate  
67 energy productions in selected OIC countries. On the other hand, to pinpoint exactly the impact of the differences of  
68 energy sources on different economic structures. The conclusions would have particular relevance for assessment  
69 related energy policies in the OIC countries.

### 3. Study Background

73 In general, energy consumption is globally increased parallel to technological progress and population growth (Kaplan,  
74 Ozturk et al. 2011). Figure (1) below depicts trends of aggregate energy consumption for the period 1991 to 2010. It is  
75 obvious that Algeria, Libya, Malaysia and Indonesia have controlled a high level of energy consumption. It is a result of  
76 the urbanization process, economic growth, industrialization and population growth (Wee, Matsumoto et al. 2008).  
77 However, natural gas represented 63 percent of energy consumption in Algeria in 2002 and is the main source of  
78 Algeria's electricity generation (Grein, Nordell et al. 2007). In Indonesia, the industrial energy consumption has soared by  
79 6 percent per year since 1990, faster than the economic growth rate of 4.5 percent a year (EER 2011).

81 **Figure 1:** Aggregate energy consumption in the countries of study, 1991-2010 (Thousand metric ton of oil equivalent)



83  
84 **Source:** By the author based on data of SESRIC- Statistical, Economic and social research and training centre for  
85 Islamic countries, Turkey (<http://www.sesric.org/databases-index.php>)

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88 On the contrary, Saudi Arabia and the UAE represent a corresponding low level compared to the said countries at the  
89 mentioned period, but energy consumption of these economies has grown quickly and caused a shortage in the natural  
90 gas supply which is a major source for power generation (Marc Hormann and Joern Carlos Kuntze 2012). Moreover, the  
91 energy consumption trend is also hardly affected by the sharp increase of energy after the 1992-1994 period experienced  
92 by many countries caused by the inclusion of a specific energy source "combustible renewable and waste" which was  
93 highly consistent for Indonesia (Costantini and Martini 2010).

94 In Table (1) below, we note that the growth levels of energy consumption were positive –except that for crude oil  
95 production of Indonesia- over the period 1991 to 2010, on average. However, these levels have ranged from 0.02 to 0.05  
96 for the production of natural gas and consumption of electricity. In contrast, the generation of electricity witnessed a high  
97 growth, particularly in the UAE, Malaysia and Indonesia by 0.08, 0.07 and 0.07 respectively. This fact could be explained  
98 by the positive growth levels of these economies, especially in Malaysia and Indonesia, where their GDP per capita  
99 growth rate rose by 0.06 and 0.07 respectively. Furthermore, we note that the growth levels of aggregate energy  
100 consumption are less than the growth of per capita GDP, and vice versa for the UAE and Saudi Arabia.

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**Table 1:** Growth of energy consumption and production, and GDP per capita, on average 1991-2010 (percentages)

Country	Energy consumption	Crude oil production	Electricity production	Natural gas production	GDP per capita
UAE	0.05	0.00	0.08	0.03	0.02
S. Arabia	0.04	0.00	0.05	0.04	0.03
Algeria	0.02	0.02	0.05	0.02	0.04
Libya	0.02	0.01	0.06	0.05	0.02
Malaysia	0.05	0.00	0.07	0.05	0.06
Indonesia	0.03	-0.02	0.07	0.02	0.07

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**Source:** Calculated by the author based on data of SESRIC- Statistical, Economic and social research and training centre for Islamic countries, Turkey (<http://www.sesric.org/databases-index.php>).

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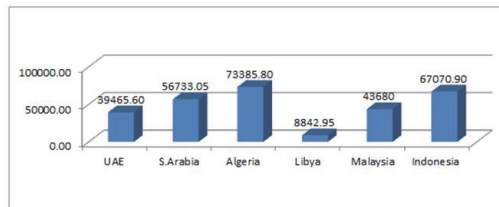
This means, the achieved value added of non-oil countries is higher than that of oil countries, particularly the UAE and Saudi Arabia. Meaning that, Malaysia and Indonesia have reached economies of scale because of their growth levels are higher than the growth of energy consumption, where their growth is related to the growth of their manufactured industries (Yean 1997, Timmer and Szirmai 2000) . In Libya, the consumption growth was equal to its GDP per capita growth level, while is less in Algeria, as shown in Table above.

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In respect of energy production, it is well known that Saudi Arabia and the UAE are major crude oil producers compared to other OIC member countries of the study. They are the dominant source of energy use. However, this feature could be considered a key factor for efficiency in terms of energy use for both two countries. Accordingly, the economic growth is still highly linked to oil sector and other industries that related to the energy sector despite of pursuing many economic policies to diversifying the non-oil industries (Fatimah Kari 2013). Furthermore, we noted that in Algeria and Malaysia, the natural gas and oil controlled at 36 percent and 20 percent of the GDP, respectively (Yean 1997, UEA 2012). While oil export revenues are extremely crucial to the growth of Libyan economy. It represents 90 percent of the total revenues (Mohamed Ekhlal 2007). Also, Algeria and Indonesia reached for the second rank in terms of natural gas production in comparison with other countries of this study (Timmer and Szirmai 2000). However, they produced 73385.80 and 67070.90 million standard cubic meters, as shown in the following figure:

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**Figure 2:** Production of Natural Gas, on average, 1991-2010 (Million standard cubic meters)



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**Source:** By the author based on data of SESRIC- Statistical, Economic and social research and training centre for Islamic countries, Turkey (<http://www.sesric.org/databases-index.php>)

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In respect of electricity generation, we see that Saudi Arabia and Indonesia have dominated on a higher level, which amounted by 139.21 and 97.20 billion kilowatt-hour on average for the period 1991-2010. However, through the previous presentation, we saw that the high positive growth of energy consumption and production is the mainstream for the countries of the study over the period 1991-2010. Therefore, our next analysis will be focusing on the impact of these main energy sources on the aggregate energy consumption, as well as the efficiency of energy use and the linkage between the economic growth and energy consumption for these economies.

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#### 4. Data and Variables

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The study uses a panel data approach consists of six OIC countries which involves 120 balanced observations for the period 1991 to 2010 (t = 1...20). For diagnostic tests, the data formed as samples, which are; GCC (Saudi Arabia and the UAE), EA (Malaysia and Indonesia), and NA (Libya and Algeria). In the panel data technique, the model is regressed for



the full observations of each country selected for this study.

The variables used in the model are; aggregate energy consumption, crude oil production, electricity production, natural gas production, and GDP per capita. However, the major reason of this model is to empirically investigate the impact of crude oil, natural gas, and electricity on energy consumption in order to state which variable is leading for more efficiency over the period of the study.

#### 4.1 Model specification

The model proposed is derived from the idea of Medlock and Soligo (Costantini and Martini 2010) which postulated that the energy consumption as a function of economic output. Accordingly, we selected three components of energy production as a main economic output and input of economic growth for the study variables; namely crude oil, electricity and natural gas, as follows:

$$Ec_{ij} = f(Pco_{ij}, PNG_{ij}, Pe_{ij}, Gdp)$$

Where energy consumption ( $Ec$ ) at time  $t$  is a function of production of crude oil ( $Pco$ ), Electricity ( $Pe$ ) and natural gas ( $Png$ ). However, in this specification, the economic growth is also expressed in terms of energy production variables, as well as GDP per capita. Therefore, a suitable representation of this relation could be represented by the following equation:

$$\text{Log}_{10}(Ec) = a + b1 \text{log}_{10}(Pco) + b2 \text{log}_{10}(Pe) + b3 \text{log}_{10}(Png) + b4 \text{log}_{10}(GDP) + ui$$

Where ( $a$ ) intercept,  $b1$ ,  $b2$ ,  $b3$  and  $b4$  are the slope coefficients. ( $u$ ) error term at time  $t$ . Furthermore, the variables of the model are measured as follows; ( $Ec$ ) thousand metric ton of oil equivalent, ( $Pco$ ) thousand barrels per day, ( $Pe$ ) billion kilowatt-hours, ( $Png$ ) million standard cubic meters, and ( $GDP$ ) US dollar.

#### 4.2 Diagnostic tests and results

In order to ensure the validity of the data of study, as well as the correlation between the variables used, we have conducted several diagnostic tests. These tests infer that the variables are statistically valid. Thus, it could be used for setting an economic analysis for the result of the estimators of this study. These tests are:

##### 4.2.1 Unit root test

Prior to running the regression, the Augmented Dickey Fuller test (ADF) is essential for testing the stationary of panel data series (Lall 1998). However, the obtained values confirm that the regression result of this study is not spurious. However, we found that the variables in their levels were not stationary at both 1 percent and 5 percent significant levels. Table (2) illustrated that the data are stationary at the difference one, and statistically significant at their 1 percent and 5 percent levels. This implies that the variables of the study could be estimated by the model adopted.

**Table 2:** Unit root test of the variables of the study

Variable	t-statistics	1% critical value	5% critical value	Prob <sup>(*)</sup>
Log EC	-11.67185	-2.584707	-1.943563	0.0000
Log PCO_GCC	-10.81117	-2.584707	-1.943563	0.0000
Log PE_GCC	-13.10038	-2.584707	-1.943563	0.0000
Log PNG_GCC	-10.92187	-2.584707	-1.943563	0.0000
Log GDP_GCC	-10.96986	-2.584707	-1.943563	0.0000
Log PCO_EA	-10.81520	-2.584707	-1.943563	0.0000
Log PE_EA	-10.70325	-2.584707	-1.943563	0.0000
Log PNG_EA	-10.85689	-2.584707	-1.943563	0.0000
Log GDP_EA	-10.93444	-2.584707	-1.943563	0.0000
Log PCO_NA	-12.12554	-2.584707	-1.943563	0.0000
Log PE_NA	-11.68523	-2.584877	-1.943587	0.0000
Log PNG_NA	-11.04173	-2.584707	-1.943563	0.0000
Log GDP_NA	-11.21126	-2.584707	-1.943563	0.0000

\*MacKinnon (1996) one-sided p-values.

Source: By the author based on Eviews software.

183 4.2.2 Correlation test

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For measuring the strength and direction of the linear association between the variables of study, we have conducted the Pearson correlation test. As well known, the degree of correlation of coefficients will vary from -1 to +1. A negative sign indicates a presence of perfect negative linkage between the variables. And vice versa in terms of obtaining a positive sign (Olayiwola and Okodua 2009). Table (3) illustrates the strength of a linear association between the variables of the GCC sample – Saudi Arabia and the UAE. However, the pearson correlation test shows that there is a large positive strength<sup>(\*)</sup> between the aggregate energy consumption and the production of crude oil, electricity generation, and natural gas production, which amounted to be 0.91, 0.79 and 0.85 respectively. Whereas the linkage between EC and per capita GDP was a medium negative, (-0.412). Accordingly, we can say that a positive relationship implies as a value of one variable increases so does the value of another variable, and vice versa in terms of a negative correlation.

**Table 3:** Pearson correlation test for the GCC sample

		EC_GCC	PCO_GCC	PE_GCC	PNG_GCC	GDP_GCC
EC_GCC	Pearson Correlation	1	.912**	.798**	.857**	-.412**
	Sig. (2-tailed)		.000	.000	.000	.008
	N	40	40	40	40	40
PCO_GCC	Pearson Correlation	.912**	1	.634**	.595**	-.707**
	Sig. (2-tailed)	.000		.000	.000	.000
	N	40	40	40	40	40
PE_GCC	Pearson Correlation	.798**	.634**	1	.798**	-.119
	Sig. (2-tailed)	.000	.000		.000	.463
	N	40	40	40	40	40
PNG_GCC	Pearson Correlation	.857**	.595**	.798**	1	.066
	Sig. (2-tailed)	.000	.000	.000		.686
	N	40	40	40	40	40
GDP_GCC	Pearson Correlation	-.412**	-.707**	-.119	.066	1
	Sig. (2-tailed)	.008	.000	.463	.686	
	N	40	40	40	40	40

Source: By the author based on SPSS software.

\*\* . Correlation is significant at the 0.01 level (2-tailed).

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Therefore, it is clear that the correlation result is fit for these variables to be estimated in order to test how much the energy produced components affect the level of aggregate energy consumption over the period of the study, 1991-2010.

**Table 4:** Pearson correlation test for the EA region (Malaysia and Indonesia)

		EC_EA	PCO_EA	PE_EA	PNG_EA	GDP_EA
EC_EA	Pearson Correlation	1	.739**	.690**	.899**	-.672**
	Sig. (2-tailed)		.000	.000	.000	.000
	N	40	40	40	40	40
PCO_EA	Pearson Correlation	.739**	1	.101	.589**	-.917**
	Sig. (2-tailed)	.000		.534	.000	.000
	N	40	40	40	40	40
PE_EA	Pearson Correlation	.690**	.101	1	.817**	-.022
	Sig. (2-tailed)	.000	.534		.000	.891
	N	40	40	40	40	40

(\*) Strength of association

positive

negative

Small

0.1 to 0.3

-0.1 to -0.3

Medium

0.3 to 0.5

-0.3 to 0.5

Large

0.5 to 1.0

-0.5 to 1.0

Source: Delliitte (2011). "Energy on demand: the future of GCC energy efficiency " Deloitte. from [http://www.deloitte.com/assets/Dcom-MiddleEast/Local%20Assets/Documents/Industries/Energy%20&%20resources/E&R%20whitepapers/me\\_er\\_whitepaper4\\_energy\\_efficiency.pdf](http://www.deloitte.com/assets/Dcom-MiddleEast/Local%20Assets/Documents/Industries/Energy%20&%20resources/E&R%20whitepapers/me_er_whitepaper4_energy_efficiency.pdf).

PNG_EA	Pearson Correlation	.899**	.589**	.817**	1	-.414**
	Sig. (2-tailed)	.000	.000	.000		.008
	N	40	40	40	40	40
GDP_EA	Pearson Correlation	-.672**	-.917**	-.022	-.414**	1
	Sig. (2-tailed)	.000	.000	.891	.008	
	N	40	40	40	40	40

\*\* Correlation is significant at the 0.01 level (2-tailed).

**Source:** By the author based on SPSS software.

Furthermore, Table (4) shows the association between the variables of EA sample- Malaysia and Indonesia. However, we have found that all variables are correlated, and the production of natural gas (PNG) dominated on a significant level of correlation with energy consumption. This means the important role of natural gas of these countries as a main source of energy, where the positive relationship is amounted to be a 0.899. Moreover, PCO and PE are situated at the second and third rank, 0.73 and 0.69 respectively. While the per capita GDP has a large negative correlation. This implies the increase of economic growth and per capita by one time have led to reduce the level of energy consumption by 0.67 times over the period 1991-2010. Meaning that, the economic growth of EA sample has led to achieving an efficiency in term of using energy sources. However, this result could be attributed to the role of advanced technologies used in the manufacturing sectors of these economies (Lall 1998). Furthermore, it is worth noting that the growth levels of natural gas production in Malaysia and Indonesia were less than that of per capita GDP. However, the PNG have grown by 0.05 percent and 0.02 percent while the per capita GDP by 0.06 percent and 0.07 percent in both two countries, respectively as shown in Table 1. Again these percentages confirm that the economic growth in Malaysia and Indonesia was not leading to increasing levels of PNG consumption.

**Table 5:** Pearson correlation test for the sample of NA (Algeria and Libya)

		EC_NA	PCO_NA	PE_NA	PNG_NA	GDP_NA
EC_NA	Pearson Correlation	1	-.075	-.274	.831**	.306
	Sig. (2-tailed)		.642	.083	.000	.052
	N	41	41	41	41	41
PCO_NA	Pearson Correlation	-.075	1	.943**	-.446**	.899**
	Sig. (2-tailed)	.642		.000	.003	.000
	N	41	41	41	41	41
PE_NA	Pearson Correlation	-.274	.943**	1	-.593**	.788**
	Sig. (2-tailed)	.083	.000		.000	.000
	N	41	41	41	41	41
PNG_NA	Pearson Correlation	.831**	-.446**	-.593**	1	-.165
	Sig. (2-tailed)	.000	.003	.000		.303
	N	41	41	41	41	41
GDP_NA	Pearson Correlation	.306	.899**	.788**	-.165	1
	Sig. (2-tailed)	.052	.000	.000	.303	
	N	41	41	41	41	41

Source: By the author based on SPSS software.

\*\* Correlation is significant at the 0.01 level (2-tailed).

Table (5) illustrates that the PNG variables of Algeria and Libya have a large association with the energy consumption, while other variables were not statistically significant. This confirms the significance of the PNG as a major energy source, which positively influenced the level of aggregate energy consumption over the period of the study. It is a crucial determinant of economic growth of NA sample.

#### 4.2.3 Cointegration test

The Johansen trace test for cointegration is regressed to find out whether there is a long-run association between the variables of each sample in the study. Table (6) shows the presence of cointegration in the EA and NA samples, while in the GCC sample did not exist. Table 6 below states that there is no cointegration between aggregate energy consumption (EC) of GCC sample and the energy producing components, PCO, PE, PNG and per capita GDP. However, there is no

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significance at 0.01 level, and this means the long –run relationship does not exist in the case of GCC sample. Whereas, the above table illustrated a log-run relationship for the variables of the samples EA and NA. This means, the variables involved in the regression equation will move together (Engle and Granger 1987). However, the regression result will be analysed as a short-run relationship for the variables of GCC sample, and as a long-run relationship for EA and NA samples.

**Table 6:** Johansen trace test result for cointegration

Variable	Hypothesized No. of CE(s)	Eigenvalue	Trace statistics	0.5 Critical value	Prob.**
Log EC_GCC, Log PCO_GCC, Log PE_GCC, Log PNG_GCC, Log DP_GCC	None	0.519775	55.15858	69.81889	0.4124
	At most 1	0.426834	28.75257	47.85613	0.7800
	At most 2	0.132748	8.715690	29.79707	0.9934
	At most 3	0.084254	3.588368	15.49471	0.9339
	At most 4	0.011592	0.419763	3.841466	0.5171
Log EC_EA, Log PCO_EA, Log PE_EA, Log PNG_EA, Log GDP_EA	None *	0.735467	83.49730	69.81889	0.0028
	At most 1	0.423102	35.62492	47.85613	0.4155
	At most 2	0.201711	15.82166	29.79707	0.7248
	At most 3	0.147485	7.711431	15.49471	0.4968
	At most 4	0.053176	1.967126	3.841466	0.1608
Log EC_NA, Log PCO_NA, Log PE_NA, Log PNG_NA, Log GDP_NA	None *	0.964129	243.1253	69.81889	0.0000
	At most 1 *	0.851687	123.3236	47.85613	0.0000
	At most 2 *	0.690817	54.62018	29.79707	0.0000
	At most 3	0.274318	12.36258	15.49471	0.1404
	At most 4	0.022505	0.819444	3.841466	0.3653

Source: By the author based on Eviews software.  
(\* ) denotes rejection of the hypothesis at the 0.05 level.  
(\*\*) MacKinnon-Haug-Michelis (1999) p-values.

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**5. Model Estimation**

To indicate an ideal choice between fixed effect and random effect estimators in panel data context (Skrabic and Tomic-Plazibat 2009), the Hausman test is used. However, we have found that the probability is less than 0.05 (Prob.< 0.05) and statistically significant at 0.01 level, as shown in Table 7. Therefore, fixed effect regression is preferred. As well as, Durban-Watson value is amounted by 2.01 and this means that the model adopted is apart from auto-correlation statistic problem. However, this model is reliable and it could be used for analysing the result presented in Table 8.

**Table 7:** Hausman test result for the model of study

Test Period Random effects			
Test Summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob.
Period random	175.676308	12	0.0000

**Source:** By the author based on Eviews software.

**5.1 The model result**

All GDP per capita variables –except for Indonesia- are statistically significant at 1 percent and 5 percent levels, therefore we can say that a one time increase of this variable is leading to rising level of aggregate energy consumption by 0.18, 0.28, 0.46 and 0.51 times in Algeria, Malaysia, Libya, and the UAE respectively. Accordingly, it can be seen that Algeria and Malaysia have achieved an efficiency for the total GDP, where a one unit of GDP has produced with a relatively low level of energy. In Saudi Arabia, the increase of level of GDP per capita by one time has effected in dropping level of aggregate energy consumption by 0.21 times. This result could be explained by the growing of non-oil industries in this country, in which the value added achieved does not cause in consuming a high level of energy as other energy-based industries.

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**Table 8:** Regression result of the model, fixed effects

Dependent Variable: EC  
Method: Panel Generalized Method of Moments  
Sample: 1991 2010  
Cross-sections included: 6  
Total panel (balanced) observations: 120

Variable	Coefficient	Std. Error	t-Statistic	Prob.
GDP_ALG	0.188631	0.086564	2.179079	0.0319(**)
GDP_IN	0.044983	0.051950	0.865900	0.3888
GDP_KSA	-0.216433	0.098095	-2.206357	0.0299(**)
GDP_LY	0.467797	0.057044	8.200694	0.0000(*)
GDP_MY	0.289433	0.052548	5.508022	0.0000(*)
GDP_UAE	0.515065	0.216886	2.374823	0.0197(**)
PCO_ALG	-0.079843	0.090675	-0.880536	0.3809
PCO_IN	-0.022307	0.196530	-0.113504	0.9099
PCO_KSA	0.367640	0.176956	2.077577	0.0406(**)
PCO_LY	-0.208123	0.091883	-2.265092	0.0259(**)
PCO_MY	-0.313152	0.181500	-1.725357	0.0879
PCO_UAE	-0.042509	0.152740	-0.278310	0.7814
PE_ALG	0.464068	0.129373	3.587046	0.0005(*)
PE_IN	0.368870	0.090338	4.083224	0.0001(*)
PE_KSA	0.002408	0.012980	0.185508	0.8532
PE_LY	-0.071694	0.031288	-2.291398	0.0243(**)
PE_MY	0.066164	0.167924	0.394013	0.6945
PE_UAE	0.449979	0.068523	6.566816	0.0000(*)
PNG_ALG	-0.016580	0.111748	-0.148373	0.8824
PNG_IN	0.124094	0.238066	0.521259	0.6035
PNG_KSA	1.126528	0.093495	12.04906	0.0000(*)
PNG_LY	0.420888	0.042286	9.953361	0.0000(*)
PNG_MY	0.646959	0.188679	3.428886	0.0009(*)
PNG_UAE	0.031726	0.095707	0.331487	0.7410
C	1.838164	0.295218	6.226458	0.0000

Effects Specification

Cross-section fixed (dummy variables)

R-squared	0.997876	Mean dependent var	4.726579
Adjusted R-squared	0.997192	S.D. dependent var	0.311565
S.E. of regression	0.016511	Sum squared resid	0.024534
Durbin-Watson stat	2.076402	J-statistic	90.00000
Instrument rank	31.00000		

(\*) Statistically significant at the (1%) level.  
(\*\*) statistically significant at the (5%) level.

**Source:** By the author based on Eviews software and fixed effect panel data technique.

On the other words, we can say that Saudi Arabia has a sound economic policy for reducing level of energy consumed aside to accomplish a high level of value added.

Besides, the model reveals that only crude oil production variable of Libya and Saudi Arabia are statistically significant at 0.01 and 0.05 levels. However, rising of oil production level by one time has led to increasing levels of aggregate energy consumption by 0.20 and 0.36 times in both both countries respectively. In this context, Libya's oil sector has a high efficiency in terms of energy used in the oil producing process. However, this analysis is consistent with the level of growth of crude oil production, and if we revert to Table 1 we will clearly see that the growth level of this sector in Libya is amounted by 1 percent on average for the period of the study. While in Saudi Arabia is about 0 percent for the same duration. This fact infers the necessity of accomplishing a positive growth level which enhances level of

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282 efficiency of energy use. On the contrary, the model depicts that the crude oil production variables of the rest countries of  
283 study are not statistically significant. This implies that the crude oil sector does not affect substantially as other energy  
284 resources.

285 In respect of electricity generation, the result illustrates that its increase by one time will cause in rising of level of  
286 aggregate energy consumption by 0.36, 0.44 and 0.46 times in Indonesia, the UAE, and Algeria respectively. Hence, we  
287 can say that the electricity generation of Algeria and the UAE is costly in comparison to Indonesia. However, this result  
288 could be attributed to the demand- supply gas imbalance as an input for power generation, due this factor, the UAE  
289 started since 2009 to import natural gas from other countries (Kombargi, Waterlander et al. 2010). Furthermore, we noted  
290 that the increase of level of electricity generation by one time in Libya has led to bridge level of energy consumption by  
291 0.07 times. The main reason pertains to this result is that using of electricity power as a good substitution for other energy  
292 sources, notably, Libya consume a lower level compared to other countries of this study. It generates only 17.95 billion  
293 kilowatt - hour, while in the UAE, Indonesia and Algeria are about 46.58, 97.20 and 27.96 billion kilowatt-hour. However,  
294 we can say also that Libya has an active policy which affected gradually in reducing level of energy consumption of  
295 electricity sector over the period of study. In contrast, we see that the electricity variable of Saudi Arabia and Malaysia is  
296 not statistically significant. Meaning that, the electricity generation is not an important element in its impact on the  
297 aggregate energy consumption.

