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Contents

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Global Financial Crisis: Recent Issues*

Y.V. Reddy[1]

Respected Vice-Chancellor Professor J.A.K. Tareen, respected Director Professor Ramadass, my friend Professor Ramachandran, my former colleague Dr. Samantaraya, distinguished faculty and young friends.

Just before coming here, I made a courtesy call to the Vice-Chancellor and in fifteen to twenty minutes, he convinced me about the greatness of this University. I am impressed by his dynamism. I must say that you are very lucky to be in this University.

Mr. Vice-Chancellor, you mentioned in your introductory remarks about the plurality and diversity of our country. In fact, that is the most critical part which saved us from the current global financial crisis. The financial crisis occurred because under the Anglo-Saxon leadership, most countries adopted the same model of regulation of financial sector. Moreover, all the big twenty financial conglomerates used highly sophisticated mathematical models, but every institution adopted the same model. If everybody adopts the same business model and regulation is common, then all of them would move in one direction, and there may not be adequate divergence of views in the market, and no efficient price discovery. Before the crisis, all players were playing towards the same direction indicated by similar models, and in the process the bubble got exacerbated. On the contrary, in the Indian financial system, as Professor Ramadass had pointed out in his observations, there has been a diversity of banks. There are public sector banks, private sector banks and foreign banks. Each category of these banks has different value system. Each of them represents different style of functioning.

STATE-ACTIVISM AND DIVERSITY

I will elaborate here on importance of activism by monetary and regulatory authorities and role of public sector banks. Before the crisis, there was a broad intellectual inclination for less activism and intervention on part of the Government and the central bank, because it was widely believed that the market knows the best. How will the regulator intervene in the foreign market, if the right exchange rate is not known to the monetary authority? In markets, people have stakes and price is discovered through market process – it was argued. How one will know if the asset prices are high? For example, when we in the RBI tried to restrain banks lending to housing, I was asked how I know that the housing prices are overpriced? Only market knows the right price, was the dominant view.

While it was believed that unchecked asset price hike will lead to a crisis, Alan Greenspan, head of the US central bank did not choose to prick the bubble, on the ground that action is not possible without knowing perfectly whether it is the bubble in the first place. If it is a bubble and if it creates the crisis, Greenspan preferred policy of stepping in to resolve the crisis after the event. He preferred not to intervene to stop asset price rise, without perfect knowledge of when exactly to stop it, since trying to restrain may hurt growth and employment.

The activism represented by some of us was different from position of US that I mentioned. If the asset price builds and then it breaks, by the time the central bank intervenes, the people who

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[1] Former Governor, Reserve Bank of India

* A revised version of the distinguished lecture delivered at Pondicherry University on August 12, 2011.

gained will get away with their profits. The rest of the people will have to bear the burden of adjustment. As policy makers we believed that we have to see not only which is more efficient; restraining and allowing the bubble to burst; but also who gains and who takes the pain. The gain will be for those who play in the market, and the pain will be for other people. In our country, there are so many poor people who do not play in financial markets and as policy makers we cannot afford the risk of giving pain to them, and gain to others.

Second, there was a question on counter-cyclicality of policy intervention. How to know when the cycle is up and when it is down? I was in agreement with the view that I do not have perfect knowledge about the cycle, but one can make judgment if things are very wrong. Perhaps I cannot recognize the God, but I can recognize the devil. We took a view, contrary to the general belief, that when we see something very very wrong, we know it. We do not require any formal proof beyond doubt. Therefore, we should be prepared to handle such extreme tendencies in cycles. I followed this simple approach – activism by public policy may be warranted when not acting in time may cause immense harm, even if it is based on less than perfect knowledge.

Incidentally, there is a lot of global intellectual interest on issues related to banking and in particular, role of the public sector in the light of the crisis. There is some advantage in having some presence of public sector banks in a financial system. Whether it is 20 per cent, 30 per cent or 40 per cent of market share that public sector occupies may not matter; but there is advantage in having presence of some public sector banks. My experience is that the regulation of the financial sector is very complicated. We have to regulate based on information mostly given by the regulated. If we have to regulate the banks, it is based more on information provided by the banks themselves than what is generated by the regulator independently.

In this backdrop, if all the banks are in private sector, generally the private sector people will give information which may not be entirely transparent since their common motive is only one – making profit. The public sector banks, on the other hand, will be more transparent