298 Finally, the result pertaining to natural gas production illustrated that its rising by one time will affect positively in  
299 increasing level of aggregate energy consumed by 1.12, 0.42, and 0.64 for Saudi Arabia, Libya, and Malaysia. However,  
300 this result reveals that Saudi Arabia has not achieved an efficiency, where producing natural gas is costly compared other  
301 countries such as Libya and Malaysia.

## 302 6. Concluding Remarks

303 The empirical analysis is carried out on the full observations of a fixed model regressed, and on separate sub-samples,  
304 correlation test and cointegration test. However, the study found a large positive association between the variables used  
305 for the GCC and the EA samples, except for GDP per capita. It was a large negative, where the pearson correlation test  
306 showed this fact. According to the empirical results of the model adopted, we can conclude that the growth level in the  
307 UAE is accompanied with high level of energy consumption, particularly for electricity sector as a main factor of  
308 consuming natural gas. However, this finding could be linked to growing of urbanization, as well as, energy-based  
309 industries. While in Saudi Arabia the growth level has led to bridge level of energy use despite of oil sector And natural  
310 gas production have not accomplished an efficiency. This case, however, could be explained by the role of other non-oil  
311 industries which is not based on a high level of energy use. Hence, these industries influenced positively more than that  
312 of energy sectors. In Malaysia, the growth level coupled with high level of energy use in comparison to other countries of  
313 study. This finding is a reflection of growing of the industry sector in this country. Furthermore, natural gas production  
314 does not achieve efficiency. Therefore, we can say that the Malaysian economy is highly linked to energy use especially  
315 natural gas as a major source of energy. In addition, the electricity sector in Indonesia is efficient compared to the rest  
316 countries of study. And vice versa for Algeria, the electricity generation sector has led for consuming a high level of  
317 energy. While its GDP per capita growth level has an efficiency, hence, this means that the economic growth in Algeria is  
318 based on sectors in which does not rely on a high level of energy use. Whereas the Libyan economy is highly linked to  
319 natural gas production, which ensure that the growth level achieved is related to energy sector more than other  
320 components of the economy.

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# Analyzing Relationship between Job Satisfaction and Algerian Excellence Model: A Study on Algerian Quality Award Winners

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## Abstract

The main purpose of the study was to determine the relationship between job satisfaction and Algerian excellence model criteria. A survey that contains Algerian excellence model criteria and job satisfaction questionnaire are applied to Algerian quality award winners. The study contained 326 questionnaires which were collected from the employees of these companies. 203 questionnaires were returned and included in statistical analyze. The data were analyzed using SPSS in order to evaluate the relationships. The results showed significant relationship between job satisfaction and Algerian excellence model ( $p < 0.05$ ). The relationship between job satisfaction and organizational excellence shows that organizations that are going to implementing organizational excellence model, should be aware of job satisfaction which has a supporting role for the successful implementation. Furthermore, it seems that numerous factors affecting Algerian excellence model criteria can induce significant differences in the organizational excellence scores of these organizations.

**Keywords:** Job Satisfaction, Algerian excellence model criteria

## 1. Introduction

Whether an organization is from the public or private sector, manufacturing or services, big or small, it must manage its resources well to achieve superior performance. With changing global economic conditions, it needs to be nimble and adaptable to ensure its sustainability. Over the last years, the business excellence initiative has helped organizations enhance their management systems and processes to achieve sustained growth. Organizations use the business excellence framework as a roadmap for their business excellence journey. It helps them to assess where they are on the journey, identify gaps, and take actions for improved performance. Business Excellence Model is a management tool which is used by managers to assess their organizations and to perform the organizational change to pursue business excellence. Business excellence designed awards to win by the organizations whom applied these models, winning the quality awards and business excellence awards is now becoming a favorite objective.

Excellence model is a systematic framework for evaluating of organizations performance. Recognizing weakness and strength points and also improvable points of organization could be the outcomes of such evaluation model. In the industrial domain organizational excellence and job satisfaction are related together, a lot of studies were done on excellence model and job satisfaction find that there is a relationship between them.

## 2. Business Excellence Models

Business Excellence Models (BEMs) were first called Total Quality Management models. Today they are usually referred to as Business Excellence Models – this term helps to communicate the importance of “excellence” in all aspects of a business, not only product and process quality. The models are used to assess how well business excellence core values and concepts (the ingredients of success) are embedded in an organization. These models are now used in at least 83 countries as a key mechanism to help businesses to improve<sup>1</sup>.

BEMs help organizations to assess their strengths and areas for improvement and guide them on what to do next. BEMs provide senior managers with a holistic method with which to manage their business and get buy-in to key decisions that will lead to sustainable and measurable success. In a sense, the BEMs serve as the organization's own

<sup>1</sup> - Robin Mann and Musli Mohammad, *Understanding Business Excellence: An awareness guidebook An awareness guide book for SMEs for SMEs, Asian Productivity Organizations, 2012, p 4*



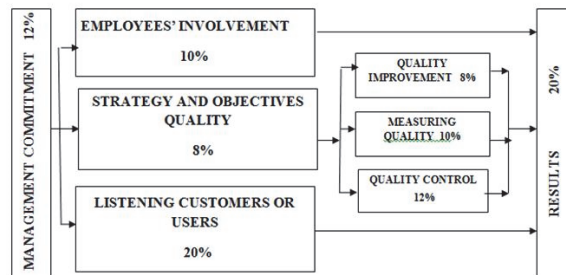
54 internal business consultant – ensuring that business decisions incorporate the needs of all stakeholders, are aligned to  
55 the organization's objectives and take into account current thought on international best practices.

56 The existing BEM have in most cases been developed or been supported by national bodies as a basis for award  
57 programs and for the widespread adaption of the principles and methods of TQM and Business Excellence. Today,  
58 Majority countries awards base their frameworks upon the Malcolm Baldrige National Quality Award (MBNQA) criteria or  
59 the European Foundation for Quality Management (EFQM)/ European Excellence Award criteria, or Deming awards the  
60 Japanese excellence model, or create an appropriate model.

### 61 62 3. Basis of Algerian Excellence Model

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64 Like the industrialized countries, Algeria has a recognition system of the efforts of companies in the field. Indeed, the  
65 program for Development of a National Standards System, approved by the Government in March 2000, has included the  
66 institution of the Algerian Price of Quality. The award was launched in 2003 by the Ministry of Industry, it consists of a  
67 competition open to companies and organizations operating in Algeria. It contains eight criteria<sup>2</sup>:

- 68 - Management commitment
- 69 - Employees' involvement
- 70 - Listening customers or users
- 71 - Strategy and objectives quality
- 72 - Measuring quality
- 73 - Quality improvement
- 74 - Quality control
- 75 - Results
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79 **Figure 1: The Algerian Excellence Model**

### 80 81 4. Job Satisfaction

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83 Job satisfaction as any combination of psychological, physiological and environmental circumstances that cause a person  
84 truthfully to say I am satisfied with my job. According to this approach although job satisfaction is under the influence of  
85 many external factors, it remains something internal that has to do with the way how the employee feels. That is job  
86 satisfaction presents a set of factors that cause a feeling of satisfaction<sup>3</sup>.

87 The job satisfaction is an individual's positive measurable judgment on his or her working conditions. job  
88 satisfaction is an internal state, which was an affective evaluation on the job by liking or disliking and the degree<sup>4</sup>.

89 Job satisfaction defined as a more of an attitude, an internal state. It could for example, be associated with a  
90 personal feeling of achievement either quantitative or qualitative. Although most people are satisfied with their jobs  
91 overall, they are not necessarily happy with all aspects of their jobs. And it is defined as a pleasurable emotional state

<sup>2</sup> - Ministry Of Industry SME And Promotion Of Investisement, Algerian Quality Awards, 2012 ; Pp 9-11

<sup>3</sup> - Brikend Aziri , Job Satisfaction: A Literature Review, Management Research And Practice Vol. 3 Issue 4 ,2011, P77

<sup>4</sup> Yanhan Zhu, A Review Of Job Satisfaction, Asian Social Science, Vol 9, No 1, Published By Canadian Center Of Science And Education, 2013; P 294

92 resulting from the appraisal of one's job; and it is an affective reaction to one's job, and an attitude towards one's job<sup>5</sup>.  
93 Job satisfaction is defines as a pleasurable or positive emotional state resulting from the appraisal of one's job or job  
94 experiences<sup>6</sup>.

95 Job satisfaction is a result of employee's perception of how well their job provides those things that are viewed as  
96 important. it is generally recognized in the organizational behavior field that job satisfaction is the most important and  
97 frequently studied attitude. There are three important dimensions to job satisfaction<sup>7</sup>:

- 98 ■ Job satisfaction is an emotional response to a job situation. As such it cannot be seen, it can only be inferred.
- 99 ■ Job satisfaction is often determined by how well outcome meet or exceed expectations. For instance, if  
100 organization participants feel that they are working much harder than others in the department but are  
101 receiving fewer rewards they will probably have a negative attitudes towards the work, the boss and or  
102 coworkers. On the other hand, if they feel they are being treated very well and are being paid equitably, they  
103 are likely to have positive attitudes towards the job.
- 104 • Job satisfaction represents several related attitudes which are most important characteristics of a job  
105 about which people have effective response. These are: the work itself, pay, promotion opportunities,  
106 supervision and coworkers.

## 108 5. Research Model

109 According to the literature, Algerian excellence model has relationship with job satisfaction with eight criteria:

- 110 - Management commitment
- 111 - Employees' involvement
- 112 - Listening customers or users
- 113 - Strategy and objectives quality
- 114 - Measuring quality
- 115 - Quality improvement
- 116 - Quality control
- 117 - Results
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Independent Variable	Dependent Variable
Algerian excellence model	Job satisfaction
Management commitment	
Employees' involvement	
Listening customers or users	
Strategy and objectives quality	
Measuring quality	
Quality improvement	
Quality control	
Results	

120 These factors are presented in the following research model.

### 121 5.1 Management commitment

122 Management commitment is terms of providing resources and active involvement in process improvement. Active  
123 involvement refers to monitoring SPI activities and developing personal interest in process improvement initiative that  
124 ultimately brings up energy, passion and excitement among employees<sup>8</sup>. Management commitment must be driven by a  
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<sup>5</sup> - Louise Van Scheers Johan Botha, *Analysing Relationship Between Employee Job Satisfaction And Motivation*, *Journal Of Business And Retail Management Research (Jbrmr)* Vol. 9 Issue 1, October 2014 , P 100

<sup>6</sup> - Me Sempane Hs Rieger G Roodt , *Job Satisfaction In Relation To Organisational Culture* , *Sa Journal Of Industrial Psychology*, 2002, P 23

<sup>7</sup> Adeyinka Tella, C.O. Ayeni, S. O. Popoola, *Work Motivation, Job Satisfaction, And Organisational Commitment Of Librery Personnel In Academic And Research Libraries In Oyo State, Nigeria*, *Library Philosophy And Practice*, 2007, Pp 4-5

<sup>8</sup> - Ashfaq Ahmad, *Making Management Commitment Happen In Spi*, *Master Thesis In Software Engineering And Management, Department Of Applied Information Technology, It University Of Göteborg, Sweden*, 2007, P 12

128 strong desire to improve the quality all business of a company<sup>9</sup>. Top management must not only give a lead to the rest of  
129 the company but also ensure that the necessary decisions and actions are taken. Only top management has the  
130 motivation and the power to effect changes<sup>10</sup>. This criteria is measuring in the Algerian model by answering these  
131 questions:

- 132 ✓ How does the leadership drive the company's or organization's quality approach?
- 133 ✓ How the leadership does set the example by internal and external actions?
- 134 ✓ How the leadership does values the efforts and successes quality of individuals and teams?

135

## 136 5.2 Strategy and objectives quality

137

138 The most significant change is the requirement for quality objectives. ISO 9001:2000 requires that quality objectives be  
139 established at each relevant function and level within the organization. The manner in which quality objectives are  
140 established and managed will have an enormous impact on the organization's performance. The quality objectives will  
141 either drive strategic improvements throughout the organization, significantly elevating the importance of the quality  
142 management system, or they'll simply become a meaningless exercise in data collection<sup>11</sup>. This criteria is measured by  
143 answering these questions:

- 144 ✓ How is the quality strategy actually connected to the global strategy of company or organization?
- 145 ✓ How is quality strategy deployed like objective in all functions of the company or organization?
- 146 ✓ How are the strategy and quality objectives known by all staff and what are the incentives for there to take  
147 part?

148

## 149 5.3 Quality control

150

151 Quality is a universal value and has become a global issue. In order to survive and be able to provide customers with  
152 good products, Quality can be defined as fulfilling specification or customer requirement, without any defect. A product is  
153 said to be high in quality if it is functioning as expected and reliable. Quality control refers to activities to ensure that  
154 produced items are fulfilling the highest possible quality. Most of tools and techniques to control quality are statistical  
155 techniques<sup>12</sup>. This criteria is measured by answering these questions:

- 156 ✓ How to control the quality of products and services?
- 157 ✓ How to control operational processes and support?
- 158 ✓ How to control the quality of benefits of suppliers and subcontractors?

159

## 160 5.4 Measuring quality

161

162 Quality measures can drive improvement in a number of ways, in Algerian excellence model measuring quality is realized  
163 by answering to these questions:

- 164 ✓ How does the leadership of the company or organization choose Indicators which enable it to achieve its  
165 objective qualities?
- 166 ✓ How the company or organization staff has the appropriate indicators monitoring quality in their work?
- 167 ✓ How to use indicators for improvement?

168

## 169 5.5 Quality improvement

170

171 Quality improvement is the combined and unceasing efforts of everyone to make the changes that will lead to better  
172 outcomes<sup>13</sup>. This criteria realized by answering these questions:

<sup>9</sup> - Dominic Cooper, *The Impact Of Management's Commitment On Employee Behavior: A Field Study, The 7 Professional Development Conference And Exhibition, Kingdom Of Bahrain, March 18-22 2006*, P 1

<sup>10</sup> - Nadeem Yousaf, *Top Management Commitment For Tqm – A Process Model, Pakistan's 10th International Convention On Quality Improvement, November 27-28 2006, Lahor, Pakistan*, P 5

<sup>11</sup> - [Http://www.Qualitydigest.Com/Magazine/2000/Nov/Article/Using-Quality-Objectives-Drive-Strategic-Performance-Improvement.html](http://www.qualitydigest.com/Magazine/2000/Nov/Article/Using-Quality-Objectives-Drive-Strategic-Performance-Improvement.html)

<sup>12</sup> - Hairulliza Mohamad Judi, Ruzzakiah Jenal And Devendran Genasan, *Quality Control Implementation In Manufacturing Companies: Motivating Factors And Challenges, Applications And Experiences Of Quality Control*, Ognyan Ivanov Edition, 2011, P 495

<sup>13</sup> - Bruce Jennings, Mary Ann Baily, Melissa Bottrell And Joanne Lynn, *Health Care Quality Improvement: Ethical And Regulatory Issues, The Hastings Center Garrison, New York, 2007*, P 84

- 173 ✓ How to analyze relative results to the performance of process?
- 174 ✓ How to build the quality improvement actions related with the objectives of the company or organization and
- 175 results?
- 176 ✓ How are driven the actions of quality improvement?
- 177 ✓ How to ensure the effectiveness of improvement actions?

178

#### 179 5.6 *Listening customers or users*

180

181 Customer satisfaction is defined as a customer's overall evaluation of the performance of an offering to date. This overall  
182 satisfaction has a strong positive effect on customer loyalty intentions across a wide range of product and service  
183 categories<sup>14</sup>. Customer satisfaction realized by: Satisfaction surveys, satisfaction compared to the competition,  
184 relationship with consumer associations, market research necessary changes in fashion and taste, Design, respecting the  
185 environment, reliability, price, service after sale, gifts...ect, This criteria is measured by answering these questions:

- 186 ✓ How is measured the satisfaction of customers or users the company or organization?
- 187 ✓ How are supported is treated claims Customer and what is the capacity reactivity the company in this area?
- 188 ✓ How are supported in advance, explicit needs and implicit customers or users?
- 189 ✓ How to take include of all the needs of customers or users and, from the conception of products or services?
- 190 How are identified competitors or entities offering the same products or services?
- 191 ✓ How the company or organization reacts facing the performance of its competitors or entities offering the same
- 192 products or services?

193

#### 194 5.7 *Employees' involvement*

195

196 Employees involvement at all levels is important to gain competitive advantages and business overall success<sup>15</sup>.  
197 Employee involvement should be considered while decisions making as the employees have to implement the decisions.  
198 Managers should create a participative climate by sharing the information and involving the employees in decision  
199 making. Encouraging the employees to express their ideas relating to work concerns is the practice of information  
200 sharing. Employee involvement results in superior quality decisions which produce encouraging organizational and  
201 personal outcomes<sup>16</sup>. This criteria realized by answering these questions:

- 202 ✓ How staff can propose actions to improve quality?
- 203 ✓ How to encourage the implication staff in implementation quality?
- 204 ✓ How to measure the adhesion staff on the quality approach?
- 205 ✓ How is staff informed and trained to achieve the quality objectives?
- 206 ✓ How does staff informed of the actions and successes quality of the company or organization?

207

#### 208 5.8 *Results*

209

210 The last stage in Algerian excellence model is display the results which are achieved, this criteria incite the company or  
211 organization to answer these questions:

- 212 ✓ What the results of the company or organization are in concerns the satisfaction of its customers or users?
- 213 ✓ What are the results of actions concerning satisfaction and engagement staff?
- 214 ✓ What are the results of the company or organization in terms of: Evolution of financial results, profits, market  
215 share, and notoriety?
- 216 ✓ What are the measured results by performance indicators (costs of obtaining quality and poor quality, main  
217 deadlines, productivity)?
- 218 ✓ What contribution provided by the company or organization to its environment, especially in community life in  
219 the reduction of nuisance in the development of employment, etc...?

<sup>14</sup> - Anders Gustafsson, Michael D. Johnson, & Inger Roos, *The Effects Of Customer Satisfaction Relationship Commitment Dimensions And Triggers On Customer Retention*, Journal Of Marketing, Vol. 69, American Marketing Association, October 2005, P 210

<sup>15</sup> - Luis Mendes, *Employees' Involvement And Quality Improvement In Manufacturing Small And Medium Enterprise (SME): A Comparative Analysis*, African Journal Of Business Management, Vol 6, 13 June, 2012, P 6982

<sup>16</sup> - Aamna Shakeel Abbasi, Ali Muslim Bin Aqeel And Ali Naseer Awan, *The Effectiveness Of Leadership, Performance And Employee Involvement For Producing Competitive Advantage With A Tqm Orientation: A Conceptual Framework*, Mediterranean Journal Of Social Sciences, Vol. 3, January 2012, P 86

The evaluation grid used by the jury has a total of 1000 points. The number of points awarded in each criteria varies according to their relative importance the success quality project

## 6. Research Hypotheses

This research framework was developed in accordance with the literature review. From the review, it was noticed that Algerian excellence model is related to job satisfaction. Therefore, the principal hypothesis

- **H<sub>1</sub>**. Algerian excellence model is positively related to job satisfaction in Algerian organizations.

There is a statistically significant relationship between Algerian excellence model and job satisfaction, this hypothesis can be divided into the following sub-hypotheses:

- **H<sub>a</sub>**. Management commitment is positively related to job satisfaction.
- **H<sub>b</sub>**. Employees' involvement is positively related to job satisfaction.
- **H<sub>c</sub>**. Listening customers or users is positively related to job satisfaction.
- **H<sub>d</sub>**. Strategy and objectives quality is positively related to job satisfaction.
- **H<sub>e</sub>**. Measuring quality is positively related to job satisfaction.
- **H<sub>f</sub>**. Quality improvement is positively related to job satisfaction.
- **H<sub>g</sub>**. Quality control is positively related to job satisfaction.
- **H<sub>h</sub>**. Results are positively related to job satisfaction

## 7. Review of the Literature

As stated earlier relationship between business excellence model and job satisfaction has been a popular topic for researchers in a wide area of fields including industrial, public administration, business and service sector. This will assure the ability to compare the finding of this research with modern previous studies.

### 7.1 Huseyin Arasli, Sarvnaz Baradarani, 2014

The main aim of the study was to evaluate the relationship between leadership, management by fact, continuous improvement, all work is process, people based management, teamwork with job satisfaction of the frontline employees of 3, 4 and 5 star hotels in Tehran, as well as the relationship of the job satisfaction with the organizational citizenship behavior. The study contained 314 questionnaires which were collected from the frontline employees of the hotels in Tehran. The data were analyzed using PLS in order to evaluate the relationships between the business excellence practices with job satisfaction and organizational citizenship behavior. Having adopted the questionnaires it has been investigated that only leadership and teamwork had non-significant effect on job satisfaction of the frontline employees working in three, four and five star hotels of Tehran that led to organizational citizenship behavior. The study suggests various implications for the hotel managers, politicians and policy makers of Iran, in order to achieve higher levels of job satisfaction as well as organizational citizenship behaviors in their hotels.

### 7.2 Rasoul Faraji, Kazem Danesh San, Hosein Poursoltani, 2012

The main purpose of the study was to determine the relationship between job satisfaction and organizational excellence in physical education (P.E.) general offices of Iran's provinces. A survey that contains European Foundation for Quality Management (EFQM) criteria and job satisfaction questionnaire are applied to P.E. general offices of Iran's provinces (ten provinces selected by classified random manner). Validity of the questionnaires verified by the experts and their reliability also calculated in a pilot study ( $\alpha=0.928$  and  $\alpha=0.83$  respectively for EFQM and job satisfaction questionnaires). 550 questionnaires distributed among the staff however, 337 questionnaires were returned and included in statistical analyze. The results showed significant relationship between job satisfaction and all EFQM excellence model criteria ( $p<0.05$ ). About job satisfaction, there was no significant difference in between the ten selected organizations. However, a significant difference observed between selected provinces' organizational excellence ( $p<0.05$ ). The relationship between job satisfaction and organizational excellence shows that organizations (specially sport organizations) that are going to implementing organizational excellence model such as EFQM, should be aware of job satisfaction which has a supporting role for the successful implementation. Furthermore, it seems that similar employment rules were the reason for non-significant differences among the selected organizations' job satisfaction. On the other hand, it seems that numerous factors affecting EFQM criteria can induce significant differences in the organizational excellence scores of these

274 organizations

275

276 7.3 *Marija Savić, Predrag Djordjević, Ivan Mihajlović and Živan Živković, 2013*

277

278 The paper presents the results of empirical research on the effects of some criteria of the EFQM excellence model on  
279 satisfaction and loyalty of the employees in the banking sector in Serbia. All but one of the hypotheses in the defined  
280 model were proven by statistical evaluation of empirical results. The one which could not be proven is the hypothesis of a  
281 positive impact of the organization's relationship toward security and society on the business result, which makes  
282 specificity of transitional economic conditions in which the studied banking sector operates. Statistical analysis was  
283 performed using V.16 LISREL software package where statistical significances of the studied set were defined together  
284 with band t values of the defined paths in the defined model. Researchers have shown that criteria of EFQM excellence  
285 model can be used to develop and improve the functioning of the banking system in Serbia and develop the TQM  
286 practice.

287

### 288 8. Research Methodology

289

290 For the research, whose results are presented in this paper, a questionnaire survey was used, which was sent to 326  
291 employees of the organization quality awards winners in Algeria. Questions in the questionnaire were combined using the  
292 results of previous researches. Total number of questions in the survey amounted to 52 divided into 09 groups. After  
293 consultations and visits, 203 correctly completed, which presents a response of 62%. The following table describes the  
294 dimensions of the study:

295

296 **Table (1):** Dimensions of the research

297

N	Dimension	No. of Items
1	Management commitment	7
2	Employees' involvement	7
3	Listening customers or users	6
4	Strategy and objectives quality	5
5	Measuring quality	3
6	Quality improvement	5
7	Quality control	6
8	Results	7
9	Job satisfaction	6
<b>Total</b>		<b>52</b>

298

299 The question in the survey was rated using Likert

300

301 **Table (2):** The Likert scale model in answering the questionnaire

302

Weight	Descriptive interpretations excellence	Descriptive interpretations job satisfaction
1	Don't Know	Disagree very much
2	We have plans	Disagree
3	On our way	Sometimes
4	Close to good	Agree
5	Fully done	Agree very much

303

304 Table (3) shows the results for Kolmogorov-Smirnov and Shapiro Wilks test of normality. From table (3), the(p-  
305 value=0.000) for each field is smaller than 0.05level of significance, then the distribution for each field is not normally  
306 distributed.

307

308

309

310

311

**Table (3):** Kolmogorov-Smirnov and Shapiro Wilks test of normality

	Kolmogorov-Smirnov <sup>a</sup>		
	Statistic	N	Signification
MC	,220	326	,000
SOQ	,221	326	,000
LCU	,220	326	,000
QC	,222	326	,000
MQ	,225	326	,000
QI	,220	326	,000
EI	,220	326	,000
R	,240	326	,000
JS	,234	326	,000

8.1 Internal validity

Internal validity of the questionnaire is the first statistical test that used to test the validity of the questionnaire. It is measured by a scouting sample, which consisted of 203 questionnaires through measuring the correlation coefficients between each paragraph in one field and the whole filed. Tables below clarifies the correlation coefficient for each paragraph of the field. The p-value (sig) are less than 0.01, so the correlation coefficients of this field are significant at  $\alpha = 0.01$ , so it can be said that the paragraphs of this field are consistent and valid to be measure what it was set for

**Table (3):** Correlation of each paragraph of the total of this field

Paragraph	Spearman Correlation Coefficient	P-value (sig)
Leaders have developed a set of values and a code of ethics for organization.	0.650	0.000**
Leadership reward employee efforts to achieve quality	0.824	0.000**
Improvements throughout the organization are monitored, reviewed and championed by leaders.	0.508	0.000**
Leaders identified external stakeholders & have regularly engage with them.	0.527	0.000**
Leaders inspire people and create a culture of excellence.	0.880	0.000**
Leaders assure the organization is agile and flexible enough to face change effectively.	0.796	0.000**
Our internal communication is efficient and works in all directions : Top-down, Bottom-up and Lateral	0.679	0.000**
<b>Management commitment</b>		

\*\*correlation is significant at the 0.01 level.

**Table (4):** Correlation of each paragraph of the total of this field

Paragraph	Spearman Correlation Coefficient	P-value (sig)
quality is related to the strategy of our organization	0.627	0.000**
Our People understand the Mission, Vision, Values and Strategy and their evaluation is based on those	0.733	0.000**
We have created a culture that develops and rewards people's dedication, skills, talents and creativity	0.236	0.000**
We ensure that all necessary data and information are appropriately shared and understood	0.457	0.000**
We have a system of rewards and recognition to honor and motivate our people	0.857	0.000**
<b>Strategy and objectives quality</b>		

\*\*correlation is significant at the 0.01 level.

345 **Table (5):** Correlation of each paragraph of the total of this field  
346

Paragraph	Spearman Correlation Coefficient	P-value (sig)
Our Strategy is based on a thorough understanding of the needs and expectations of our customers and users.	0.475	0.000**
We develop our Products and Services in order to create optimum value for customers.	0.695	0.000**
Our products and services are produced and delivered to meet, or exceed, customer needs.	0.696	0.000**
We manage and enhance customer relationships by knowing	0.455	0.000**
We build and maintain a dialogue with all our customers, based on openness, transparency and trust.	0.428	0.000**
Technology is used appropriately, as a support to listen to customer or user.	0.377	0.000**
<b>Listening customers or users</b>		

\*\*correlation is significant at the 0.01 level.

347 **Table (6):** Correlation of each paragraph of the total of this field  
348  
349  
350

Paragraph	Spearman Correlation Coefficient	P-value (sig)
We have chosen our partners and suppliers based on our quality Strategy and manage our relationships with them accordingly.	0.652	0.000**
Our relations with them are based on mutual trust, respect and openness.	0.490	0.000**
Our cooperation with partners and suppliers is based on sustainable benefits	0.503	0.000**
We control the quality of products and services	0.426	0.000**
We control operational processes and support	0.776	0.000**
We control the benefits of quality suppliers and subcontractors	0.629	0.000**
<b>Quality control</b>		

\*\*correlation is significant at the 0.01 level.

351 **Table (7):** Correlation of each paragraph of the total of this field  
352  
353  
354

Paragraph	Spearman Correlation Coefficient	P-value (sig)
We choose indicators that will allow it to achieve its objective qualities	0.377	0.000**
The employees have the appropriate indicators for monitoring quality of their work	0.187	0.000**
We used indicators for improvement	0.503	0.000**
<b>Measuring quality</b>		

\*\*correlation is significant at the 0.01 level.

355 **Table (8):** Correlation of each paragraph of the total of this field  
356  
357  
358

Paragraph	Spearman Correlation Coefficient	P-value (sig)
We analyzed the results for the performance of the process	0.706	0.000**
We built the quality improvement actions in relation to the objectives of the organization and results	0.295	0.000**
We conducted the actions of quality improvement	0.565	
We measure efficiency improvement actions?	0.360	0.000**
We effectively promote and market our products and services	0.646	0.000**
<b>Quality improvement</b>		

\*\*correlation is significant at the 0.01 level.

359  
360  
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364  
365

**Table (9):** Correlation of each paragraph of the total of this field

Paragraph	Spearman Correlation Coefficient	P-value (sig)
employees can propose quality improvement actions	0.836	0.000**
manager encouraging the involvement of employees in the implementation of quality	0.861	0.000**
managers measured staff adhesion to quality approach	0.595	0.000**
the employee is knowledgeable and trained to meet quality goals	0.969	0.000**
We design and manage processes taking into account our Stakeholders' needs.	0.764	0.000**
We effectively promote and market our products and services	0.672	0.000**
Our organization regularly supports activities that encourage employees' improvement.	0.779	0.000**
<b>Employees' involvement</b>		

\*\*correlation is significant at the 0.01 level.

366  
367  
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369

**Table (10):** Correlation of each paragraph of the total of this field

Paragraph	Spearman Correlation Coefficient	P-value (sig)
We have indicators in our people-survey to monitor the satisfaction of our employees.	0.371	0.000**
We use indicators to assess the environmental impact of the organisation.	0.409	0.000**
We have developed indicators to assess and improve employees' productivity.	0.320	0.000**
We achieve the quantitative goals we set for the indicators concerning our people.	0.702	0.000**
We compare our performance with benchmarks for the indicators concerning our people.	0.809	0.000**
We measure our financial health with an appropriate set of indicators.	0.850	0.000**
We have indicators to measure our productivity and our overall operational performance.	0.891	0.000**
<b>Results</b>		

\*\*correlation is significant at the 0.01 level.

370  
371  
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**Table (11):** Correlation of each paragraph of the total of this field

Paragraph	Spearman Correlation Coefficient	P-value (sig)
In my job, I have a satisfaction to do a good work	0.796	0.000**
What happens to my company is important to me, I'm too interested about what are our organization faced	0.679	0.000**
I'm always happy to meet people from my team work over the organization	0.627	0.000**
When there is a decision to make in my work team, everyone participates	0.733	0.000**
The salary that i receive is appropriate	0.236	0.000**
I find that I have a enough job security in this company	0.457	0.000**
<b>Job satisfaction</b>		

\*\*correlation is significant at the 0.01 level.

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## 8.2 Structure Validity of the Questionnaire

Structure validity is the second statistical test that used to test the validity of the questionnaire structure by testing the validity of each field and the validity of the whole questionnaire. It measures the correlation coefficient between one field and all the fields of the questionnaire that have the same level of liker scale.

**Table (12):** correlation coefficient of each field and the whole of questionnaire

Paragraph	Spearman Correlation Coefficient	P-value (sig)
Management commitment	0.888	0.000**
Employees' involvement	0.897	0.000**
Listening customers or users	0.965	0.000**
Strategy and objectives quality	0.983	0.000**
Measuring quality	0.924	0.000**
Quality improvement	0.874	0.000**

Quality control	0.892	0.000**
Results	0.881	0.000**
Job satisfaction	0.978	0.000**

\*\*correlation is significant at the 0.01 level.

Table (12) clarifies the correlation coefficient for each field and the whole questionnaire. The p-values (sig.) are less than 0.01, so the correlation coefficient of all the fields is significant at  $\alpha=0.01$ , so it can be said that the fields are valid to be measured what it was set for to achieve the main aim of the study.

### 8.3 Questionnaires reliability

The reliability of an instrument is the degree of consistency which measures the attribute; it is supposed to be measuring (Polit&Hunger, 1985). The less variation an instrument produces in repeated measurements of an attribute, the higher its reliability. Reliability can be equated with the stability, consistency, or dependability of a measuring tool. The test is repeated to the same sample of people on two occasions and then compares the scores obtained by computing a reliability coefficient (Polit&Hunger, 1985).

### 8.4 Cronbach's Coefficient Alpha

Cronbach's alpha is a measure of internal consistency, that is, how closely related a set of items are as a group. It is considered to be a measure of scale reliability. A "high" value for alpha does not imply that the measure is unidimensional. If, in addition to measuring internal consistency, you wish to provide evidence that the scale in question is unidimensional, additional analyses can be performed. Exploratory factor analysis is one method of checking dimensionality. Technically speaking, Cronbach's alpha is not a statistical test; it is a coefficient of reliability (or consistency). The Cronbach's coefficient alpha was 0.775 which indicates a reliability of the questionnaire

### 8.5 Profile of the Study Sample

The following table describes the profile of the study sample:

**Table (14):** Profile of the study sample

	Percent	
Years of experience	Less than 10 years	14.79
	10-less than 20	40.67
	20 and above	44.54
	<b>Total</b>	<b>100%</b>

### 8.6 Structural Equation Model

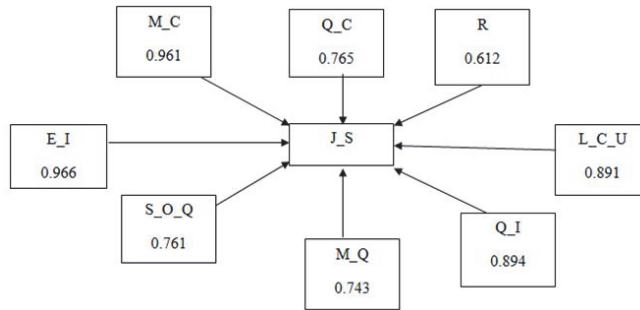
The Structural Equation Model (SEM) is a common and extremely powerful multivariate statistical analysis technique that includes specialized versions of a number of previous analysis methods as special cases. SEM is employed for building and more often testing statistical models. As in all multivariable techniques, the sample size plays a very important role for estimation and interpretation of the results, as it provides a basis for estimating the error sampling. Generally, it is accepted that the minimum size of the sample that provides the applicability of the use of the technique should overcome 100 units. In this survey the size is 203.

### 8.7 Test of hypotheses

After the tests, the results showed the error variances on each construct, which are presented in figure (02).In the same tables the overall formations of the model are presented, which will be evaluated according to the data that came out of the survey.

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431

**Figure 2.** Structural model of some of Algerian model of excellence criteria relationship with job satisfaction



432  
433

## 9. Results and Discussion

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The results of the obtained structural model are show that:

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438

management commitment has a positive relationship with job satisfaction ( $b=0.961, p<0.001$ ), which mean that hypothesis Ha (Management commitment is positively related to job satisfaction) is true, This result is compatible with (Kaplan, Ogut, Kaplan& Aksay), they find that job satisfaction and organizational commitment has a great importance for the employees in services industry. High job satisfaction and organizational commitment level of the employees enable them to provide a high motivation. By this way, they will show a maximum effort to reach the organizational commitment objectives. As a result of this effort, the organization will be inimitably overtopped<sup>17</sup>

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443

Employees' involvement has a positive relationship with job satisfaction ( $b=0.966, p<0.001$ ), which mean that hypothesis Hb. (Employees' involvement is positively related to job satisfaction) is true. This result is compatible with (Bhatti & Qureshi) their study is indicating that certain employee Participation could influence Job satisfaction<sup>18</sup>

445  
446

Listening customers or users has a positive relationship with job satisfaction ( $b=0.891, p<0.001$ ), which mean that hypothesis Hc. (Listening customers or users is positively related to job satisfaction) is true. This result is compatible with (Zhaleh Zohreh Kermani), he find that job satisfaction have a positive relation between with customer satisfaction<sup>19</sup>

449  
450

Strategy and objectives quality has a positive relationship with job satisfaction ( $b=0.761, p<0.001$ ), which mean that hypothesis Hd. (Strategy and objectives quality is positively related to job satisfaction) is true.

451  
452

Measuring quality has a positive relationship with job satisfaction ( $b=0.743, p<0.001$ ), which mean that hypothesis He. (Measuring quality is positively related to job satisfaction) is true.

453  
454

Quality improvement has a positive relationship with job satisfaction ( $b=0.894, p<0.001$ ), which mean that hypothesis Hf. (Quality improvement is positively related to job satisfaction) is true.

455  
456

Quality control has a positive relationship with job satisfaction ( $b=0.765, p<0.001$ ), which mean that hypothesis Hg. (Quality control is positively related to job satisfaction) is true.

457  
458

Results has a positive relationship with job satisfaction ( $b=0.612, p<0.001$ ), which mean that hypothesis Hh. (Results are positively related to job satisfaction) is true.

459  
460

The results of the structural analysis indicate the strength of relationship between Algerian excellence model and job satisfaction, this include that the hypothesis H1. (Algerian excellence model is positively related to job satisfaction in Algerian organizations) is true.

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463

## 10. Conclusion

464  
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According to the results, we find that the Algerian model of excellence has a strong relationship with job satisfaction, the model has given a great attention to the involvement of staff in achieving excellence through the commitment of

466

<sup>17</sup> - Metin Kaplan, Emine Ogut, Asli Kaplan and Kadir Aksay, *The Relationship between Job Satisfaction and Organizational Commitment: The Case of Hospital Employees*, *World Journal of Management* Vol. 4. No. 1. March 2012 P 28

<sup>18</sup> - Komal Khalid Bhatti and Tahir Masood Qureshi, *Impact Of Employee Participation On Job Satisfaction, Employee Commitment And Employee Productivity*, *International Review of Business Research Papers* Vol.3 No.2 June 2007, p 67

<sup>19</sup> - Zhaleh Zohreh Kermani, *A Study of the Linking Between Job Satisfaction and Customer Satisfaction: A Case Study of Iran Insurance; Kerman; Iran*, *Journal of Marketing Development and Competitiveness* vol. 7(4) , 2013, p 107

467 management to adopt culture quality, valuation efforts of the staff to improve the quality, and develop an effective system  
468 to motivate him, Plus achieving high performance, leads to achieve a high level of job satisfaction.  
469

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# The Characteristic of Social Danger of Offence in Scientific and Legislative Definitions in the Member Countries of the Commonwealth of Independent States and European Countries

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## Abstract

The purpose of the study is to substantiate that all types of offence and not only crimes have social danger. The achievement of this purpose should facilitate the normal functioning of the regime of legality and the legal order. Moreover, it will help the law enforcer not to bring to responsibility the offender whose actions only formally fall within the characteristics of *corpus delicti* and do not have social danger, which in its turn is consistent with the concept of a law-governed state, fair law and fair justice. The obtained results will be useful for judges, prosecutors, students of law schools, legal practitioners. To achieve this purpose the following methods will be used: dialectical, comparative legal, formal legal. The use of the dialectical method allows to study the phenomenon in its complexity and interconnection with the practice and its development in social relations. The comparative legal method allows to go beyond the framework of the Russian Federation's legal system, to compare legislative definitions of offence in different countries and to identify their common features. The use of these methods has been tested by science and practice, which indicates their effective applicability to legal studies. To achieve this goal the article examines the social danger and its characteristics based on legislative definitions of an offence in different countries. It offers a comparative and legislative analysis of the concept of "offence" based on regulatory legal acts of different countries. The authors assert that all offences are not only crimes possess characteristics of social danger. A conclusion is made that a punishment which exceeds a criminal punishment cannot be imposed if an offence does not involve social danger. To a certain extent, we can judge about the nature and degree of social danger by the type of sanctions and the amount of adverse abridgment of rights that shall be imposed on the entity that has violated the legal norm. Social danger is a universal characteristic of an offence. Being a phenomenon of the real world, it does not depend on the legislation of a particular country nor on the type of its legal system. On the other hand, fixation of social danger in the law text depends on a legislator's will. Working out of a universal approach to social danger allows to avoid law enforcement mistakes, violations of human rights and freedoms, as well as facilitates integration of legal systems and the establishment of a law-governed state.

**Keywords:** criminal offence; social danger; harm; causing of harm; illegality; characteristics of the offence

## 1. Introduction

The question whether all offenses without exception present social danger has been under discussion in the legal literature for decades. Some experts do not mark out social danger as a distinctive feature or equate it to the concept of social maleficence. For example, V.I. Smirnov (1998) writes "Social danger is an essential characteristic of a criminal offense and cannot be acknowledged as a characteristic of other offenses" (p. 5). According to V.V. Maltsev (1986) "social danger is a characteristic of any offense (infringement)" (p. 5). A well-known theorist of law S.S. Alexeyev (1982) said that "in terms of the nature of social danger (maleficence) offenses can be subdivided into crimes and misdemeanors (administrative, disciplinary and civil)" (p. 4).

It is noteworthy that the dispute about the social danger as a characteristic of an offense as debatable not only in Russian but also in international literature. I.G. Carvell and E. Swinfen Green (1970) give a formal definition of a crime suggesting that "a good working definition of the crime is the one that presents a crime as an act or dereliction that is banned by law under threat of punishment" (p. 31). I.L. Baton (1979) supports formal and material definition of the crime. He notes that "crime is an act or dereliction, or course of conduct that are considered illegal and dangerous for society as

58 a whole ... prohibited by law and deserving a punishment" (p. 13). According to C. Beccaria (1939) "the only true measure  
59 of crimes is the harm that they bring to the nation" (p. 223).

60 Of all legal definitions of offenses, only the Criminal Code of the Russian Federation mentions the characteristic of  
61 a social danger. Art. 14 of the Criminal Code provides the following: "A socially dangerous act, committed with guilt and  
62 prohibited by this Code under threat of punishment, shall be deemed to be a crime". In the Tax Code a tax offense is  
63 defined as "an unlawful (in violation of tax legislation) act (action or inaction) of a taxpayer, tax agent or other persons  
64 entailing liability under the present Code" (art. 106). According to the Code of Administrative Offences of The Russian  
65 Federation "a wrongful, guilty action (omission) of a natural person or legal entity which is administratively punishable  
66 under this Code or the laws on administrative offences of subjects of the Russian Federation shall be regarded as an  
67 administrative offence" (Art. 2.1). The fact that some legislative definitions of offenses fail to point out the characteristic of  
68 a social danger does not mean that offenses do not present a social danger.

## 70 2. Research part and application of comparative law methods

71  
72 It should be noted that the legislative systems of various countries of the world are not unanimous in their definitions of  
73 social danger as a distinctive feature of the term "crime". In the former Soviet Union countries characteristic "social  
74 danger" refers in legislation to the terms "crime". For example, the Penal Code of the Republic of Belarus (2003) provides  
75 that "a socially dangerous act (action or omission), committed with guilt, specified by the present Code and prohibited by  
76 it under threat of punishment, shall be deemed to be a crime" (art. 11). Almost a similar phrasing is presented in the  
77 Criminal Code of the Republic of Tajikistan (2001) (p. 223). The Criminal Code of the Republic of Lithuania (2003)  
78 formulates not the concept of social danger, but the concept of "danger" (art. 12). Similarly, the Criminal Code of  
79 Lithuania (2003) classifies all offenses into misdemeanors and crimes, but a characteristic of social danger is specified  
80 both in the definition of a crime as well as in the definition of a criminal misdemeanor. The Criminal Code of the Republic  
81 of Moldova (2003) uses a related concept of a "prejudicial act" (art. 23).

82 Similarly, this issue is resolved in the legislation of the former socialist countries. For example, the Code of  
83 Criminal Procedure of the Republic of Poland (2001) states that "a prohibited act that constitutes an insignificant social  
84 danger shall not be deemed as a crime" (p. 47). According to the Criminal Code of Bulgaria (2002) "crime shall be an act  
85 dangerous to society (action or inaction), which has been culpably committed and which has been declared punishable  
86 by law" (art. 9). Furthermore the Criminal Code of Bulgaria (2002) defines the concept of "social danger". Art. 10 provides  
87 that "dangerous to society shall be an act which threatens or harms the person, the rights of the citizens, the property, the  
88 legal order established by the Constitution in the Republic of Bulgaria or other interests, protected by the legal system" (p.  
89 131).

90 In accordance with well-established traditions, the characteristic of social danger is not stated in the legislative  
91 formulations of the concept of "crime" in some European countries. Thus, in Section 12 of the Criminal Code of the  
92 Federal Republic of Germany (2002) it is emphasized that "felonies are unlawful acts punishable by a minimum of  
93 sentence of one year's imprisonment" (p. 125). According to Art. 10 of Criminal Code of the Swiss Confederation (2002)  
94 "felonies are offences that carry a custodial sentence of more than three years. Misdemeanours are offences that carry a  
95 custodial sentence not exceeding three years or a monetary penalty" (p. 75). In criminal laws of these countries a formal  
96 definition of the concept of "crime" is provided.

97 In criminal legislation of France there is no legal definition of the concept of "crime" at all. Thus, the Criminal Code  
98 of the French Republic (2002) introduces a new criterion for differentiation of criminal acts for their classification, that is  
99 the seriousness of criminal offence. In accordance with Art. 111-1, "criminal offences are categorised as according to  
100 their seriousness as felonies, misdemeanours or petty offences" (p. 67). According to Art. 111-3 "No one may be  
101 punished for a felony or for a misdemeanour whose ingredients are not defined by statute, nor for a petty offence whose  
102 ingredients are not defined by a regulation. No one may be punished by a penalty which is not provided for by  
103 the statute, if the offence is a felony or a misdemeanour, or by a regulation, if the offence is a petty offence" (p. 68).  
104 In fact, according to French Criminal Code the concept of crime follows from Art. 111-3.

105 Characteristics of the offence threat to society are considered dubiously in specialized legal literature as well.  
106 Experts in the field of administrative and financial law answer this question in a different way. A.V. Kurakin, A.V. Drozdov  
107 and A.V. Zubach (2001) believe that "an essential feature of an offence, which is characteristic of an administrative  
108 offence, is its social danger" (p. 3). Yu. N. Beloshapko (2001) does not single out a characteristic of social danger in the  
109 concept of a financial offence (p. 134).

## 2.1 Dialectical part. From general to specialized research and its analysis

N.A. Gromov and S.A. Polunina (1998) include harmfulness to society into the concept of a criminal procedure offence (p. 40), while according to S.G. Olkov (1994), criminal procedure offences represent social danger (p. 15).

Researchers specializing in civil law deny the characteristic of social danger in civil offences (Slesarev, 1980, p. 7). L.A. Syrovatskaya (1990) believes that a disciplinary offence does not represent social (p. 40). S.A. Shushpanov (2002) refers social danger, wrongfulness, guiltiness, and disciplinary punishability to the characteristics of an official misdemeanor (p. 16). Defining the concept of a constitutional delict, V.A. Vinogradov (2002) does not include the social danger characteristic in it (p. 27).

Thus, debates about the social danger issue as the characteristic of an offence are conducted both in the general theoretical literature and in the special literature.

## 2.2 Comparison of characteristics of different types of offences

We believe that all offences represent social danger. If an act does not represent social danger, i.e. it does not inflict harm on social relations and does not put it at threat of inflict harm, it cannot be regarded as an offence. It is a mistake to think that only crimes represent social danger. A crime differs from other offences in the extent of social danger. For instance, the Criminal Code of the Russian Federation provides for a liability for evasion of customs duties. However, there is a criminal liability for this crime only in case of a large-scale evasion. If an evasion was not of a large-scale character, it means that there is no corpus delicti in the actions of an individual or a legal entity, but there are formal elements of an administrative offence. However, an administrative offence also represents social danger, as there is a possibility of exemption from liability in case of a minor administrative offence. It is enshrined in Art. 2.9. of the Code of Administrative Offences of the Russian Federation that "where an administrative offence is insignificant, a judge, or a body, or an official authorized to resolve a case concerning the administrative offence, may relieve the person, who has committed the administrative offence, of administrative responsibility and limit themselves to a reprimand". The possibility of exemption from administrative liability emphasizes the presence of social danger in administrative offences, as in case of its absence (minor character of the offence), the person is exempt from the administrative offence. It is the extent of social danger that differs a crime from other offences, but the threat is present in all types of offences. Thus, V.M. Vedyakhin and A.F. Galuzin (1996) correctly point out that criminal contraband differs from a similar customs offence also in the extent of social danger (p. 4).

There is another conclusion in favor of the fact that not only crimes, but also all offences are characterized by social danger. For many types of offences there are liabilities that are more severe in their consequences than for some types of crimes. Thus, there is a quite clear limit for property fines in the Criminal Code of the Russian Federation. The upper limit is equal to one million rubles. In case a civil offence is committed, reimbursement of damages is limited to the size of the damages. A fine of ten thousand rubles is provided for the violation of the submission period for filing an application for the registration with a tax authority for the period of more than 90 days, whereas the minimum criminal fine is two thousand fifty rubles.

## 3. Conclusion and Results

A punishment that exceeds a criminal penalty by its size may not be imposed for an offence that does not represent social danger. To a certain extent, we can judge about the character and the extent of social danger based on the type of the sanction that determines the scope of unfavorable limitation of rights that the subject who infringed a legal norm has to endure.

Social danger is a universal characteristic of an offence. Being a phenomenon of the real world, it does not depend on the legislation of a particular country nor on the type of its legal system. On the other hand, fixation of social danger in the law text depends on a legislator's will. Working out of a universal approach to social danger allows to avoid law enforcement mistakes, violations of human rights and freedoms, as well as facilitates integration of legal systems and the establishment of a law-governed state.

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## Economic Institutions of Russian Academic Science

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### Abstract

*In this paper, the basic provisions of the transactional theory of economic institutions of science are examined. It is shown that contemporary institutional theory of science determines the formation of economic and theoretical perspectives and applied methodologies for assessing the development of economic institutions. Results are presented from the authors' many years of empirical analysis of factors affecting Russian economic invention institutions, scientific publications and academic mobility.*

**Keywords:** *institutional theory, science, organisation of science, transaction costs.*

## 1. Introduction

Five Nobel Economics Prizes awarded for the development of institutional economics bear witness to the relevance of the institutional approach to economic research. In 1986, the Nobel Prize in Economics was won by John Buchanan for research on policy assessment as a process of exchange. His work led to the formation of the institutional theory of public choice. In 1991, the Prize in Economics was awarded to Ronald Coase for his work on "the institutional structure of production." In this work, he showed the possibility of assessing the institutional structure of the firm through a correlation of transaction costs and the type of organisation carrying out the activity – whether market-oriented or hierarchical. Douglass North won the Nobel Prize in 1993 for his assessment of economic activity over time. In 2007, the prize was awarded to Leonid Hurwicz, Eric Maskin, and Roger Myerson for their development of a theory of economic mechanisms. The mathematical foundation of the research consisted of a game theory based on a number of institutional principles. Thus, with the laureates the principle of the controller was introduced towards the implementation of agents of formal institutions and the principle of the focal point, which determines the convergence of actions with well-known rules. The 2009 Prize was awarded to Oliver Williamson and Elinor Ostrom for the development of the theory of economic organisation. Williamson is the author of the famous dependency of transaction costs on specific assets pertaining to an intermediate region between the firm and the market; these are identified and described in terms of network-centric organisations. Despite these impressive achievements, an essential sphere of human activity – scientific work – so far remains only in the initial stage of institutional analysis of its content.

Hence, the aim of this study was to review recent work on institutional description of the economic institutions of science with subsequent determination of impacts on key economic institutions of knowledge generation in the field of scientific activity.

## 2. Science as an Autonomous System

At the present time, science has achieved significant autonomy in relation to other areas of activity such that the "augmentation and transmission of scientific knowledge is the objective function of scientific activity, subject to the autonomy of science"<sup>1</sup>. Thus it is necessary to share the activities of generating inventions (creation of new knowledge) and innovative activity (introduction of new knowledge).

One of the first to draw attention to the distinction between inventions and innovations was Joseph Schumpeter. In

<sup>1</sup> Oleynik A.N. *Towards an institutional theory of science // Social studies and modernity. 2014. № 1. pp. 29-35: p. 30.*

55 his study entitled "The Theory of Economic Development" he noted that "new discoveries and inventions are constantly  
56 replenishing the existing stock of knowledge. [...] The functions of the inventor and the general technician do not coincide  
57 with the function of the entrepreneur. As such, the entrepreneur is not the spiritual creator of new combinations  
58 (resources – E.P.)"<sup>2</sup>.

59 According to Schumpeter, the implementation of new combinations by entrepreneurs includes the following five  
60 cases: "1) the production of new goods or the creation of a new quality of goods, 2) the introduction of a new mode of  
61 production, 3) the development of a new market, 4) the provision of a new source of raw materials, 5) the carrying out of  
62 an appropriate reorganisation"<sup>3</sup>. Thus, for Schumpeter, innovations (the first and second activities of an entrepreneur)  
63 precede inventions, i.e. the creation of new discoveries and patents.

64 The identification of inventions as the first phase of the innovation process is noted in studies by Russian  
65 scientists. Thus, it is noted that "innovative interaction occurs before the appearance of innovation – from the point at  
66 which inventions emerge – of new scientific and technical knowledge, the project of acquiring things that up to that point  
67 did not exist"<sup>4</sup>. And further: "A sign of the end of the invention phase is a completion of the transformation of knowledge  
68 into the product and the presence of monopoly rights over the result (either achieved by legal means or due to a  
69 temporary lack of competition due to the novelty of the products)"<sup>5</sup>.

70 Thus, the life cycle of scientific and technological activities consistently includes three phases: inventions (new  
71 knowledge, patents) – innovation (introduction of new knowledge) – imitation (replicating the introduction of new  
72 knowledge). Consequently, one can speak of invention institutions being established as norms of interaction between  
73 economic agents to generate new scientific knowledge as a result of fundamental and applied research<sup>6</sup>. In this case, the  
74 development of Schumpeter's ideas consists in the description of a three-phase cycle of institutional research activities<sup>7</sup>.  
75 From here opens the possibility of a division of scientific researchers into generators of knowledge, innovators and  
76 imitators of scientific achievements.

77 Another view of the functional division of scientists consists in separating the orientation of researchers to solve  
78 various problems. Thus to Burton Clark belongs the selection and justification of the three major orientations of university  
79 research activities<sup>8</sup>. The fundamental orientation of traditional universities implies service to its own academic ideals. The  
80 applied direction provided in business universities is focused on the implementation of ideas that have commercial  
81 potential, whereas the scientific work of the socially oriented higher education institute primarily implements objectives set  
82 by society and the State.

83 On the other hand, Nonaka and Takeuchi<sup>9</sup> as well as Lundvall and Borrás<sup>10</sup> have noted that the process of  
84 generation and application of knowledge requires a dynamic transformation of tacit and codified knowledge, as well as  
85 strong interactions of people both within organisations and between one organisation and another. If friction always  
86 applies to the transfer of codified knowledge with respect to time and distance, understood and applied tacit knowledge is  
87 embodied in people and organisations<sup>11</sup>.

88 In this connection, one should distinguish between two types of basic knowledge: analytical (scientific basis) and  
89 synthetic (engineering basis)<sup>12</sup>. These types reflect different ratios of implicit and explicit (codified) knowledge,  
90 designations of possibilities and limitations, qualifications and skills, requirements of organisations and institutions  
91 involved in specific innovation challenges and pressures from the globalised economy.

<sup>2</sup> Schumpeter J.A. *The Theory of Economic Development. Capitalism, Socialism and Democracy*. Trans. with M. Eksmo, 2008. p.158.

<sup>3</sup> Schumpeter J.A. *The Theory of Economic Development. Capitalism, Socialism and Democracy*. Trans. with M. Eksmo, 2008. pp.132-133.

<sup>4</sup> Rygalin D.B. *Systematisation of Problems and Identification of Trends Towards Sustainable Innovation Interactions // Creative Economy*. 2009. № 5. pp. 106-113: p. 108.

<sup>5</sup> Kortov S.V. *Management of Innovative Processes in a Region on the Basis of Evolutionary Modelling*. Diss. at soisk. ATLA. step. Dr. Econ. of Sciences. Ekaterinburg: IE Ural branch of the Russian Academy of Sciences, 2005. p. 60

<sup>6</sup> Popov E.V., Popov D.E. *Inventions as the Basis for Innovation // Problems of the Theory and Practice of Management*. 2013. № 2. pp. 101-108.

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<sup>8</sup> Clark B.R. *The Higher Education System: Academic Organization in Cross-National Perspective*. Berkley: University of California Press, 1983. p. 315

<sup>9</sup> Nonaka, I. and Takeuchi, H. *The Knowledge Creating Company*, Oxford – New York: Oxford University Press, 1995.

<sup>10</sup> Lundvall, B.-A. and Borrás, S., *The Globalising Learning Economy: Implications for Innovation Policy*, Luxembourg: European Communities, 1997.

<sup>11</sup> Nightingale, P. *A Cognitive Model of Innovation // Research Policy*, 1998, 27, 689-709.

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92 The basis of analytical expertise corresponds to the position of industry, where scientific knowledge is very  
93 important and where the generation of knowledge is often based on cognitive and rational processes, or on formal  
94 models. Examples include genetics, biotechnology and information technology. The basis of analytical expertise is more  
95 codified than the other type of knowledge. Codification is increasingly used for the following reasons: the emergence of  
96 knowledge often based on existing studies; the generation of knowledge based on the application of scientific principles  
97 and methods; the process of transmission of knowledge more formally organised (e.g., R&D units); and the output of  
98 knowledge generation documented in the reports, electronic files and patents.

99 The basis of synthetic knowledge corresponds to the position of industry where innovations play a major role  
100 through the use of existing knowledge or new combinations of knowledge. Often this takes the form of a solution to a  
101 specific problem faced by buyers and their suppliers. Here, studies are of less importance than in the analytical type of  
102 knowledge. For synthetic knowledge, applied research is required, often in the form of products or processes<sup>13</sup>.

103 Thus, science as an autonomous economic system can be represented by a wide variety of functional researcher  
104 roles.  
105

### 106 3. Scientific Transactions and Transaction Costs 107

108 The first economist to focus conceptually on non-production interactions between economic agents was John  
109 Commons<sup>14</sup>, who proposed the transaction as the basic unit of economic activity analysis. According to his ideas,  
110 transactions are the "alienation and acquisition, between individuals, of the rights of property and liberty created by  
111 society". As noted by Commons: "The ultimate unit of activity [...] must contain in itself the principles of conflict, mutuality  
112 and order. This unit is a transaction"<sup>15</sup>.

113 The most detailed definition of the transaction was provided by Oliver Williamson as follows: "A transaction is the  
114 transfer of goods or services from the final point of one process to the starting point of another, adjacent to the first one. It  
115 is the end of one stage of activity and the beginning of another"<sup>16</sup>.

116 As noted by Victor Martins-da-Rocha and Yiannis Vailakis, transaction search, transportation, storage and  
117 measurement information comprise the major endogenous transactions even in the traditional markets such as financial  
118 markets<sup>17</sup>.

119 However, according to a broad study of the literature made by Aric Rindfleisch et al<sup>18</sup>, it is shown that the study of  
120 transaction type is one of the most promising areas within the contemporary field. How, then, can the transactions of  
121 economic agents be systematised? The answer to this question can be obtained by referring to the concept of the market  
122 potential of the enterprise<sup>19</sup>, demonstrating a variety of transactions at the level of a business entity.

123 The market potential comprises the sum total of tools and capabilities available to the enterprise in the realisation  
124 of its market activity. The institutional nature of the market potential of the company is to structure established norms of  
125 interaction between economic agents, designed in such a way as to best realise its market activities.

126 Analysis of the structure of the market potential of the company shows that non-production activity should be  
127 included amongst the transactions of economic agents – namely, analytical and communication activities (if they are not  
128 the main production processes of the economic agent). Assuming that the analytical work includes searching for  
129 information and market analysis (search for buyers), and communication – promotion of goods, protection of property  
130 rights and protection from opportunism, the principal types of transactions of manufacturing enterprises can be divided  
131 into five transaction types. These comprise the following<sup>20</sup>: 1) information retrieval; 2) market analysis; 3) protection of  
132 property rights; 4) protection against opportunism; 5) promotion of products.

133 The typology of transactions permits a shift to economic institutions that support well-established norms of

<sup>13</sup> Asheim B.T. and Coehen L. *Contextualising Regional Innovation Systems in a Globalising Learning Economy //Journal of Technology Transfer*. 2006. Vol. 31. pp. 163-173.

<sup>14</sup> Commons J.R. *Institutional Economics //American Economic Review*. 1931. Vol. 21. N 4. pp. 649-672.

<sup>15</sup> Commons J.R. *The Problem of Correlating Law, Economics and Ethics //Wisconsin Law Review*. 1932. Vol. 8. pp. 3-26: pp. 4.

<sup>16</sup> Williamson O.E. *Transaction-Cost Economics: The Governance of Contractual Relations //Journal of Law and Economics*. 1979. Vol. 22. pp. 233-261: pp. 235.

<sup>17</sup> Martins-da-Rocha V.F., Vailakis Y. *Financial Markets with Endogenous Transaction Costs //Economic Theory*. 2010. Vol. 45. pp. 65-97: pp. 68.

<sup>18</sup> Rindfleisch A., et al. *Transaction Costs, Opportunism and Governance: Contextual Considerations and Future Research Opportunities //Market Letters*, 2010. Vol. 21. pp. 211-222.

<sup>19</sup> Popov E.V. *Market Potential of the Firm //International Advances in Economic Research*. 2004. Vol. 10. N 4. pp. 337-338.

<sup>20</sup> Popov E.V. *Transactions & Institutions //Montenegrin Journal of Economics*, 2012. Vol. 8, N 2, pp. 115-125.

134 interaction between economic agents<sup>21</sup> and an evaluation of the transaction sector of the economy.

135 When speaking of the Ural school of institutional studies, it is necessary first of all to note the development of the  
136 transactional theory of economic institutions<sup>22</sup>. The principal content of the theory consists in the quantification of the  
137 quality of institutions through the evaluation of economic transactions.

138 The transactional theory of economic institutions is based on the following scientific principles:

- 139 • boundedness of transactions according to John Commons<sup>23</sup>,
- 140 • formation of the transactional sector according to John Wallis and Douglas North<sup>24</sup>,
- 141 • non-production nature of transaction costs according to Robert Matthews<sup>25</sup>,
- 142 • proportionalities of asset-specific transaction costs according to Oliver Williamson<sup>26</sup>.
- 143 • minimisation of transactions in the formation of economic institutions according to Ronald Coase<sup>27</sup>.

144 Scientific ideas are advanced in terms of the authors' original theoretical development on the typology of  
145 transactions, the valuation of crises, the definition of transaction costs on financial statements<sup>28</sup>, the assessment of the  
146 closeness of ties between hybrid organisations and the valuation of economic institutions according to transaction  
147 costs<sup>29</sup>.

148 In discussing scientific transactions, it is advisable to locate the resource indicators of differentiation of knowledge  
149 according to the degree of their impact on the informational, human and material resources of the organisation. The  
150 transactional view of the evolution of economic institutions in determining the differentiation of knowledge resource  
151 indicators lies in identifying the difference between the dynamics of change in transaction costs required for the formation  
152 and maintenance of various institutions that generate operational, structural and functional knowledge<sup>30</sup>.

153 The development of an institutional approach to the assessment of scientific activity permits the design of  
154 institutional atlases<sup>31</sup> and an evaluation of the transaction costs of scientific productivity<sup>32</sup>.

155 The economic literature widely used classification of transaction costs by Thrainn Eggertsson<sup>33</sup> and Andrey  
156 Nesterenko<sup>34</sup> However, the classification of transaction costs developed by the authors of the present study enables a  
157 simulation of the dynamics of their development<sup>35</sup>.

158 An important achievement in the institutional analysis of scientific activities relates to the formation of methods of  
159 allocation of transaction costs in the financial statements of academic institutions<sup>36</sup>. It is shown that, in addition to  
160 scientific production activities, academic organisations also carry out transactional activities. These include: publishing,  
161 information and library/software research, the organisation of scientific conferences and participation in conferences,  
162 advertising and exhibition activities, the implementation of international relations, legal activities and the formation of  
163 public opinion. On this basis, transaction costs can be systematised in respect of items of financial statements<sup>37</sup>.

<sup>21</sup> Popov E.V., Sergeev A.M. *Contemporary Russian Institutionalism: Towards a Continuation of Discussions // Problems of Economics*. 2010. № 2. pp. 103-116.

<sup>22</sup> Popov E.V. *Transaction Estimation of Institutions // Advances in Economics and Business*. 2014. Vol. 2. N 1. pp. 58-64.

<sup>23</sup> Commons J.R. *Institutional Economics // American Economic Review*. 1931. Vol. 21. N 4. pp. 649-672; pp. 652.

<sup>24</sup> Wallis J., North D. *Measuring the Transaction Sector in the American Economy, 1870-1970 // Long-Term Factors in American Economic Growth*, Ed. by S. L. Engerman and R.E. Gallman. Chicago: University of Chicago Press, 1986. pp. 95-148.

<sup>25</sup> Matthews RCO *The Economics of Institutions and Sources of Growth // Economic Journal*. 1986. Vol. 96. N 12. pp. 903-910.

<sup>26</sup> Williamson O.E. *Strategizing, Economizing and Economic Organization // Strategic Management Journal*. 1991. Vol. 12. N 1, pp. 75-94.

<sup>27</sup> Coase R.H. *The Nature of Firm // Economica*, 1937, Vol. 4. N 10. pp. 386-405.

<sup>28</sup> Popov E.V., Vlasov M.V., Veretenikova A.Y. *Knowledge Generation Within a Firm as an Object of Institutional Design // Actual Problems of Economics*. 2013. No 1. pp. 463-478.

<sup>29</sup> Popov E.V. *The Transaction Theory of Institutions // Proceedings of the 11<sup>th</sup> Eurasia Business and Economics Society Conference (Ekaterinburg, 12-14 September 2013). Turkey, Istanbul: EBES, 2013. pp. 765-776.*

<sup>30</sup> Popov E.V., Vlasov M.V. *Resource Differentiation of Knowledge // Business*. 2011. Vol. 3. N 2. pp. 211-217.

<sup>31</sup> Popov E.V. *Institutional Atlas // Atlantic Economic Journal*. 2011. Vol. 39. N 4. pp. 445-446.

<sup>32</sup> Popov E.V. & Vlasov M.V. *Transaction Costs for Research Productivity // International Journal of Business and Management*. 2013. Vol. 8. N 2. pp. 78-85.

<sup>33</sup> Eggertsson T. *Economic Behaviour and Institutions*. Cambridge: Cambridge University Press. 1990. 408 p.

<sup>34</sup> Nesterenko A.N. *Economy and Institutional Theory*. M.: Editorial URSS, 2002.

<sup>35</sup> Popov E.V. *Diffusion Model of Transaction Cost Dynamics // Journal of Economics and Business*. 2011. Vol. 2. N 3. pp. 222-229.

<sup>36</sup> Popov E.V. and Vlasov M.V. *Research Productivity Dependence on Transaction Costs // Proceedings of the 13<sup>th</sup> European Conference of Knowledge Economy*. University of Cartagena, Spain: Academic Publishing Ltd, 2012. pp 967-974.

<sup>37</sup> Popov E.V., Vlasov M.V., Orlova N.V. *Transaction Costs Generate Explicit Knowledge of an Academic Institution // Management in Russia and Abroad*. 2011. № 1. pp. 107-115.

#### 4. Economic Institutions of Inventions

The phenomenon of the transformation of knowledge into the primary productive force was predicted in the 1960-70s in the works of Peter Drucker, Daniel Bell and Alvin Toffler<sup>38</sup>. The competitive advantages of the firm began to be interpreted in relation to the ability to benefit from the electronic resources of the Internet and e-commerce, to attract and retain "knowledge workers" and create a "learning organisation"<sup>39</sup>. It is no coincidence that one of the most fruitful achievements of strategic management theorists in recent years, formed on the basis of the resource approach, has been the concept of the "knowledge-creating company"<sup>40</sup> and development that proceeds according to the intellectual capital of the firm.

All economic activities of business entities are put into effect in accordance with various institutions. On the one hand, the charter, job descriptions and other formal documents supporting the creation and processing of raw materials for a new product or service; that is, economic institutions, emerging and functioning in the process of changing the resources of an economic entity and whose valuation may be expressed in terms of transformation costs. At the same time, for the activities to create new value and facilitate their market implementation, different operations are required when undergoing a change of ownership, which arise in the processes and functioning of institutions, the valuation of which can be assessed in terms of transaction costs<sup>41</sup>.

In his monograph "Elements of Reform Theory", V.M. Polterovich identifies several stages in the development of innovations in industrial enterprises: borrowing, i.e. the acquisition (purchase) of new knowledge; copying (the duplication of knowledge created by other companies); imitation and pioneering research and development<sup>42</sup>. By analogy, in order to facilitate the development of the process of creating new values in industrial enterprises, invention institutions can be classified as follows: institutions of borrowing, copying, imitation and generation.

To identify patterns in processes involved in controlling inventions, the Institute of Economics of UB RAS carried out a series of group interviews in 2014 with the heads of medium-sized industrial enterprises located in the Sverdlovsk region. A distinctive feature of these companies is that the primary activity is high-tech processing of raw materials in the process of creating new values.

In terms of carrying out activities relating to inventions, 78% of surveyed companies plan to use inventions in the form of borrowing in the short term up to 1 year (Table 1).

**Table 1:** The distribution of various types of inventions depending on the planning horizon (per cent)

Type of Invention	Planning Horizon			
	up to 1 year	1-3 years	3-5 years	>5 years
Borrowing	78	21	6	2
Copying	11	59	12	7
Imitation	8	12	56	10
Generation	3	8	28	81
Total	100	100	100	100

This change planning horizon has been chosen because this type of invention is not developed directly by business entities but purchased on the open market; thus, it quickly becomes obsolete and loses its value. For the copying and imitation of inventions, the planning horizon increases by an average of 2-3 years (59% of copying inventions coincides with a planning horizon of 1-3 years). The most distant planning horizon is applied when inventions having no analogues are generated directly by an economic entity (in 81% of cases the generation of inventions has a planning horizon of more than 5 years).

The results showed that in 75% of cases when changing information resources, the relevant inventions are not generated by the enterprises themselves, but are rather borrowed (purchasing borrowed inventions on the open market);

<sup>38</sup> Drucker P. F. *The Theory of the Business*//Harvard Business Review. 1994. Sept.-Oct.; Bell D. *The Coming of Post-Industrial Society: A Venture of Social Forecasting*. - NY:Basic Books, 1973; Toffler E.*Third wave-M* .:ACT,2010.

<sup>39</sup> Katkalo V.S. *Strategic Management Theory: Stages of Development and the Basic Paradigm* // Bulletin of Saint Petersburg State University. 2002. Ser. 8. Vol. 3. (24). pp. 3-26.

<sup>40</sup> Nonaka and Takeuchi. *The company is the creator of knowledge. The origin and development of innovations in Japanese firms*. M.: Olympus Business. - 2003

<sup>41</sup> Popov E.V. *Transactional Theory of Institutions* // Economic Analysis: Theory and Practice. 2013. № 27. pp. 2-12.

<sup>42</sup>Polterovich V.M. *Elements of Reform Theory*. M.: Economics. 2007 - 445p.

203 in 12% of cases they are copied from other enterprises; and only in 4% of cases is the new knowledge developed by  
204 themselves, i.e. generated (Table. 2). Consequently, when changing the information resources of the enterprise, the most  
205 significant are the institutions of borrowing inventions.  
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207 **Table 2:** Distribution of generation of inventions while varying the type of enterprise resource (per cent)  
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Type of Invention	Type of Resource		
	Informational	Organisational	Material
Borrowing	75	16	4
Copying	12	38	7
Imitation	9	34	12
Generation	4	12	77
Total	100	100	100

209 When making changes in the organisational structure, the most important in the studied companies are: copying of  
210 inventions (38% of cases) and imitation of inventions (34% of cases). When changing the organisational structure,  
211 independent enterprises generate inventions in an average of 12% of cases. Consequently, when changing the  
212 organisational-structural resources of the enterprise, the most significant are the institutions of copying and imitating  
213 inventions.  
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215 When asked about the importance of the various kinds of inventions by changes in fixed assets of enterprises, the  
216 answers were distributed as follows: use of generation of inventions – in 77 cases out of 100; other types of inventions –  
217 in 23 cases. That is, when changing the fixed assets of enterprises, the most important institutions are those that  
218 generate inventions.

219 Consequently, the following patterns of institutional cycles of inventions in industrial enterprises are revealed:

- 220 • the planning horizons for changes and invention cycles widespread throughout the enterprise are interrelated:  
221 for the generation of new knowledge, a "long" time horizon is required and "long" life cycle institutions generate  
222 inventions, whereas the short life cycle of institutions of borrowing inventions coincides with the short life cycle  
223 of the respective inventions, bringing about changes in the information resources of the enterprise;
- 224 • when changing the information resources of the enterprise, the most important are the institutions of borrowing  
225 inventions;
- 226 • when changing the organisational-structural resources of the enterprise, the most significant are the  
227 institutions of copying and imitating inventions;
- 228 • institutions generating inventions are used primarily to change the basic (material) resources of the enterprise.

229 In connection with the invention institutions of manufacturing companies, the authors have developed a model of  
230 institutional knowledge generation based on the principles of project management, which includes an analysis of the  
231 institutional environment, a statement of problem, goals and objectives of institutional design, institutional project  
232 development (based on the design principles of V. Tambovtsev), the implementation of the institutional project and its  
233 adjustment as well as monitoring of the functioning of the institutional environment. The novelty of this institutional design  
234 model of knowledge generation is an extended arsenal of methodological tools for institutional design in the economic  
235 sphere of science<sup>43</sup>.

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## 237 5. Economic Institutions of Publication Activity

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239 One major activity of scientific institutions is the activity of publication. Factors of influence on the development of these  
240 institutions can be both competitive (grant) funding as well as the dynamics of changes in transaction costs. Working  
241 hypotheses for empirical research were formulated on the basis of the results obtained by the authors of the present  
242 paper in previous studies and a dataset available for the analysis.

243 Within the analysed dataset the size of the financing of various competitions of basic research in the context of  
244 various scientific fields is included as an independent variable. The number of published articles on the results of projects  
245 in various competitions of scientific works is included as the dependent variable.

246 The first two hypotheses are quite obvious, serving to establish a relationship between the number of published

<sup>43</sup> Popov T.V., Vlasov M.V., Veretenikova A.Y. *Knowledge Generation within a Firm as an Object of Institutional Design //Actual Problems of Economics*. 2013. N 1. pp. 463-478.

247 papers and initial project funding received.

248 *Hypothesis 1:* The proportion of published articles (of the total number of published articles) on the results of  
249 fundamental research is directly proportional to the allocation of funding of specified research programmes on a  
250 competitive basis.

251 *Hypothesis 2:* The proportion of published articles on the results of fundamental research is directly proportional to  
252 the allocation of funding to independently defined research projects on a competitive basis.

253 Specified research programmes were classified as projects carried out according to the particular scientific fields or  
254 scientific problems. The second hypothesis is distinguished from the first due to the research objectives being determined  
255 by the authors of the projects themselves when assessing the publication activity of such projects.

256 The third hypothesis may also be considered obvious; however, its quantitative content is not trivial.

257 *Hypothesis 3:* The rate of increase in publication activity as a result of fundamental research varies with funding  
258 granted according to various competitive criteria. It can be assumed that the growth rate of publications is proportional to  
259 the scientific novelty of the problems selected.

260 The third hypothesis is connected to the likelihood that the research objectives may vary from one competitive  
261 context to the next: from solving conventional research task to carrying out creative exploratory studies. The  
262 determination of traditional problems is prior to the implementation of an exploratory research initiative in a specified  
263 research programme.

264 To test the working hypotheses, data on the results of basic research conducted in 2012 in research organisations  
265 of one of the regional offices of the Russian Academy of Sciences, which receives appropriate funding on a competitive  
266 basis, was analysed.

267 Data from several dozen research organisations participating in the specified research programmes (programmes  
268 of the Presidium of Russian Academy of Sciences and Russian Academy of Sciences thematic departments) was  
269 analysed, as well as competitive tenders of scientific project initiatives.

270 To ensure comparability of the data, normalisation of funding and number of published articles on the total volume  
271 of funding and the total number of corresponding articles in a specific field was carried out. As a result, a dataset was  
272 obtained in the form of the relative proportion of funding and the relative proportion of publication activity in the  
273 aggregated data.

274 To test the first hypothesis, the proportion of published scientific articles was compared to the set of fundamental  
275 research programmes and their contribution to total funding for the respective competitions (Table. 3)

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277 **Table 3.** The dependency of the publication activity on financing in respect of the competitive programme of fundamental  
278 research

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Programme Types indicators Field of Science	RAS Presidium Programme		Thematic programmes of RAS branches	
	Proportion of Financing, %	Proportion of published articles, %	Proportion of Financing, %	Proportion of published articles, %
Mathematics	14.9	22.1	25.8	24.6
Physics	26.3	22.2	30.4	24.7
Chemistry	14.9	11.5	23.2	23.9
Biology	21.2	22.7	3.6	3.7
Earth Sciences	13.8	15.3	13.7	17.9
Economics	3.1	2.0	-	-
Humanities	2.8	4.2	3.3	4.2

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281 The data presented in Table 3 show convincing proof of the first hypothesis of a direct proportional share of articles  
282 published on the results of fundamental research on the share won by competitive funding for specified research  
283 programmes.

284 To test the second hypothesis, the proportion of published scientific articles was compared according to the results  
285 of fundamental research from the proportion of the total funding allocated for competition of independently defined  
286 research projects (Table. 4)

287 The data presented in Table 4 show convincing proof of the second hypothesis of a direct proportional dependency  
288 of published articles on the results of fundamental research allocated competitive funding to independently defined  
289 research projects.

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**Table 4.** Dependency of publication activity on funding for independently defined scientific projects (per cent)

Indicators Field of Science	Proportion of funding %	Proportion of published articles, %
Mathematics	6.6	4.7
Physics	30.4	24.4
Chemistry	7.0	9.7
Biology	23.3	18.7
Earth Sciences	29.2	36.0
Economics	2.3	2.8
Humanities	1.2	3.7

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To verify the third hypothesis, a graph of publication activity on the share of funding for competition of specified research projects was constructed, consisting of programmes of the Presidium of the Russian Academy of Sciences, thematic programmes of RAS Branches, as well as the independently defined research projects funded by competition. The analysis demonstrates the validity of the third hypothesis showing that the growth rate of publication activity on the results of fundamental research varies according to funding by various competitions.

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In this connection, the lowest publications growth rate  $dN$  from changes in funding  $dK$  occurs with the competitive projects of the programme of the Presidium of Russian Academy of Sciences ( $dN/dK = 0.906$ ), and the highest rate occurs with projects under the programmes of the thematic departments of the RAS ( $dN/dK = 1.092$ ). Publication activity in the performance of independently defined research projects occupies an intermediate position between the two previously mentioned cases ( $dN/dK = 0.956$ ).

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Apparently, this result can be explained by the greater riskiness of positive results in solving problems of the Presidium of the Russian Academy of Sciences. Increased preparation time for models and experiments leads to a reduction in the available time for preparing scientific publications. It should be noted that the conclusion about the high volatility of the fundamental results of the competition programme of the Presidium of Russian Academy of Sciences corresponds to an increased scatter in the data resulting from these competitions, obtained during the verification of the first hypothesis<sup>44</sup>.

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The results of earlier studies have shown that increasing the proportion of young employees of the scientific organisation by 1% with an increase in transaction costs by 1% increases the publication activity of all institutions by 7%<sup>45</sup>.

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The overall result of the impact of young people on scientific productivity is also confirmed by the measurement of publication activity according to the number of published articles rather than the volume of publications.

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An interesting discussion concerns the distinct dynamics of publication activity for Russian and foreign journals. Here the situation is not entirely unambiguous. However, even in this case, the proportion of young scientists in the surveyed institutions is directly proportional to the dynamics of scientific activity in the publication of articles in Russian journals. The same dependency on the dynamics of the publication of articles in international journals corresponds to the proportion of mature scientists in academic institutions.

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The obtained dependences can be explained by the fact that, in an effort to quickly obtain scientific prestige, young scientists focus to a greater extent on the publication of articles in more accessible Russian journals. The preparation and transmittal of articles in foreign journals, on the other hand, requires the experience and knowledge of mature researchers. Therefore, an increase in the proportion of mature scientists leads to exacerbated dynamics from the impact of additional transaction costs of publication activity in foreign scientific press.

## 6. Scientific Mobility of Economic Institutions

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The dynamics of the mobility of scientific researchers can be similarly analysed. By the dynamic mobility of scientists is understood a specific, empirically determined, exponential dependency of changes in the number of conference papers to changes in transaction costs of academic institutions. Table 5 presents the exponents of the experimental dependences for similar institutions in the natural sciences, differing only by the proportion of young researchers (the largest proportion

<sup>44</sup> Popov E.V., Vlasov M.V., Schastlivtseva E.V. *Competitive Research Funding // Economic Analysis*. 2014. № 22. pp. 2-8.

<sup>45</sup> Popov E.V., Vlasov M.V. *Dependence of Research Productivity on Transaction Costs // Actual Problems of Economics*. 2012. N 5. pp. 427-437.



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of young researchers in the first establishment and the lowest in the fourth).  
The empirical relationships obtained do not show a causal link between the proportion of young employees and the mobility of scientists. However, some trends can still be identified<sup>46</sup>.  
As the table shows, a decrease in the proportion of young scientists from the second to the fourth institution will decrease the dynamics of mobility of researchers according to changes in transaction costs.

**Table 5.** The exponents of the dynamics of the mobility of scientists on changes in transaction costs (in the number of conference papers)

Name of institution	Exponential indicators		
	All conference papers	Russian conference papers	International conference papers
First institution	0.56	0.31	2.67
Second institution	0.92	0.95	0.57
Third institution	0.40	1.12	-0.07
Fourth institution	0.28	0.26	0.30

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Thus, an increase of 1% in the proportion of young employees with a 1% increase in transaction costs can increase the mobility of all scientific academic institutions by more than 10%. This is the maximum score obtained from a comparison of the second and fourth institutions, but it helps an understanding of the impact of young scientists participating in conferences. In other words, an increase in the number of young scientists is a reliable scientific basis for the development of mobility with the appearance of additional transaction costs relating primarily to travel expenses and organisational contributions to conferences.

However, the dynamics of academic mobility in relation to participation in the Russian conferences increases with the proportion of mature scientists (from the first to the third institution). Apparently, this fact testifies to the traditions and experience of participation of mature scientists in Russian conferences, as well as the wide range of possibilities for such participation for mature employees of the Academy of Sciences.

On the other hand, in accordance with empirical data, an increase in the proportion of young employees from the third to the first institution sharply increased the mobility of scientists participating in international conferences. The explanation for this phenomenon lies in the desire of young scientists to quickly conquer a more attainable "scientific Olympus" compared with the approach of mature scientists to participation in international conferences, including participation facilitated by a deeper knowledge of foreign languages.

However, publication activity – and, to a greater degree, the academic mobility of scientists – is determined by transaction costs. How, then, can transaction costs be reduced (and, for example, the publication activity and academic mobility of researchers continue to be maintained)? The answer to this question lies in a consideration of the transactional function. An analytical view of the transactional function shows a reduction of transaction costs in the formation of well-established rules of economic activity<sup>47</sup>.

Reducing transaction costs of publication activity will occur in the case of a well-established list of academic journals and stable requirements for the publication of scientific articles. In this situation, the costs to the researcher of searching for information related to the publication of research material will be kept to a minimum value.

Reducing the transaction costs of academic mobility will take place during the formation of a well-established list of scientific conferences and stable requirements for participation in these conferences. In this case, the cost of travel expenses and organisational contributions can be kept to a minimum value, for example, due to more early booking of tickets and hotels, as well as an earlier (and economical) payment of a registration fee.

The main conclusion of the review of the transactional function states that the institutional design and structuring of creative activity can lead to savings of transaction costs, and, consequently, to increase the impact of scientific institutional publication activity and the mobility of scientists.

It should be noted that similar results were obtained for universities. Thus, according to the financial statements, the hypothesis concerning the dependence of the dynamics of invention institutions on the dynamics of changes of transaction costs on the publication activity and scientific mobility is empirically proved<sup>48</sup>. An analysis of the financial

<sup>46</sup> Popov E.V., Vlasov M.V. *The Mobility of Young Scientists // Economic Analysis: Theory and Practice*. 2012. № 3. pp. 43-52.  
<sup>47</sup> Popov E.V. *Transaction Function of the Firm //Chapter 8. In "Progress in Economic Research". Vol. 25. Ed. A. Davidze. N.Y.: Nova Science Publishers, 2012. pp. 177-186.*  
<sup>48</sup> Popov E.V. and Vlasov M.V. *Managing Knowledge Generation at Universities //Proceedings of the 15th European Conference on Knowledge Management. Portugal: Santarem University. 2014. vol. 2. pp. 811-816.*

statements of one of the natural divisions of federal universities reliably identified three dependencies. First, an increase in the generation of knowledge in the form of the publication of articles and participation in conferences is directly proportional to the growth of transaction costs relating to research activities. Second, the transaction rate of generation of knowledge in the form of exponential participation in exhibitions (the derivative function of the number of exhibits on transaction costs) is proportional to the number of business entities created by the analysed subdivisions of the university. Third, the transaction rate of generation of knowledge in the form of research reports is proportional to the volume of extra-budgetary burden on university staff. The scientific novelty of the proof of the dependency of the dynamics of invention institutions on the dynamics of changes in transaction costs is to build an adequate institutional approach to the analysis of publication activity and scientific mobility.

The allocation of transaction costs from financial statements would introduce a transactional rate of the growth of knowledge that characterises the susceptibility of effective knowledge generation to changes in the relevant transaction costs. The authors' concept of a transactional rate of knowledge generation develops the theoretical and methodological position of the transactional theory of economic institutions in the economic sphere of science<sup>49</sup>.

To increase the effectiveness of research activities in the university sector of science, it is first necessary to increase funding for travel costs of professors and students to participate in scientific activities. A direct correlation between the dynamics of financing the costs of knowledge generation and scientific activity has been identified. An increase in transaction costs provides an increase in scientific output in the scientific university sector<sup>50</sup>.

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Consequently, this review of recent work on the institutional description of the economic institutions of science with subsequent determination of impacts on key economic institutions of knowledge generation in the field of scientific activity have allowed the following theoretical and applied results.

It is shown that scientific activity is an autonomous system with different functional content in terms of structure of researchers. Therefore, there is the possibility of a division of workers in scientific research into generators of knowledge, innovators and imitators of scientific achievements. It follows that one should distinguish between two bases of knowledge: the analytical (scientific basis) and the synthetic (engineering basis).

The transactional theory of economic institutions includes the principles of boundedness of transactional activities, the formation of the transaction sector and the non-production nature of transaction costs – these costs being proportional to asset specificity – and a minimisation of the transaction as a consequence of the formation of institutions imposed by the founders of this theory.

The scientific ideas of the typology of transactions, assessment of crises, determination of transaction costs from accounting, estimations of the closeness of the connections of hybrid organisations and cost evaluation of economic institutes for transaction expenses can be advanced as bases for planning further scientific research in a deepening of the transaction theory of institutions.

The allocation of transaction costs from financial statements would introduce a transactional rate to the growth of knowledge that characterises the susceptibility of effective knowledge generation to changes in the relevant transaction costs.

The obtained empirical results allow various factors to be classified, such as the kinds of competitive financing, changes in transaction costs of searching for information and the promotion of scientific production, that significantly affect the dynamics of economic invention institutions, publication activity and academic mobility.

<sup>49</sup> Popov E.V., Vlasov M.V., Veretennikova A.Y. *Institutional Design of Knowledge Generation in Business Entities // Journal of Economic Theory*. 2012. № 3. pp. 71-84.

<sup>50</sup> Popov E.V., Vlasov M.V. *The Scientific Impact of the University//FES: Finance, Economics, Strategy*. 2012. № 5. pp. 9-14.

## Characteristics of the Financial System of the Russian Federation

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### Abstract

*This article provides an overview of some of the elements of the modern financial system of the Russian Federation both in retrospect and in future. In particular, the following elements: the federal budget, extra-budgetary funds, the banking system are considered. Within the analysis of the federal budget the dynamics of revenues and expenditures and their ratio to GDP for the future 2014-2017 is shown. Review of extra-budgetary funds is disclosed through the analysis of revenues and expenditures of the Pension Fund, Social Insurance Fund and the Federal Obligatory Health Insurance Fund in the past 10 years. Also the dynamics of payments of insurance fees for the 1991-2014 is shown. Also the characteristics of the assets of the banking system for 2009-2013 are given.*

**Keywords:** *the financial system, the budget system, the banking system, state budget funds*

## 1. Introduction

### 1.1 Introduction to the Problem

The financial system of the Russian Federation consists of the elements that characterize the state structure of the country and the economic foundations of its economic activity. The main elements of the system are the Federal Budget, extra-budgetary funds, the banking system. The current state of these elements is not effective enough. Low efficiency is characterized by a very low rate of GDP growth, which, in turn, affects the formation of budget revenues and extra-budgetary funds, as well raising the refinancing rate leads to a rise in the cost of money. That, as a result, is unlikely to affect the increase in GDP growth. These facts are, in fact, the problem of modern financial system, i.e. its poor capacity to implement tasks of the state. The article describes the state of the elements of the financial system both in retrospect and in future on the basis of realistic forecast of socio-economic development of the Russian Federation until 2020.

58 1.2 *Disclosure of the Importance of the Problem*

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60 The development of the Russian economy in recent years has faced a number of constraints that may persist in the long  
61 term. It refers to the reduction of investment and consumer demand, continued outflow of capital, not the best situation in  
62 the global financial markets and the markets of Russia exported goods.

63 Economic growth in 2013 was 0.4%. According to analysts' opinion the results of 2014 may be zero growth in the  
64 economy. The main reason is lack of financial resources. At the same time, under the circumstances, the main source of  
65 additional investment for the future can only be internal sources.

66 The current rate of growth of economic indicators, according to experts' opinion is not enough to realize the  
67 envisaged social guarantees. Increase of budgetary payments are possible in the case of intensive annual economic  
68 growth in the range of 4-7%. Many regions are experiencing an acute shortage of revenues for the above indicated  
69 measures.

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71 1.3 *Description of Research in this Field*

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73 The Poorly formed financial system is the biggest obstacle to economic growth: the business lacks money and existing  
74 institutions are unable to provide the necessary funds. It is believed that there are two financial models: the Anglo-Saxon  
75 and Continental ones. The first is characterized by strong investment banks and brokers (for example - the United  
76 States), the second's main element is the classic banks (e.g. Germany). Taking into account the peculiarities of Russia,  
77 there was formed a mixed model with the developed infrastructural institutions and the predominance of banks among  
78 financial market participants.

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80 **2. Methodology**

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82 2.1 *Definition of the Object of Research*

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84 The financial system is the basis for the development of the economy, but at the same time it shows how developed this  
85 economy is. The profitability of the Federal Budget, extra-budgetary funds, banking system are currently the most  
86 important objects of study in the framework of the entire financial system. In this connection, the objects of study of this  
87 article were chosen the above mentioned elements of a modern financial system: the Federal Budget, state funds and the  
88 banking system.

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90 2.2 *Determination of its Main Characteristics*

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92 The article deals with the following characteristics of the financial system: revenues and expenditures of the federal  
93 budget and the consolidated budgets of the Russian Federation, the revenues and expenditures of the Pension Fund, the  
94 Social Insurance Fund, the Federal Fund of Obligatory Health Insurance, rates of insurance contributions, assets of the  
95 banking sector in Russia.

96  
97 2.3 *The Choice of Research Method*

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99 In the process of preparing the article there were used the following scientific methods of research. Historical and logical  
100 methods were used for a detailed study of the socio-economic processes, development of the financial system of the  
101 Russian Federation in their historical sequence simultaneously with logical generalizations that allow to evaluate these  
102 processes in general and to draw general conclusions. The method of analysis and synthesis helped to promote the  
103 study of socio-economic phenomena as in parts (analysis) as well as a whole (synthesis), which provided a systematic  
104 approach to the selection of the study. To clean the object under study from the particulars and to reflect of the most  
105 important sides of the objects there was used the method of scientific abstraction. The analysis of the practical data was  
106 performed by using comparison, grouping and aggregation methods.

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### **3. Results**

#### *3.1 The Set of the Analyzed Data*

In order to obtain the reliable results of the study the authors analyzed the statistics of revenues and expenditures of the Federal Budget, the Pension Fund, the Social Insurance Fund, the Obligatory Health Insurance Fund. The analysis of the indicators characterizing the state of the modern banking system was made. The initial data for the analysis presented in the official website of the Central Bank of the Russian Federation, Federal State Statistics Service, as well as analytical data of mass media, scientific works of modern economists in the field of the financial system.

#### *3.2 The Initial Data*

The analyzed initial data are sufficiently verified as, mainly, are represented by the Russian legislation, data of the state structures. The analysis is made on the basis of both retrospective and prospective data.

#### *3.3 Statistics and Data Analysis*

The formation of the results of the study was significantly influenced by static analysis of revenues and expenditures of the Federal Budget, the Pension Fund, the Social Insurance and Obligatory Health Insurance Fund. The rates of change of the studied indications, the level of deficit and surplus were determined. The analysis of the Federal Budget is presented for the future, and the statistics of financial resources of the extra-budgetary funds is studied in the retrospective recently. While reviewing the statistics of the banking sector an analysis of the current state of the Russian banking system was presented.

### **4. Discussion**

#### *4.1 The Main Problems of the Russian Financial System.*

These problems include: the balance of revenues and expenditures of the budgets of all levels of the budgetary system; budgets of state extra-budgetary funds; reduction in the rate of inflation; strengthening and improvement of the banking sector in order to ensure economic growth.

#### *4.2 Key Indicators of Economic Development and the State Budget of Russia.*

The financial system of the Russian Federation consists of the elements that characterize the state structure of the country and the economic foundations of its economic activity. One of the key elements of the system is the State Budget. The Ministry of Finance published a draft of the Federal Budget for 2015-2017. According to the Prime Minister Dmitry Medvedev, Russia's budget for 2015 should be much realistic and take into account the sanctions imposed on Russia. (Russian news agency ITAR-TASS, (2014, August 29) Access: <http://itar-tass.com/ekonomika/1408327>).

Today's geopolitical tension leads to a slowdown in economic growth. Under these conditions, the preservation of rational measures and macroeconomic policy framework will help to limit downside risks compared to the forecast. (International Monetary Fund (2014, October 1), Russian Federation: Concluding Statement of the IMF staff visit in September 2014). In September 2014 was published on 16 th semi-annual ranking of international financial centers, developed by London commercial research center Z / Yen. The rating is based both on macroeconomic indicators and surveys. According to the rating Moscow dropped by 7 positions, taking the 80th out of 83. (Yeandle, M., Mainelli M., GFCI 16 International Launch, Casablanca Finance City Authority, Casablanca (Morocco), 22 September 2014).

The Government of the Russian Federation on September 30th this year contributed to the State Duma a draft of the Federal Budget for 2015 and the planning period of 2016 and 2017. Table 1 shows the indicators of social and economic development of the Russian Federation, which are based on the project.

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**Table 1.** Main indicators of economic development (taking into account the Crimean Federal District), % by 2013 (Review of Economic Indicators (2014, October 15)).

	2013	2014 (estimate)	2015 (forecast)	2016 (forecast)	2017 (forecast)
GDP growth	101,3	100,5	101,2	102,3	103,0
The Consumer Price Index	106,5	107,5	105,5	104,5	104,0
The industrial production index	100,4	101,7	101,6	101,7	102,1
Investments in fixed assets	99,8	97,6	102	101,6	102,9
Real disposable cash income	103,2	100,3	100,4	102,6	103,3
Real wages	104,8	101,5	100,5	102,8	104,6
Retail trade turnover	103,9	101,9	100,6	102,9	103,4
Export of goods, bln. USD	527,3	511,2	494,2	498,2	507,3
Imports of goods, bln. USD	315,0	291,3	299,2	305,5	316,6
The price of oil "Urals", USD / Bbl	107,9	104,0	100,0	100,0	100,0
The price of gas (the average contract including CIS countries), USD / Thousand m3	342	321	289	282	278
Dollar exchange rate, rubles for USD	31,8	35,7	37,7	38,7	39,5

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The bill presupposes to increase revenues by 517.4 billion rubles, which is 1.2% of GDP. The increase of the forecast revenues is associated with an increase in oil and gas revenues by 898.6 billion rubles while the value of non-oil revenues decreased by 381.2 billion rubles. The increase of expenditures by 151.5 billion rubles is planned in the bill. The greatest increase in expenditures compared to the value in the current budget law on the bill provided under Articles of national economy (279 053.5 or 0.5% of GDP) and national defense (086.1 254 or 0.4% of GDP). In addition, the reduction in expenditures on environmental protection, social policy, physical culture and sports, as well as debt service and intergovernmental transfers of a general nature are planned.

Let's consider the execution of an extended and consolidated budgets in 2014. According to the Federal Treasury, the expanded budget revenues in January-August 2014 amounted 17.143 billion rubles, or 37.4% of GDP, compared to 37.0% of GDP in the previous year. The costs of the expanded budget amounted 15.632 billion rubles, or 34.1% of GDP, compared to 34.9% of GDP in the previous year. In January-August 2014 there was a reduction of the expanded budget in relation to GDP - by 0.8 percentage points of GDP. Thus, the cash surplus budget was extended in January-August 2014 1512 billion rubles, or 3.3% of GDP compared to a surplus of 2.0% of GDP in the previous year.

Rising of revenues was mainly due to export duties and taxes on natural resources. The largest increase for the period of January-August 2014 compared to the value for the same period last year experienced defense spending (0.5% of GDP), while, at the 0.1% of GDP decreased expenditure on "National Security and Law Enforcement activity." Mostly spending on social policy (1.1% of GDP) fell, which is associated with a decrease in transfers to the Pension Fund of Russia from the federal budget.

Consolidated budget revenues amounted in January-August 2014 to 14.08 billion rubles, or 30.7% of GDP as compared to 30.2% of GDP in the previous year; expenditures - 12.825 billion rubles, or 27.9% of GDP, compared to 29.0% of GDP in the previous year. Interest payments were amounted to 295 billion rubles, or 0.7% of GDP, which corresponds to the level of the previous year. Non-interest expenditures are 12.473 billion rubles, or 27.2% of GDP as compared to 28.3% of GDP in the previous year. Thus, the cash surplus of the consolidated budget in January-August 2014 reached 1.255 billion rubles, or 2.7% of GDP compared to a surplus of 1.2% of GDP in the previous year. The primary surplus of the consolidated budget was amounted to 1.608 billion rubles, or 3.5% of GDP compared to a surplus of 1.9% in the previous year.

The total volume of state domestic government debt of the Russian Federation on the 1 of October 2014, expressed in government securities (BFL Federal loan bonds-GSO Government savings bonds-BDBL bonds of domestic bond loans) reached 4.4961 billion rubles and in the past month increased by 10 billion rubles or by 0.2% (from the beginning of the year it grew by 63.7 billion ruble or 1.4%). In September the attraction of domestic debt was minimal (only one issued additionally BFL-Federal loan bonds 26215), due to unfavorable market conditions. On the other hand, the repayment of domestic debt did not happen. In 2014 (according to the number 349-FL of 02.12.2013 "On the Federal Budget for 2014 and the planning period of 2015 and 2016") net attraction of domestic debt in government securities has been supposed in the amount of 485.0 bln. rubles, that presupposed the attraction of domestic debt in securities at the level of 808.7 billion rubles. According to the latest Amendments, which came into force on 30.06.14, the borrowing program has been substantially reduced: net attraction of domestic debt to 135.0 billion rubles., Gross attraction - up to 658.7. Attracting foreign debt in Eurobonds in 2014 is not planned (previously assumed equivalent 233.8 billion rubles.).

207 The upper limit of the state internal debt of Russia, scheduled for the end of 2014, in accordance with the adopted  
208 amendments, is reduced by 357 billion rubles up to 6.8885 billion. rubles, as for the external debt by \$ 7 billion dollars up  
209 to 64.9 billion dollars.

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211 **4.3 State Extra-budget Funds of the Russian Federation.**  
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213 Extra-budgetary funds in Russia are to implement social insurance. Insurance funds are formed through insurance  
214 contributions, and when the insured event happens the insurance indemnity is paid. The Russian Pension Fund, Social  
215 Insurance Fund and the Obligatory Health Insurance Fund are involved into compulsory insurance. Prior to 2001 the  
216 State Employment Fund functioned. The sources of replenishment of extra-budget funds are contributions for compulsory  
217 social insurance and funds and means of the Federal Budget. The contributors are organizations and individual  
218 entrepreneurs. The amount of contributions depends on the income of employees. In this case, extra-budgetary funds are  
219 insurers, employers (organizations and individual entrepreneurs) are insurants and employees are the insured. Insurance  
220 contributions are determined by the Federal Law of 24 July 2009 № 212-FL "On Insurance Contributions to the Pension  
221 Fund of the Russian Federation, the Social Insurance Fund of the Russian Federation, the Federal Compulsory Medical  
222 Insurance Fund." The contribution rates are differentiated for different categories of payers. Typically, the size of the rate  
223 up to 2016 was 30% of payroll (PFR - 22% FSS - 2.9%, OHIF- 3.1%). The dynamics of contributions is presented in the  
224 table.

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226 **Table 2.** Change in contribution rates (UST), in% of payroll  
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Name	Years										
	Insurance contributions				Unified social tax				Insurance contributions		
	1991	1992	1993 1996	1997 2000	2001	2002 2004	2005 2006	2007 2009	2010	2011	2012 2014
Pension Fund of Russia	20,6	31,6	28,0	28,0	28,0	28,0	20,0	20,0	20,0	26,0	22,0
Social Insurance Fund of Russian Federation	5,4	5,4	5,4	5,4	4,0	4,0	2,8	2,9	2,9	2,9	2,9
Federal Obligatory Health Insurance Fund	-	-	3,6	3,6	3,6	3,6	3,2	3,1	3,1	5,1	5,1
State Employment Fund	-	2	2	1,5	-	-	-	-	-	-	-
<b>TOTAL</b>	<b>26,0</b>	<b>39,0</b>	<b>39,0</b>	<b>38,5</b>	<b>35,6</b>	<b>35,6</b>	<b>26,0</b>	<b>26,0</b>	<b>26,0</b>	<b>34,0</b>	<b>30,0</b>

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229 Legislation sets limit value base for calculating the contributions:

- 230 - From 1 January 2014 - 624 000 (Government Decree of 30.11.2013 N 1101);
- 231 - On 1 January of 2013 - 568,000 rubles (Government Decree of 10.12.2012 N 1276);
- 232 - From 1 January 2012 - 512,000 rubles (RF Government Resolution 24.11.2011 N 974);
- 233 - From 1 January 2011 - 463 000 (Government Decree of 27.11.2010 N 933).

234 The contributions to the Pension Fund can be calculated even in excess of the limit value, but at a rate of 10%  
235 (212-FL).

236 In addition, the Social Insurance Fund receives contributions for compulsory accident insurance (from injury).  
237 These obligations for employers are determined by the Federal Law of the Russian Federation of 24 July 1998 N 125-FL  
238 "On compulsory social insurance against accidents at work and professional diseases." Thus, in the FSS fees are 2.9%  
239 plus contributions from accidents, which are in the range of 0.2 to 8.5% of payroll. The contribution rate of accidents  
240 depends on the degree of risk of 32 degrees in a whole, and are defined by the Federal Law of 22.12.2005 № 179-FL  
241 "On insurance rates for compulsory social insurance against accidents at work and professional diseases in 2006" (179  
242 FL acts in 2014). Taking into account the contributions from accidents the minimum rate of contributions for compulsory  
243 insurance and provision is 30.2% and the maximum is 38.5% of payroll.

244 The contributions for individual entrepreneur are determined basing on the minimum wage and are defined in the  
245 Federal Law 212-FL and 167-FL of 15.12.2001 "On Mandatory Pension Insurance in the Russian Federation." In 2014,  
246 the minimum wage is 5554 rubles. Individual entrepreneur, as the insured, makes contributions to the Pension Fund and  
247 FOHIF. The contributions are defined as follows: 1 salary × (26% + 5,1%) × 12, where 26% and 5.1% are the rates of  
248 insurance contributions to the Pension Fund and the FOHIF. This formula is for those entrepreneurs whose annual  
249 revenue does not exceed 300,000 rubles. In this case, the amount of the contribution is 20,727.53 rubles, of which the  
250 contributions to the Pension Fund is 17,328.48 rubles, and to the FSS is 3399.05 rubles. If the revenue exceeds 300,000  
251 rubles, in addition to 20,727.53 rubles, the FSS must also pay 1% of revenue over the limit, but not more than 138,627.84

252 rubles. (eight times the minimum wage  $\times$  26%  $\times$  12 months.). The total maximum payment of the individual entrepreneur,  
253 as the insured, to the Pension Fund and FOHIF is 142,026.89 rubles for a year.

254 Let's consider the dynamics of the revenues and expenditures of the extra-budget funds. The data on the revenues  
255 and expenditures are presented on the official website of the Federal State Statistics Service (<http://www.gks.ru>).  
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257 **Table 3.** Income and expenditure of the Pension Fund of the Russian Federation (millions of rubles)  
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Year	Supply sum	The pace of change over previous year in %	Expenditure sum	- Deficit + Surplus	
				sum	%
2000	431281	388,65	341056	90225	20,92
2001	532120	23,38	514837	17283	3,25
2002	699871	31,53	789621	-89750	-12,82
2003	843141	20,47	804076	39065	4,63
2004	1015800	20,48	967540	48260	4,75
2005	1349601	32,86	1299113	50488	3,74
2006	1637580	21,34	1537257	100323	6,13
2007	1946817	18,88	1786457	160360	8,24
2008	2730172	40,24	2357793	372379	13,64
2009	3222649	18,04	3008660	213989	6,64
2010	4610084	43,05	4249235	360849	7,83
2011	5255643	14,00	4922109	333534	6,35
2012	5890364	12,08	5451219	439145	7,46
2013	6388390	8,45	6378549	9841	0,15

259 **Table 4.** Supply and expenditure of the Social Insurance Fund (millions of rubles)  
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Year	Supply sum	Expenditure sum	- Deficit + Surplus	
			sum	%
2000	86581	69995	16586	19,16
2001	89018	93721	-4703	-5,28
2002	116393	125608	-9215	-7,92
2003	137250	136161	1089	0,79
2004	159276	140568	18708	11,75
2005	186692	165312	21380	11,45
2006	218913	208151	10762	4,92
2007	295368	303062	-7694	-2,60
2008	360476	379385	-18909	-5,25
2009	440046	448501	-8455	-1,92
2010	463777	491199	-27422	-5,91
2011	558595	497569	61026	10,92
2012	630784	531226	99558	15,78
2013	603499	566225	37274	6,18

262 **Table 5.** The revenue and expenditure of the Federal Obligatory Health Insurance Fund (millions of rubles)  
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Year	Supply sum	Expenditure sum	- Deficit + Surplus	
			sum	%
2000	2887	2872	15	0,52
2001	3988	4005	-17	-0,43
2002	5089	5081	8	0,16
2003	5795	5807	-12	-0,21
2004	6813	6762	51	0,75
2005	83003	71507	11496	13,85



2006	125524	119407	6117	4,87
2007	157817	158177	-360	-0,23
2008	162621	168706	-6085	-3,74
2009	126562	130037	-3475	-2,75
2010	101844	109124	-7280	-7,15
2011	348437	310428	38009	10,91
2012	966542	932158	34384	3,56
2013	1101352	1048723	52629	4,78

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After analyzing the data of the supply and expenditure of extra-budgetary funds, attention is drawn to the 2000 and 2001 years. While in 2000, there was high overall surplus of 20.92% and 19.16%, respectively, to the PFR and the FSI, in 2001 there was a deficit. It should be noted that the unified social tax (UST) in return for contributions was introduced in 2001. But at the same time, the burden on the employer's in the social security in 2001 decreased to 35.6%, while in 2008 it amounted to 38.5% of the payroll. The 2005th was remarkable, when the UST was reduced from 35.6% to 26%. Basically, this decrease was due to the reduction of contributions to the Pension Fund. This decline led to an increase in revenue to the PFR by 33%, indicating the formal increase in the income of employees. It can be assumed that the reduction of the burden on the employer led, to some extent, to the refusal of salaries "in an envelope." In 2008 there was a fairly high increase in profitability of the PFR, and in 2009 the increase was twice as little, 40% and 18%, respectively. That was the result of the economic crisis and the slowdown in the increase of incomes of employees. In recent years, the rate of insurance contributions has not been stable: in 2010 it was 26% , in 2011 - 34%, and 30% in 2012-2014. The profitability of the PFR, in nominal terms, has increased at a slower rate.

Today one of the urgent tasks of the Russian financial system is a pension provision, which has not been solved yet. The reasons for the imperfections of pension provision may be different: a significant change in the demographic structure of the population; low incomes of individuals; imperfect financial market, where the funded part of pensions should grow, etc. At the same time, high wages of workers will increase the burden of social insurance and, consequently, an increase in manufacturers' costs. And in the end, it will have an impact on prices. Therefore, the main reason for the imperfections of pension insurance is the lack of an effective balanced economy.

#### 4.4 The banking system of the Russian Federation

The banking system of the country is one of the main components of the economic body, it forms huge amounts of capital, serves the investment and production needs of enterprises, as well as the needs of the population in additional financial resources.

The diversity and complexity of the changes necessitate their deeper understanding, as well as the desirability of an effective mechanism development of the banking sector in the current post-crisis market conditions.

The banking system of the country is an active participant in a full-scale financial modernization of the Russian economy. In accordance with the concept of the long-term socio-economic development of the Russian Federation up to 2020 it is noted that it is supposed to create a financial center in this country for the implementation of dynamic economic development, innovation and strengthening of Russia's position in the world community. To achieve this goal huge amounts of money will be required and for that it will be needed to involve the banking system. The participation in innovative modernization of the economy will allow the banking sector to get real benefits in the form of a significant increase in long-term resources and increasing demand for loans on the part of the real sector of economy as a result of the development and strengthening of the financial condition of business entities, as well as the increase of the investment activity of the population.

At the same time in recent years in the Russian economy there have been evident significant negative changes. The external economic conditions for the Russian economy have been influenced by the global economic downturn and the impact of the financial crisis that began in September 2008 and intensified in 2009. The financial crisis has led to a significant decline in economic activity in the world, resulting in facing significant losses from lending activities in the Russian banking sector. Deterioration in the financial condition of the organizations - the borrowers- in many areas of economic activity has led to a deterioration in the indications of the performance of the majority of banks, including indications of asset quality and profitability. According to the Bank of Russia data, in 2009 the growth rate of banking sector assets slowed down considerably, and the increase was only 5.0% and their value was equal to 29,430.0 billion (compared to 39.2% in 2008 ). (Central Bank of the Russian Federation (2014, October 2)).

Since 2010, the Russian economy has had a tendency to overcome the consequences of the global financial crisis.

311 These events affected the banking sector. After the crisis, lending to the economy became more active.

312 Taking into account the results of 2012, in 2013 there was a positive dynamics of the development of the Russian  
313 banking sector, while the GDP growth rate declined from 3.4% in 2012 to 0.4% in 2013. Despite this situation, banks  
314 estimated more conservatively their risks and intensively created reserves for possible losses on loans. As a result, the  
315 assets of the banking system increased during 2013 by 16% and amounted to 57,423.1 billion rubles, and the profit of the  
316 banking sector was only slightly lower than in 2012 (994 billion rubles). (Central Bank of the Russian Federation (2014,  
317 November 1)).

318 As you know, the main part in the structure of bank assets is occupied by loans to businesses and individuals.

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320 **Table 6.** Assets and loans made by commercial banks for 2009-2014 (billions of rubles.)

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Year (for 01.01)	Assets	Loans	The share of loans in total assets (%)
2009	28022,3	19362,4	69,1
2010	29430,0	19179,6	65,2
2011	33804,6	21537,0	63,7
2012	41627,5	27911,0	67,0
2013	49509,6	32887,0	66,4
2014	57423,1	38767,9	67,5
Growth rate (times)	2,1	2,0	-

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323 As you can see, the growth rate of assets and loans during this period are the same, and the share of the loan portfolio of  
324 the banking sector's assets has slight variations from 63.7% in 2011 to 69.1% in 2009, indicating certain difficulties in the  
325 activities of banks. As for 01.01.2014 the bulk of the loans were given to organizations - 23,678.0 billion rubles (61.1%),  
326 loans to individuals - 9,957.1 billion rubles (25.7%), credit organizations - 5130.6 billion rubles (13.2%).

327 Despite the positive changes in the Russian banking sector it has not been fully implemented yet its stimulating  
328 opportunities. It does not have sufficient resource potential yet, is subjected to high risks, does not have the necessary  
329 safety margin, has difficulties in increasing its capital base. It does not allow to actively influence the development of the  
330 economy for the banking system. There are a number of significant drawbacks that reduce the effectiveness of  
331 management and hinder economic growth in the banking system as a whole and the individual credit institutions. In  
332 developed countries, the banking system plays a key role in the socio-economic development of the country. In Russia, it  
333 possesses the led (driven) role. It is not in vain that in recent years, more attention has been paid to increase of the  
334 participation of the banking sector in economic development. To make this there should be developed the conceptual  
335 approaches to estimation of commercial banks, contributing to the effectiveness of their activities, adequate to the  
336 requirements of a modern market economy and international standards in accordance with the Basel Agreement.

337 It should be noted that the banking system of Russia in all respects is far behind the developed countries'. Despite  
338 the strong growth, the volume of loans issued it does not correspond to the tasks of economic growth the country facing.  
339 The share of bank loans in the structure of sources of investment financing Russian enterprises, compared to the  
340 developed countries, is small - only 8-10%, whereas, in the US it is 40%, on average in the EC it is 42-45%, Japan - 65%.  
341 Most of the population of Russia is not included in the banking system. According to reports, only 25% of Russians have  
342 bank accounts, while in Western Europe - the entire adult population. Less than 10% of the population use plastic cards,  
343 while in developed countries there are 1-2 cards per inhabitant. (Trubovich E., Russia's banking system. The Central Bank  
344 and commercial banks (2014, October 10))

345 The urgent is the question of saturation of banking services in the regions, because consumer loans, mortgages,  
346 credit cards are popular only in large cities.

347 Russian banking institutions operating in its market niche have their own range of clientele. At the same time the  
348 process of universalization of banks is activating in Russia, and it has an objective character. In such a market-based  
349 approach it is easier to stand in confrontation with competitors, they can quickly respond to changing market conditions.

350 The role of banks, in terms of the investment process, is not what the value of their assets they are willing to  
351 restructure in long-term investments, but how secure will be the accumulation of funds of their clients - participants of the  
352 investment process and how effective will be the mechanism for subsequent placement of these funds.

353 According to analysts, in the next 3-5 years, the banking sector will continue to grow at a moderate pace with the  
354 policy of recovery of the banking sector, developed by the Bank of Russia. In addition, it will enhance the resilience of the  
355 banking system to external situations and ensure ongoing funding needs of the economy and adequately protect the  
356 rights of depositors and creditors.

357 **5. Conclusion**

358  
359 A review of the individual elements of the financial system was made in the article .The overview of extra-budgetary funds  
360 is presented, based on a retrospective analysis of their revenues and expenditures. The retrospective is by 2000-2014  
361 years. The contribution insurance rates for 2014 will remain stable, but after 2015 they can change. Since 2001 the rates  
362 were changed four times. Of course, this is connected with the search for an effective mechanism of compulsory social  
363 insurance. A striking example is the contributions for an individual entrepreneur. In 2013, the burden on the employer in  
364 social insurance was doubled, which led to the curtailment of business activities. But in 2014 the legislature changed the  
365 rules of insurance, but the conclusions will be made at the end of the year. The Russian system of compulsory social  
366 insurance does not lack drawbacks. Among them there is the failure to follow the principles of insurance. These problems  
367 can be attributed to external factors: unfavorable state of the national economy, a high level of income differentiation.  
368 The ratio between the average income of the poorest 10% and 10% of the richest parts of the population was 16.7. The  
369 minimum wages are equal to 78.8% of the subsistence minimum working age population. This situation destabilizes the  
370 social insurance system, the financial resources which are directly dependent on the size of the salary of the insured  
371 persons. For comparison, according to the International Labour Organization, the minimum wages in most countries are  
372 several times the normal cost of living.

373 Thus, the system of social extra-budget funds of Russia needs further reforming, improving the collection and  
374 distribution of insurance contributions in order to better meet the needs of citizens and the state as a whole. In response  
375 to the global challenges the developed overseas Pension, Social Security and Medicare systems implemented parametric  
376 reforms. However, the Russian system, because of the objective peculiarities of the demographic and macroeconomic  
377 characteristics, as well as a huge load of accrued liabilities of the Soviet period, should take a unique set of measures,  
378 which goes far beyond the foreign experience. The improvement of the system will lead to a happy situation in the  
379 country and increase the country's prestige on the world stage.

380 The review of the banking system showed that the level of its development is insufficient. There are problems in  
381 the organization of Russian banks cash flows in the investment field, including: the credit period; guarantee the safety of  
382 the funds invested in the banks; interest rate policy; the intended use of the recipient of investments; financing of projects  
383 in full, the sources of return on invested funds.

384 The solution to these problems, taking into account the banking sector development strategy, according to the  
385 authors, will contribute to improving such areas of banking as: an increase in the resource base of the banking sector and  
386 especially long-term resources; increase of the level of capitalization of banks; improving liquidity management; credit risk  
387 mitigation; optimal combination of large, medium and small banks.

388 The analysis of the state of the elements of the financial system of the Russian Federation allowed to critically  
389 evaluate and justify the measures that are needed to solve the problems aggravated.

390 The main problem for the analyzed elements of the financial system of the state budget, state social extra-  
391 budgetary funds and the banking system is the lack of financial resources, especially long-term ones.

392 The World Bank in September 2014 issued a report on the prospects for the Russian economy. There were  
393 presented three scenarios of economic growth: basic, optimistic and pessimistic. The baseline forecast assumes  
394 stagnation with the continuing tensions between Russia and Ukraine, as well as the appropriate sanctions. The optimistic  
395 scenario assumes a slight recovery of the economy due to reducing geopolitical tensions and the abolition of all sanctions  
396 in the end of 2014. The pessimistic scenario assumes an increase of geopolitical tensions and the imposition of new  
397 sanctions, resulting in the economy coming into a deep recession. (The World Bank in the Russian Federation, Russia  
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437

## Regional Aspects of Business Environment Creation in the SME Segment in Slovakia

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### Abstract

The aim of this article is to define, quantify and compare the significant attributes of creation and development of the business environment for small and medium-sized enterprises (SMEs) in selected regions of Slovakia. Within this stated objective, relevant factors and business relationships between entrepreneurs and the socio-economic system were analysed. The entrepreneurs' perception of their environment (state, company, banks etc.) was evaluated. The data was collected through a questionnaire. The whole research was conducted in the Bratislava region on a sample of 102 SMEs, in the region of Trencin on a sample of 105 SMEs and in the Zilina region on a sample of 168 SMEs. Thus we compared important factors of business environment in the most economically developed region of the Slovak capital to the average regions of Trencin and Zilina. Entrepreneurs stated a quality of not being afraid to risk as the most essential characteristic feature of a businessman. The following qualities were mentioned as well: expertise, responsibility and persistence.. The largest number of entrepreneurs in all the regions of Slovakia said that the state institutions just bully them and create unnecessary obstacles. Entrepreneurs indicated that commercial banks' approach to SMEs financing remains problematic.

**Keywords:** Small and Medium-Sized Enterprises, regional differences, characteristics of entrepreneurs, relationship with the State, relationship with banks

### 1. Introduction

Small and medium-sized enterprises (SMEs) have specific features and fulfill important tasks in an economic system. SMEs significantly contribute to higher employment and GDP, help to create a more intensely competitive environment which has great importance in relation to price and quality of products and services. SMEs help with their flexibility to fill the market space and they are bearers of important innovations. Moreover, SMEs must fight for customers and must seek the best location for them in the market.

SMEs play an important role in the economic system of Slovakia as well. In this country, the share of SMEs in the total number of active enterprises was 99.2%; in the total employment it was 59.5%. The share of added value was 55.6% and the share of SMEs in the profit before taxes was 51.6% in 2012. (Národná agentúra pre rozvoj malého a stredného podnikania, 2013)

For the successful development of a company it is necessary to create favourable conditions for the growth of business awareness and shape a good quality of business environment and effective relationships between firms and their environment, i.e. society, the state, politicians, banks, etc.

In this article, significant attributes of the creation and development of the business environment of the SME segment in the selected regions of Slovak Republic were examined.

### 2. Literature Review

Current research papers intensively deal with entrepreneurship and business environment from many points of view, such as economic, institutional or cultural context, influence of gender and age on entrepreneurship, business orientation,

60 customer orientation, financial risks, etc.

61 According to Cumming, Johan, and Zhang (2014), Gawel (2010) entrepreneurship has a significantly positive  
62 impact on the GDP/capita, exports/GDP and the number of patents per population, and a negative impact on  
63 unemployment rates. Their findings point to institutional and cultural impediments to the effectiveness of  
64 entrepreneurship. Institutional/legal barriers are likely to have a negative impact on entrepreneurship. These barriers  
65 influence the decision to become an entrepreneur.

66 Entrepreneurial orientation is also in question nowadays as it is considered to be an essential driver of the high  
67 financial performance of companies. Similarly, Soinenen et al. (2012) consider innovativeness, risk-taking and proactivity  
68 as essential characteristics of entrepreneurial orientation. The results of their studies do not support the assumption that  
69 entrepreneurial orientation is positively related to the profitability of small firms. On the other hand, there is a positive  
70 relationship between the entrepreneurial orientation of a firm and a firm's pace of growth. According to Eggers et al.  
71 (2013), to drive itself to grow, a firm needs to deploy a strategy centered on entrepreneurial orientation or else risk  
72 stagnation occurs. In this regard, Lasagni (2012) indicates that innovation performance is higher in the SMEs that are  
73 proactive in strengthening their relationships with innovative suppliers, users and customers. Boso, Story and Cadogan  
74 (2013) argue that a high degree of entrepreneurial orientation maximalises company performance when operating in less  
75 developed countries.

76 Furthermore, customer orientation is considered to be an essential element for small firm success. (Brockman,  
77 Jones and Becherer, 2012). Their results support the overall positive influence of customer orientation on performance  
78 and indicate that the influence is stronger as risk-taking, innovativeness and opportunity focus increase.

79 Nonetheless, there are only a few studies dealing with regional aspects. One of them is a study by Stuetzer et al.  
80 (2014) that examines connections between regional characteristics and individual entrepreneurship. They found no  
81 empirical evidence for a direct effect of the regional characteristics on an individual's start-up intentions and engagement  
82 in the start-up activity. Their findings point to relevance of the indirect effects of the regional characteristics on individual  
83 entrepreneurship. Individual opportunity perception might play an important role in the cascading-down process of  
84 regional characteristics towards the individual. However, even inhabitants of one region can differ in their perceptions of  
85 business opportunities. This could be caused by several personal and social influences. Secondly, Simon-Moya et al.  
86 (2014) and Gallardo-Vazquez and Sanchez-Hernandez (2012) point out there are significant differences among business  
87 environments of various countries and even regions. The authors suggest that politicians in every single country have to  
88 adjust the trade laws to conditions of the respective country. The same laws in countries or regions with different  
89 economies can lead to totally different results.

90 Business activities are significantly determined by the environment of a company, which forces it to use a particular  
91 method of behaviour, to use the choice of particular business goals and ways of achieving them. In this context, a crucial  
92 role is played by social environment and political and legal environment that is created by state authorities.

93 As far as we know, there exist no papers examining regional aspects of the business environment creation in  
94 Slovakia. Exactly this is the reason why we decided to carry out our research.

95 The aim of this article was to define, quantify and compare the significant attributes of creation and development of  
96 the business environment for SMEs in the selected regions of Slovakia. Within this objective, relevant factors and  
97 business relationships between entrepreneurs and socio-economic system were analysed. The entrepreneurs' perception  
98 of their environment, i.e. society, state, banks or universities was evaluated.

99 In our research we compared important factors of business environment in the most economically developed  
100 region of the Slovak capital to the average regions of Trencin and Zilina. Our aim was to measure the regional differences  
101 of business environment in Slovakia.

102

103

### 3. Methodology and Data

104

105 The research on business environment was conducted in 2013 in the selected regions of Slovakia through a  
106 questionnaire survey. In the Bratislava region (BA), 102 SMEs have been reached; in the Zilina region (ZA), 164 SMEs  
107 have been reached and in the Trencin region (TN), 105 SMEs have been reached. Companies' data was provided by  
108 their owners.

109 The composition of these regions has been chosen because it enables us to compare business environment in the  
110 most economically developed region to the averagely developed regions. Our aim was to measure the differences among  
111 these regions and to define their significance.

112 The Bratislava region is located in the West and Southwest part of Slovakia. It has an area of 2,053 km<sup>2</sup> which  
113 means it is the smallest region of Slovakia. The number of inhabitants was 628,686 and the unemployment rate was 5.4

114 % in 2011. It borders the Trnava region in the North and the East, Hungary in the South and Austria in the West. The  
115 Bratislava region is the region with the best economic performance and creates 26% of the total Slovak GDP. As for the  
116 purchasing power parity expressed by the GDP/capita (24,000 EUR), it exceeds the EU25 average by 15.90%. According  
117 to the data of Eurostat, the Bratislava region was the fifth richest region in the EU concerning GDP per capita in 2011.  
118 With 1.86 times the EU average, it overtook such regions as Stockholm, Prague or Vienna. The economy of the  
119 Bratislava region contains all the economic sectors based on the traditional industrial production of goods. The most  
120 important industrial sectors are the chemical, automotive, electronic and food industry and mechanical engineering. Over  
121 the last few years, the Bratislava region has become a European centre of automotive industry representing 30% of the  
122 overall Slovak export. (Bratislavský samosprávny kraj, 2014)

123 The Trenčín region has an area of 4,502 km<sup>2</sup>, has about 600,000 inhabitants, GDP per capita reached 10,744 EUR  
124 in 2010 and the registered unemployment rate was at 10.89% in 2012 (significantly below the overall Slovak average of  
125 14.44%).

126 The Žilina region has an area of 6,800 km<sup>2</sup>, total population is up to 700,000 and the population density is 102  
127 inhabitants per km<sup>2</sup>. The unemployment rate was raised to 11.91% in 2011. The GDP per capita was 10,794 EUR in  
128 2011.

129 In our research in the Bratislava region, the largest share of surveyed companies was comprised of SMEs  
130 operating in trade activities (33%), followed by construction firms (12%), manufacturing companies (7%), transport  
131 companies (1%) and agricultural enterprises (1%). The remaining share was formed by companies operating in other  
132 sectors.

133 In the Trenčín region, the structure of companies was as follows: manufacturing companies (21%), trade  
134 companies (21%), construction companies (18%), transport companies (4%) and agricultural firms (5%). The largest  
135 portion of companies operated in other sectors (31%).

136 In the Žilina region, the structure of companies was as follows: 17% of companies operated in the manufacturing  
137 sector, 21% in the trade sector, 17% in the construction sector, 6% in the transport sector and 1% in the agricultural  
138 sector. The largest portion of companies operated in other sectors (38%).

139 From the total number of 102 surveyed firms in the Bratislava region, 54% of them were doing business for more  
140 than 10 years, 19% of them between 5 and 10 years, 27% of them between 1 and 5 years. Therefore, it can be stated  
141 that the research was examining quite experienced entrepreneurs from this region. The size structure of companies was  
142 as follow: 83% were micro-enterprises, 12% were small enterprises and 5% were medium-sized companies.

143 From the total number of 105 surveyed companies in the Trenčín region, 54% of companies do their business  
144 more than 10 years, 25% do their business from 5 to 10 years and 21% do their business from 1 to 5 years. The size  
145 structure of the companies was as follows: 62% were micro-enterprises, 31% were small enterprises and 7% were  
146 medium-sized enterprises.

147 In the Žilina region, of 164 surveyed companies 38% do business more than 10 years, 32% represents firms which  
148 do their businesses from 5 to 10 years and 30% of surveyed companies do businesses from 1 to 5 years. Thus  
149 companies surveyed in this region were equally distributed from the perspective of business duration. As for the size  
150 structure, 66% was represented by micro enterprises, 20% were small companies and 14% were medium-sized  
151 enterprises.

152 The business environment is also determined by personal characteristics of individual entrepreneurs. Creativity,  
153 risk taking and independence increase the probability of becoming an entrepreneur and decrease the probability of  
154 becoming an employee (Belas et al. 2014; Knórr, et al. 2013). Almeida et al. (2014) show that META model (Awareness,  
155 Vision, Creativity and Opportunism) is the strongest and most consistent predictor of entrepreneurial activity. Entrepreneurial individuals are characterised primarily as enterprising and creative, and to some degree as social and  
156 investigative.

157 As entrepreneurs have to perform various tasks, they do not need only knowledge, competence and expertise, but  
158 also a complex of skills and abilities influenced by their personality. These are for example risk tolerance, emotional  
159 stability or an internal control helping them to trust their decisions (Caliendo, Fossen and Kritikos, 2014). In this context,  
160 Ilouga, Mouloungni and Sahut (2014) point out that the commitment to the profession of an entrepreneur is considered as  
161 long, complicated, loaded with obstacles, difficult to achieve, and requires the vocational skills that will enable the person  
162 to protect his or her goal from distractions, to persevere and to optimise the plausibility of achieving it. Entrepreneurs  
163 must demonstrate some resistance against the uncertainty concerning the future through their self-motivation, self-  
164 determination and initiative so as to overcome their fears and worries.

165 According to Deáková et al. (2010), Sobeková et al. (2014) the most important personal qualities for an  
166 entrepreneur are: courage, self-reliance, responsibility, determination, perseverance, proactiveness, creativity and  
167

168 scholarship in the particular area in which this businessman intends to do business.

169 Kvietok (2013) adds that a decision to take on business risks is symptomatic for a certain type of people, in more  
170 detail for individuals who are more risk tolerant are more likely to start up firms (Hvide, and Panos, 2014).

171 In line with the findings of previous research, we hypothesize the following:

172 H1: The most important feature of an entrepreneur is not being afraid of taking risks.

173 H1a: The differences in the perception of the above mentioned key characteristics of an entrepreneur are not  
174 significant within the selected regions.

175 Generally, Slovak entrepreneurs evaluate the approach of the State to their needs and interests negatively. For  
176 instance, the Business Environment Index in relation to Slovakia, which is prepared by the Business Alliance of Slovakia,  
177 fell in 2011 to the historically lowest level since 2001 (Podnikateľská aliancia Slovenska, 2012).

178 Business environment in Slovakia was negatively perceived by 56% of companies in 2013. This results from the  
179 economic survey of the Slovak Chamber of Commerce (2014) among its members, which regularly takes place at the end  
180 of the year. A positive evaluation was showed only by 2% of respondents and the remaining 42% declared that the  
181 business environment has not changed compared since 2012. The national economic policy was negatively rated by 44%  
182 of respondents, while in the year on year comparison, negative evaluations decreased by 6 percentage points. Only 4%  
183 of business entities perceived the government measures as positive and nearly a half, namely 48%, assessed the  
184 economic policy neutrally. More than 38% of respondents suggested to the government taking actions in the field of tax  
185 burden and reducing administrative burden. Participants in the survey suggested, for example, returning to a flat rate of  
186 income tax, reducing the rates of Value Added Tax, or taking effective measures against tax evasion. Approximately 33%  
187 of business subjects required fundamental improvements in law enforcement and taking measures to accelerate solutions  
188 of commercial disputes. The greatest risks to businessmen were the following: high tax burden, poor law enforcement or  
189 cronyism and corruption in public procurement (Slovenská obchodná a priemyselná komora, 2014).

190 Therefore, we hypothesize the following:

191 H2: More than 50% of entrepreneurs think the State only bullies them and does not help them in their business  
192 activities.

193 H2a: The differences in the assessment of the State's approach are not significant within the selected regions.

194 H3: More than 60% of entrepreneurs think it is right that the State supports them financially.

195 H3a: There are no regional differences in the assessment of the State's financial support.

196 H4: The reception of the State financial support in the regions of Trencin and Zilina is higher than 20%.

197 H4a: The reception of the State financial support is significantly higher in the regions of Zilina and Trencin than in  
198 the region of Bratislava.

199 The financial gap represents an extremely significant problem of SMEs since many of these companies have very  
200 limited access to external financial resources (European Commission, 2011).

201 Lofstrom, Bates and Parker (2014) state that an entry into the low-barrier lines of business requires only modest  
202 amounts of financial capital and little in the way of owner advanced educational credentials, while in high-barrier fields,  
203 potential entrepreneurs typically need to assemble substantial capital and the skill requirements facilitating successful  
204 operation are often high.

205 Di Giuli, Caselli and Gatti (2011) state that for small and medium-sized enterprises the credit availability is a vital  
206 element for their development. Covaci (2008) adds that SMEs are perceived as being more risky than big companies  
207 because they show a higher sensitivity to economic shocks while disposed to an inferior capacity to absorb variations.

208 In this context, many researchers, such as Dierkes et al. (2013), Kirschenmann and Norden (2012), and Neuberger  
209 and Rätke (2009) present that companies in the segment of SME are smaller, more informationally opaque, riskier and  
210 more dependent on trade credit and bank loans. According to Canales and Nanda (2012), small businesses, and  
211 particularly young small businesses, have little internal cash flow to finance their operations and are also associated with  
212 significant asymmetric information.

213 According to Moro and Fink (2012), banks play an essential role in business financing, especially SMEs, since they  
214 have more difficulty accessing equity capital markets. The process used by banks to decide whether and how much to  
215 lend relies on different lending technologies and banks usually tend to use more than one technology at a time.

216 Several research papers on the banking sector come to the conclusion that commercial banks have tightened their  
217 lending policies as a result of the global financial crisis. On the other hand, Cumming, Johan and Zhang (2014) argue that  
218 the impact on entrepreneurship is significantly mitigated by excessively strong creditor rights that limit the entrepreneurial  
219 risk taking.

220 In line with the findings of previous research, we hypothesize the following:

221 H5: Less than 50% of entrepreneurs assess the commercial banks' approach towards them positively.



H5a: The assessment of the commercial banks' approach is more negative in the regions of Trencin and Zilina than in the region of Bratislava.

The associations in contingency tables were analysed by Pearson statistics for count data. P-value was being compared with standard a 5% confidence level. P-value which is lower than this confidence level leads to the rejection of the null hypothesis. The null claims there is no association between variables. The calculations were performed in the statistical packages XL Statistics and R. The instruments of descriptive statistics, namely percentages and means were also used.

#### 4. Research Results and Discussion

Table 1 contains crucial personal features, skills and abilities of an entrepreneur according to entrepreneurs themselves. The results of our research confirmed H1. In the entrepreneurs' point of view, the most important characteristic of an entrepreneur is not being afraid to take risks. Other frequently chosen qualities were expertise, responsibility and persistence.

H1a was confirmed as well. We found no statistically significant differences in the perception of the importance of not being afraid to take risks among the selected regions.

The values of test criteria (p-value = 0.2511/0.2372) show that there are no significant differences in the structure of all responses we got in the selected regions. We discovered only partial, but interesting relations. For instance, entrepreneurs of the Bratislava region stated less often than entrepreneurs of the Trencin and Zilina regions that expertise is a vital feature (p-value = 0.0135/0.0285) and more often they preferred optimism (p-value = 0.0349/0.0151).

The findings within our research are compatible with the conclusions of the presented studies, such as: Knörr, Alvarez and Urbano (2013), Caliendo, Fossen and Kritikos (2014), Ilouga, Mouloungni and Sahut (2014), Deáková et al. (2012), and Soinen et al. (2012).

We share the same opinion as Kvietok (2013) that a significant part of the motivation to take risks in business results from the motivation for success. To achieve the set goals, successful people are willing to take reasonable risks associated with the feedback about the level of achieved results. Entrepreneurs are sort of managed by an inner feeling, which means that they feel their personal fate is the result of their own efforts. They are independent, autonomous and rely upon themselves, which are the main characteristics of entrepreneurial personalities. Psychological research on entrepreneurs has shown that another characteristic feature of entrepreneurs is the ability to make decisions under conditions of uncertainty. Entrepreneurs are stimulated by success itself more than by money. Money is simply a measure of achievement and success.

**Table 1:** The Most Important Characteristics of an Entrepreneur

What qualities and skills must an entrepreneur have? (Please give a maximum of up to three answers.)	BA in %	TN in %	ZA in %	p-value: BA:TN/BA:ZA/TN:ZA
1. undeterred by risk	53.92	59.05	51.83	0.4593/0.7414/0.4593
2. persistence	44.12	40.00	38.41	0.5485/0.3576/0.7949
3. creativity	18.63	18.10	27.44	0.9203/0.1031/0.0784
4. imagination	3.92	5.71	7.32	0.5485/0.2585/0.6101
5. expertise	36.27	53.33	50.00	0.0135/0.0285/0.5961
6. quality of education	5.88	4.76	3.66	0.7188/0.3953/0.6527
7. intelligence	9.80	7.62	12.20	0.5755/0.5485/0.2301
8. responsibility	34.31	43.81	46.95	0.1615/0.0424/0.6171
9. intuition	19.61	12.38	7.93	0.1556/0.0050/0.2263
10. decisiveness	23.53	21.90	17.68	0.7795/0.2460/0.3898
11. patience	19.61	19.05	17.68	0.9203/0.6965/0.7795
12. optimism	18.63	8.57	8.54	0.0349/0.0151/0.9920
13. other	2.94	1.90	0.61	0.6241/0.1285/0.3222
p-value BA:TN/BA:ZA/TN:ZA				0.2511/0.2372/0.2420

**Source:** Authors' data and calculation

To present the entrepreneurs' assessment of the State's approach towards them is the objective of Table 2 below.

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**Table 2:** The State Approach towards Entrepreneurs' Needs in the Selected Regions of Slovakia

How do you assess the State's attitude to entrepreneurs' needs?	BA in %	TN in %	ZA in %	p-value: BA:TN/BA:ZA/TN:ZA
1. I feel the State is just bullying us	54.90	54.29	53.05	0.9283/0.7718/0.8415
2. The State is not fulfilling its duties	40.20	40.95	38.41	0.9124/0.7718/0.6745
3. The State is fulfilling its duties	3.92	4.76	5.49	0.7642/0.5619/0.7949
4. The State helps us in our business activities	0.98	0.00	3.05	0.3077/0.2713/0.0703
p-value BA:TN/BA:ZA/TN:ZA				0.7712/0.6595/0.3355

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**Source:** Authors' data and calculation

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Based on the results of our research, H2 was confirmed. In all the selected Slovak regions entrepreneurs frequently (more than 50%) declared that the State is just bullying them (see the Table 2).

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The values of the calculated test criteria showed there are no statistically significant differences in the assessment of the State's approach within the selected regions (p-values = 0.7712/0.6595/0.3355).

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On the contrary, only 4.90% (line 3 + line 4 of the Table 2) of entrepreneurs in the Bratislava region, 4.76% of entrepreneurs in the Trenčín region and 8.54% of entrepreneurs in the Žilina region think that the State fulfils its duties and helps them.

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Our findings are in line with the conclusions of the Business Alliance of Slovakia (Podnikateľská aliancia Slovenska, 2012) and Slovak Chamber of Commerce (Slovenská obchodná a priemyselná komora, 2014).

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We believe our research can be inspirational for politicians to form a more effective approach towards entrepreneurs. It is a paradox that politicians and experts are rather satisfied and intensively discuss the position of SMEs, but the real business practice confirms that there exists a lack of high quality SMEs business environment. Moreover, nothing has changed for a long time in Slovakia and the SMEs business environment is not properly set. Politicians, either in Slovakia or in the European Union, verbally declare their interest to solve the problems of SMEs. In fact, they perform the opposite actions. For example, there will be an application form for additional taxation from the next year in Slovakia, which may have a significant impact on the business activities of SMEs. Besides various taxes, companies will have to pay for a "business license" as well.

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Table 3 is dealing further with the entrepreneurs' assessment of the State's approach, namely of the financial support from the State.

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**Table 3:** The Assessment of the Financial Support of Entrepreneurs by the State

Do you think the State should support entrepreneurs financially?	BA in %	TN in %	ZA in %	p-value: BA:TN/BA:ZA/TN:ZA
1. Yes	65.69	67.62	74.39	0.7718/0.1285/0.2301
2. No	22.55	25.71	17.07	0.5961/0.2713/0.0873
3. I don't know	11.76	6.67	8.54	0.2041/0.3898/0.5755
p-value:BA:TN/BA:ZA/TN:ZA				0.4256/0.3128/0.2194

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**Source:** Authors' data and calculation

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Since more than 60% of entrepreneurs in all the selected regions stated that the State should support them financially, the validity of H3 was confirmed.

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H3a was also confirmed. The calculated test criteria (p-value = 0.4256/0.3128/0.2194) indicate no significant differences among the regions regarding this issue. Entrepreneurs in all the selected regions share about the same opinion on whether the State should support them financially or not.

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Moreover, we examined the intensity of the State's financial support utilisation by entrepreneurs. The results are presented in the Table 4.

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**Table 4:** The Entrepreneurs' Utilisation of the State Financial Support

Have you ever used any financial support from the State in your business activities?	BA in %	TN in %	ZA in %	p-value: BA:TN/BA:ZA/TN:ZA
1. Yes	15.69	30.48	22.56	0.0117/0.1738/0.1471
2. No	84.32	69.52	77.44	0.0117/0.1738/0.1471
p-value BA:TN/BA:ZA/TN:ZA				0.0117/0.1738/0.1471

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**Source:** Authors' data and calculation

299 The validity of H4 was confirmed. The results of our research presented in Table 6 show the level of entrepreneurs' utilisation of State financial support is higher than 20% in the regions of Trencin and Zilina.

301 The validity of H4a was partially confirmed. This hypothesis was valid for the comparison of the regions of Bratislava and Trencin (p-value = 0.0117) but significant variations between the Bratislava and Zilina region and between the Trencin and Zilina region were not found (p-values = 0.1738/0.1471). It is probable that these results are vastly influenced by the objectives of State financial support in Slovakia: the regions out of Bratislava are prioritised in obtaining money from the government and EU funds.

306 Furthermore, it would be appropriate to define boundaries between the public and the private sector and to reevaluate the existing forms of business environment deformations by the State such as various forms of subsidies, support programs and privileges in competitive environment. In terms of the market mechanism functioning, it is best if the market is able to regulate itself without any State intervention as much as possible. Probably the most important prerequisite for appropriate business environment should be a long-term and stable economic policy of the State including fair and stable tax environment. Unfortunately, it works differently in Slovakia. If the State does not have enough money, it immediately taxes entrepreneurs instead of reassessing the expenditure side of the budget.

313 Moreover, there are many cases in Slovakia in which it is obvious that the State's support for some companies is in fact a form of corruption. There are many firms doing their business exclusively in collaboration with the State. Therefore, it can be assumed that their motivation for running a business is not respectable.

316 Table 5 presents the results of our research regarding the entrepreneurs' opinion on the commercial banks' approach towards the financing of their companies.

318 **Table 5:** Commercial Banks' Approach to the SMEs Financing in the Selected Regions of Slovakia

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How do you assess the banks' approach to the financing of small and medium-sized enterprises?	BA in %	TN in %	ZA in %	p-value: BA:TN/BA:ZA/TN:ZA
1. Banks fully accept our needs and have a good relationship with us )	1.96	0.95	3.05	0.5419/0.5892/0.2543
2. Banks behave appropriately	33.33	34.29	20.12	0.8887/0.0160/0.0096
3. Banks are unhelpful	10.78	9.52	14.02	0.7642/0.4413/0.2713
4. Banks use unmeetable criteria for lending	34.31	43.81	37.20	0.1615/0.6312/0.2801
5. I cannot judge	19.62	11.43	25.61	0.1031/0.2585/0.0047
p-value BA:TN/BA:ZA/TN:ZA				0.4212/0.1796/0.0060

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322 **Source:** Authors' data and calculation

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324 As the results of our research show, the validity of H5 was confirmed. In more details, only 35.29% (line 1 + line 2 in the Table 5) of the Bratislava region entrepreneurs assess the commercial banks' approach to their financing positively. The shares of satisfied entrepreneurs were even lower in the other two regions, namely 35.24% in the Trencin region and 23.17% in the Zilina region.

328 On the other hand, it was not possible to confirm H5a. The calculated p-values indicate no differences in the negative assessment of the commercial banks' approach towards the financing of SMEs within the selected regions (see Table 5, line 3 and 4).

331 Within our research, we asked entrepreneurs how the lending policies of commercial banks have changed compared to the pre-crisis period. 36.28% of the Bratislava region entrepreneurs stated the approach of banks has worsened compared to 2008 and only 8.82% stated the approach has improved. 14.71% of them declared no difference in the approach and 40.20% could not answer this question. Similar results were obtained in the other two regions. 47.62% of the Trencin region entrepreneurs stated the approach has worsened, whereas 11.43% stated the approach has improved. 31.10% of entrepreneurs in the Zilina region declared a worse attitude of banks and 12.20% of them a better commercial banks' attitude compared to 2008. These findings are compatible with the studies of the European Commission (2011), Di Giuli, Caselli and Gatti (2011), Covaci (2008), Dierkes et al. (2013), Kirschenmann and Norden (2012), and Neuberger a R athke (2009).

340 Considering the specific conditions of the commercial bank sector, such as doing business with mostly external money and having equity capital only to cover financial risks, it is natural that banks have to protect the money of their depositors. Thus, it seems logical that banks tightened their lending policies as an answer to the global financial crisis. Nonetheless, it can be argued that some of them have changed their behaviour towards debtors from one extreme to another. Before crisis, banks were almost pushing their clients to take out new loans and shortly after, they wanted these

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clients to pay the loans back as soon as possible.

Furthermore in our research, we examined the decrease in the profitability of companies during the crisis as it has tremendous influence on the company's credibility. We found out the average profitability decrease was at 12.12% in the Bratislava region, at 14.04% in the Trenčin region and at 12.01% in the Žilina region.

## 5. Conclusion

The aim of this article was to define, quantify and compare significant attributes of the creation and development of the business environment for SMEs in the selected regions of Slovakia.

Our research showed there are certain regional variations in the assessment of important attributes of the SME segment in Slovakia. Comparing the Bratislava region as the most economically developed to the other selected regions, we found significant differences in identifying vital personal features and skills of an entrepreneur. Certain variations were discovered also in the entrepreneurs' utilisation of State financial support.

At the same time, there are several factors not significantly influenced by regional characteristics. These are the general State approach towards entrepreneurs, the assessment of State financial support, the opinion on the attitude of commercial banks in relation to SME financing.

It also has to be pointed out that entrepreneurs in the Bratislava region stated optimism as a vital quality of an entrepreneur more often than entrepreneurs in the other regions. At the same time, they declared expertise less often than entrepreneurs in the other regions.

Moreover, entrepreneurs assess the State's role in creating business environment rather negatively. Thus, the research results imply the need to improve the State's approach to entrepreneurship, to create a better image of business activities in the eyes of society and to awaken public interest in conducting business.

Although it is clear that there are certain limitations to our research (e.g. the number of companies involved in the research), we believe that our article has inferred significant incentives for the formation of a more appropriate business environment for SMEs in Slovakia.

Our future research will focus on the examination of the relationships among personal characteristics of entrepreneurs, the propensity to take risks and their financial performance.

## 6. Acknowledgement

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# The Problems of Modern Economic Development: The Fundamental Mechanics

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## Abstract

*Broad-scale economic crisis, which led to a number of serious attempts to understand the nature of ongoing social and economic processes and to analyze and evaluate the efficiency of the existing economic systems, is progressively subsiding. In current publications major attention is given to the solution of today's economic problems. Attempts are undertaken to reveal major trends of a new stage of economic development. Therefore identifying the basic patterns which led to the present-day economic crisis and which determine the pathway of the world economy development and provide a theoretical basis for economic forecasting and strategic planning of national economic development is a topical issue.*

**Keywords:** Economic crisis, economic development, monetary policy, GDP growth rate, financial system, monetary reflation, intermediate-term cycle, long economic cycle, heavy market, major contraction, upward trend.

## 1. Introduction

The statistical data analysis indicates the general recovery trend is forming affected by the enhanced business activity of the developed countries' national economies. Surely during this period, the focus is on addressing the ongoing financial and economic policy challenges.

In the US the emphasis is put on monetary policy shaped by quantitative easing and aimed at concentrating significant amounts of investment money, which creates favorable conditions during the increasing business activity and the general trend of continuous and sustained dynamics in the world economy, aimed at providing fast and steady economic growth. During the second half of 2013, the US economy was developing at the fastest pace in a decade. In the 3<sup>rd</sup> quarter the economy was growing at a 4% and in the 4<sup>th</sup> quarter – at a 3.2% rate. Although the average growth rate for 2013 was 1.9%, Chief Financial Economist at the New York's Bank of Tokyo-Mitsubishi UFJ Chris Rupkey stated: "The economy was firing on almost all cylinders as 2013 came to a close. For today, the sun is out and shining" (top.rbc.ru). Unstable but positive growth trends in the United States are observed in 2014 as well. In the 1<sup>st</sup> quarter the economy showed only 0.1% growth, while in the second quarter it reached 4% which was significantly higher than the experts' forecasts. In general, according to the Bloomberg consensus forecast, this year American GDP is to increase by 3%. This fact, along with the circumstances discussed below, indicates the potential strengthening of the US economy in the decades to come.

Canada goes through a similar stage of a gradual recovery still experiencing however the negative impacts of global trends. In this context Canadian territories' development budget totaled record-breaking 59 billion CAD. Closer attention is paid to financial incentives of innovational technology sectors. In 2012 and 2013 Canada's GDP growth equaled 1.7%. In the 1<sup>st</sup> quarter of 2014 it was 1.2%, in the 2<sup>nd</sup> quarter – 3.1%, indicating the economy's slow but steady recovery from the global financial and economic crisis (afn.by).

Despite Japan's economy did not demonstrate higher rates of economic growth many analysts were predicting, its growth rate arrived at 1.4% in 2012 and 1.5% in 2013 (top.rbc.ru).

UK GDP growth in 2013 comprised 3.1% which surpassed the 2008 level. Five largest economies of the monetary union: Germany, France, Italy, Spain and the Netherlands demonstrate positive yet very unstable dynamics, which in

57 many ways still gravitate to stagnation. Eurozone countries lay their hopes mainly on monetary economic growth stimuli.  
58 At the same time, the opposite trends emerged in the most dynamically developing economies: Brazil, Russia,  
59 India and China, which gradually began to lose their leading positions in terms of economic growth. China's economy  
60 growth rates are slowing down: from 10.4% in 2010 to 7.7% in 2013, planned growth rate for 2014 is 7.5% (Mikhaylov S,  
61 Lisovskaya V., 2014). In India, GDP growth decreased from 8.9% in 2010 to 4.7% in 2013. The same rate is projected for  
62 2014 (ved.gov.ru). In Brazil annual GDP growth by 7.5% in 2010 was followed by a decrease to 1% rate in 2012 and  
63 2.5% in 2013. 1% growth is planned for 2014 (bbc.com). The development of Russian economy also considerably slowed  
64 down: from 4% in 2010 to 1.3% in 2013. EBRD predicts zero growth rate in 2014 (Denisov A., 2014).

65 Observed economic slowdown trends in the developing countries showing a decline in efficiency of traditional  
66 economic growth drivers are the adjustment triggers in the wake of a new stage of the world economy development  
67 (Melnik M., Tikhomirova N., 2012).

## 68 69 **2. Method**

### 71 *2.1 Laws governing the falling phase of the III large economic cycle.*

72 Taking into account the ongoing debate the nature and the sources of the Great Recession as well as the need to  
73 forecast trends in global economic development, we offer our look at the issue. As opposed to the existing concepts of  
74 the subjective preconditions of the Great Recession (vedomosti.ru), our take is based on theoretical approaches to the  
75 economic cycles by N. Kondratiev (Kondratyev N.D., 2002, 379 s.), J. Schumpeter (Shumpeter Y., 2007), L. von Mises  
76 (Mizes L., 2000) and other researchers of this challenging economic problem (Yokhansson, F., 2008.).

77 Our calculations are based on the assumptions of N. Kondratiev that the turning point of the third long economic  
78 cycle is determined by the crisis of 1920-1921. J.M. Keynes recognizes the crisis to a great extent shaped the Great  
79 Depression (Keynes, J.M. 1978). Another crisis that followed in 1929-1933 indicates the end of the first intermediate cycle  
80 of the downward wave with the average duration of 10-12 years. This cycle is marked by the economic recovery in the  
81 United States, thus mass goods production based on the assembly lines was launched. That provided an unprecedented  
82 growth in labor productivity and thus a 2.8 times increase in national income by 1927 as compared to the 1913 level.

83 Similar recovery processes with varying increase of production and different price indexes were taking place in  
84 Europe and Canada. But between 1929 and 1933 a decrease in industrial production started to appear.

85 The beginning of the Great Depression is linked with the economic crisis of 1929-1933, when the unprecedented  
86 stock panic began on October 24, 1929 followed by the stock market crash, what coincides with the end of the first  
87 intermediate-term cycle of the falling phase of a K-wave.

88 Such far-reaching implications of the crisis were caused by the enhancement of the negative effect of the crisis  
89 amidst the general trend of the rising phase of a K-wave: "Indeed if we consider intermediate-term cycles that fall on a  
90 falling phase of a large wave, it is obvious that all the upward trends of elements involved in intermediate-term cycles will  
91 be weakened, and all the downward trends will intensify due to the downward nature of the K-wave phase" (Kondratiev,  
92 N. 2002).

93 Next wave's bottom generates in 1938-1939. In 1938 world's leading countries already demonstrated a decrease  
94 in industrial production. Hence the boundaries of the second intermediate-term cycle should be recognized as from 1929-  
95 1933 to 1938-1939. It can be assumed that the reduction of the second intermediate-term cycle is caused by the  
96 economies' failing to form upward trends against the backdrop of the overall falling phase.

97 The period of 1938-1945 indicates the growth of the US GDP by 65 percentage points. Meanwhile in Europe under  
98 the influence of warfare it reduced by 23%. The figure for Japan was even lower. Another decline in production is  
99 observed in the United States in 1948-1949, for the first time since the end of World War II the decline affects more than  
100 80% of economic sectors. Thus the boundaries of the 3<sup>rd</sup> intermediate-term cycle of the 3<sup>rd</sup> K-wave can be dated as 1938-  
101 1939 – 1948-1949, which makes the duration of its falling phase 28-29 years and points to the beginning of a rising phase  
102 in 1950.

### 103 104 105 *2.2 Laws governing the formation of large IV of the economic cycle.*

106 The economic recovery of the most war-torn countries was based on the significant volumes of imports from the United  
107 States including provisions for food, fuel, clothing, industrial equipment, raw materials, agricultural machinery, industrial  
108 goods, spare parts, etc., which influences the way those countries were involved in the shaping of the world's  
109 intermediate-term cycles. Until 1950 France's economy was growing fast surpassing the other European economies.  
110

Germany demonstrated high rates of industrial production. By 1950 its industrial output amounted to 113.7% of the 1936 level. UK was facing significant difficulties in stimulating economic growth which resulted in significantly lower growth rates. Japan was developing very rapidly and surpassed the European states in terms of GNP and industrial production.

However in 1957-1958, the economic crisis swept the countries much less affected by the devastating effects of World War II.

Specific for that crisis was the near absence of depression and recovery phases. The recession was followed by most considerable, widespread and long period of growth. This led to the conclusion made by G. Habeler (Haberler, G. 2007), according to whom, deep and long-lasting depressions are the thing of the past, which in our opinion is unreasonable as the similar phenomena of decline in production quickly followed by the rise was observed in crises that took place in the XVIII and XIX century.

Consequently, the 1<sup>st</sup> intermediate-term cycle of the 4<sup>th</sup> K-wave can be dated 1949-1950 – 1957-1958.

However World War II and the features of post-war reconstruction of national economies have led to mistiming of the intermediate-term cycles in the leading economies, changes in their behavior and their influence on the reproduction process.

But gradually the synchrony restored and was completed by the time of the 1973 crisis.

This crisis resembled the crisis of 1929-1933 marking a significant drop in industrial production and rate of securities. But in terms of duration and economic and social impact, they are not comparable. That's why the second intermediate-term cycle's timeframe is from 1957-58 to 1973.

The next intermediate cycle completing the rising phase of the 4<sup>th</sup> K-wave is characterized by the fact that cost defining structure imbalances developed by 1973 were not overcome before 1980-s. The economic crisis, which began in 1979 and unfolded in 1980, was intensified by inflation, which led to an unprecedented rise of private banks' interest rates and stagnation of the US economy. By the spring of 1982 26% of production capacities were idle. That crisis was a turning point of the 4<sup>th</sup> K-wave and the beginning of its falling phase.

The first intermediate-term cycle of the falling phase of the 4<sup>th</sup> K-wave in the late 80s – early 90s was marked in the US by the Black Monday of 1987 and its negative consequences. This period is characterized by the deepest economic recession since the beginning of the 80s. It lasted until 1993.

The second intermediate-term cycle is defined by the fact that by 2001, the crisis was clearly visible in almost all sectors of the US economy - from high tech to agriculture. Investments and import-export activity have reduced, stock jobbing – intensified. Similar signs of a crisis were common in Japan and European countries during that period.

The third and final intermediate-term cycle of a falling phase of a K-wave is characterized by the economic crisis of 2007, which due to its relevance is subject to thorough examination and description.

### 2.3 General and specific in the economic cycle.

However the externals of the economic crises (a significant increase in money supply and its equivalents, mass stock market speculations) at first sight is seen as their cause.

The cause of the current global economic crisis has been described in a similar way – as a collapse of the US mortgage system which triggered a panic on the stock exchange with the expected results. And there is cautious optimism that the actions that prevented the collapse of the national banking system and a catastrophic decrease in industrial production will normalize the situation and bring economic recovery.

However, the logic under economic development leaves no room for such illusions. Similar phenomena prefaced lots of economic crises before 2007.

Therefore the following intermediate-term cycles and their duration can be distinguished based on their lower turning points and their correlation with the K-waves (Table 1).

**Table 1.** K-waves' and intermediate-term cycles' duration (XX – beginning of XXI century)

Cycles	Beginning	End	Duration
Falling phase of the 3 <sup>rd</sup> K-wave	1920	1949	29 years
1 <sup>st</sup> intermediate-term cycle	1920	1929-1933	11 years
2 <sup>nd</sup> intermediate-term cycle	1929-1933	1938-1939	7 years
3 <sup>rd</sup> intermediate-term cycle	1938-1939	1949	10 years
Rising phase of the 4 <sup>th</sup> K-wave	1949	1980	30 years
1 <sup>st</sup> intermediate-term cycle	1949	1957-1958	8 years

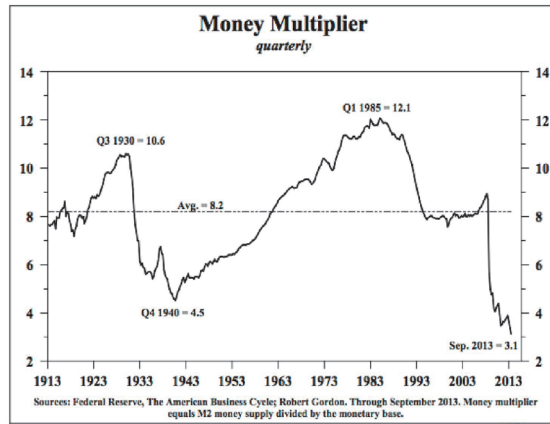


2 <sup>nd</sup> intermediate-term cycle	1957-1958	1968-1969	10 years
3 <sup>rd</sup> intermediate-term cycle	1969	1979-1980	11 years
Falling phase of the 4 <sup>th</sup> K-wave	1980	till present	≈29 years
1 <sup>st</sup> intermediate-term cycle	1980	1990-1991	10 years
2 <sup>nd</sup> intermediate-term cycle	1991	2001-2002	10 years
3 <sup>rd</sup> intermediate-term cycle	2002	till present	11 years
Total duration of the 4 <sup>th</sup> K-wave	1949	till present	≈60 years

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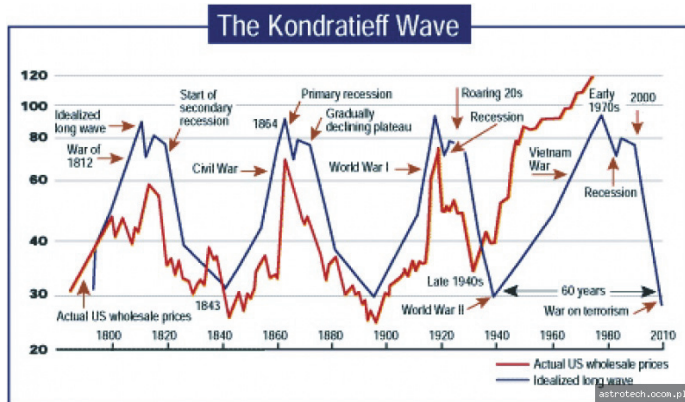
**Source:** author's calculations

The boundary of the 3<sup>rd</sup> K-wave is determined by the first post-war crisis in the US economy. It is followed by a recovery period interrupted by the 1957 crisis. In Western Europe the long post-war growth period was punctuated by the occasional minor declines in production. Major trends of the falling phase of the 3<sup>rd</sup> long wave and the 4<sup>th</sup> long wave in general are reflected in the diagram of the US money multiplier changes by G. Rubino as well as in the diagram of the K-waves by I. Gordon.



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**Diagram 1.** The US money multiplier evolution



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**Diagram 2.** I. Gordon's K-wave diagram

Average duration of the intermediate cycles of the 4<sup>th</sup> K-wave rising phase equaled as follows: 1<sup>st</sup> cycle – 8 years, 2<sup>nd</sup> cycle – 11 years, 3<sup>rd</sup> cycle – 10 years. The total timeline of the falling phase was 30 years. Specific feature of the 3<sup>rd</sup> intermediate cycle was the unsolved problems of the 2<sup>nd</sup> cycle, due to which the 1973 crisis interrupted the shaping of a

new cycle. By that time the objective economic preconditions for restoring the synchrony of the leading economies' cycles have formed in Europe and Japan that means the necessary prerequisites for the crisis have matured in their economies.

One of the other aspects of the post-war intermediate-term cycles is the reduced threshold of the economic indicators' decrease leading to a reduction in direct costs as a result of the crises, but in this regard and recovery phases have become longer.

Depressions have become rare. They became less typical for intermediate-term cycles and more correlated with the K-waves' tipping points. But a similar trend emerged in the XIX century and was noted by M. Tugan-Baranovsky (Tugan-Baranovsky, M.I. 1923).

But the most critical values for accessing economic trends in developed countries are capacity utilization and per capita GDP growth rate.

There was a sustained trend of reduction of capacity utilization. In the United States alone it comprised 75.6%, including 73.2% in manufacturing and up to 62.1% in high-tech industries.

This trend was confirmed by a significant reduction of the real GDP per capita growth rate. Compared to 1980 level, in 2001 it equaled 78.9% in the US, 66.6% in the EU, 32.2% in Japan. That's why this period of long recession and stagnation of the Japanese economy is often called the Great Recession.

### 3. Result

On that premise it can be argued that the recovery of the major world economies indicates the completion of the 4<sup>th</sup> K-wave and the beginning of the first rising intermediate cycle of the 5<sup>th</sup> K-wave which is supposed to end in 2039-2044. In this connection the US economy will again play the leading part which currently has several components. We will only mention two of the most important. Firstly, it has a significant technological advance and favorable conditions to use that advantage to form a rising phase of a K-wave. Therefore, an important feature of the new technologies is the need for large fixed investments with long life period which leads to uncertainty of future costs and prices, as well as the numerous organizational problems. Second factor is the mobility of social institutions that evolve under the influence of objective economic and structural changes brought by a rising phase of a new long wave.

Consequently, on the rising phase there occur certain tectonic shifts in the restructurization and cross-sectoral migration of employees. It is these significant changes in the structure of society that cause social disruptions. Economic, political and social institutions must prepare for these shocks in advance and acquire the appropriate flexibility, the ability to perceive the influence of radical structural economic reforms. To this end, even at present the most important function of the state should be the forecasting of upcoming changes in social institutions, deliberate preparation of the establishment and public opinion for the upcoming major changes in society, with a preliminary study of the relevant legislative and regulatory base to prevent aggravation of social contradictions.

### 4. Discussion

#### 4.1 Unsubstantiated claims about reducing the duration of high cycles.

Thus given the dynamics and duration of the intermediate-term cycles there are no sufficient grounds to state that due to the information revolution and its impact on economic reproduction long K-waves have reduced to 45-50 years, as some Russian economists point out. If such changes actually took place this would have an effect on the duration of the intermediate-term cycles. But the dynamics of their reduction and increase in time during the falling phases of the 3<sup>rd</sup> and the 4<sup>th</sup> K-waves correlate with those of preceding K-waves.

Popularity of the views according to which scientific and technological progress is accelerating and the new technologies' lead time is constantly reducing is criticized even by G. Mensch, who is thought to give theoretical grounds to such thinking. Based on empirical data G. Mensch notes that even if such phenomena exist, those are improving innovations (Mensch, G. , 1979). Reduction of the lead time of a new basis technology occurs only within certain periods and does not affect the overall duration of the K-waves. Early basic innovations of the next long wave are implemented very slowly and painfully. Very few investors venture upon this step that involves a radical shift of a focus area, the necessity to establish new production and sales channels. It is also difficult to determine how the market will react to the innovation. Thus the lead time for technological innovations decreases only with favorable technological conditions. This is explained by a decrease of uncertainty and investment risks. The more investors involved – the greater the amount of investments which in turn attracts even more money.

However the cyclic nature of economic development stays in place. That's why the assessment of the current

231 period of social production by the experts of the Bank of England can be considered as objective. According to the  
232 experts the global economic crisis of 2007 shows signs of the second Great Depression and in the materials of the World  
233 Bank, this crisis is dubbed the Great Recession.

#### 234 235 4.2 *Exaggeration of the role of monetary factors in the Great Depression and the Great Recession.*

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237 The Great Recession as well as the Great Depression developed during the falling phases of K-waves, during the 2<sup>nd</sup> and  
238 the 3<sup>rd</sup> intermediate-term cycles respectively. The lack of a common understanding of what caused the Great Depression  
239 was largely due to the fact that only the economic events that lay on the surface were subject to analysis. Intrinsically it  
240 was the global economic crisis which escalated in the late 20s - early 30s. This is shown by the synchrony of economic  
241 events. The US economy's rapid growth in the beginning of the 1920s gave way to a decline and an increasing downward  
242 trend. This is evident from the decline in production during 1924-1927 and a drop in investment in fixed production  
243 assets, a steady decline in car sales (a major durable merchandise) and decline in construction since 1926. It was  
244 becoming more obvious that a stable cyclical trend of worsening of business conditions was forming. However then and  
245 now most researchers overlook those obvious evidence of change in substantial characteristics of the economic  
246 development. The emphasis was placed on the analysis of individual monetary factors: lack of money supply in  
247 conjunction with overproduction provoked a deflation, which led to drop in commodity prices and the bankruptcy of a large  
248 part of their producers; a significant increase in speculative transactions which significantly increased the amount of  
249 fictitious capital caused financial bubbles creating an appearance of substantial excess of the money supply over  
250 demand; hidden inflation caused by violations of the gold standard which led to the increase in money supply by 62%;  
251 budget deficit growth; rise in the accounts payable used for speculation on the stock exchange; overflow of money  
252 substitutes when the money supply growth had stopped. Besides monetary factors some other contributed to the  
253 depression: the law initiated by the senators Willis C. Hawley and Reed Smoot (Smoot-Hawley Tariff Act) that raised US  
254 tariffs to record levels which led to imports reducing by several times as well as the reduction in consumer demand;  
255 overproduction; large population growth rate; inadequate response of the stock exchange which created the illusion of  
256 growth amidst the cyclical economic decline; two contradictory trends: the drop in labor productivity and the growth of the  
257 money supply; unjustified increase in demand for securities, real estate influenced by the illusion of the upcoming  
258 prosperity, etc. But even if we try to logically link together the abovementioned set of factors, we will not find the causal  
259 mechanism of the economic crisis, that led to a long depression of the American and the world economy.

260 If we analyze the publications dedicated to the research into the causes of the current global economic crisis, we  
261 will largely see the same set of monetary factors interpreted as its reason. The negative role of the substantial increase of  
262 other countries' investment in the US securities; the accumulation of foreign exchange reserves by developing countries  
263 as well as the accumulation of sovereign oil funds; Federal Reserve's low interest rate policy, etc. are seen as the specific  
264 features of the crisis. Consequently, the crisis itself was originally defined as the global financial crisis with indisputably  
265 financial origins which allegedly follows from the sequence of unfolding events. At the same time it is repeatedly stated  
266 that the trigger of the current crisis was the set of contradictions in the US mortgage market.

267 Only some time later due to the nature of its escalation and drawn analogies with the Great Depression it was  
268 named the second Great Depression or the Great Recession.

269 In fact we see the same patterns that have been observed even in studies of XX century economic cycles. In  
270 particular in the studies of M. Tugan-Baranovsky (Tugan-Baranovsky, M.I. 1923) who pointed out that each economic  
271 crisis is preceded by a financial crisis provoked by the large-scale speculative operations on the stock market. Therefore  
272 we consider the current crisis as a manifestation of a general cyclical pattern of economic dynamics.

## 273 274 5. Conclusion

275  
276 Brief overview of the major world economy centers suggests that the main negative effects of the Great Recession are  
277 barely being overcome and that the world economy generates the recovery phase of the economic cycle.

278 A substantial controversy arising in the society when implementing fundamentally new technologies over three next  
279 decades will be the need for significant organizational changes in the economic and political spheres and, therefore,  
280 improved regulatory role of the government. This is especially important because the forthcoming increase in labor  
281 productivity will be based on mass production automation, which entails a relative reduction of jobs in the production  
282 sphere and an increase in employment in the non-manufacturing sector. Consequently national economies and the global  
283 economy as a whole, are expecting large-scale structural changes, which are fraught with social upheavals, according to  
284 the patterns indicated by N. Kondratiev. He notes that the rising phases of the long waves are more likely to cause major

285 social upheavals and revolutions than the falling phases. He admits that the social upheavals are the result of the rapid  
286 growth period of the new forces in the economy.

287 Therefore, it is of utter importance to implement system solutions backed by the countries' financial, economic,  
288 scientific and technical potential, which will significantly enhance the role of the Russian economy at the world economy's  
289 recovery stage.

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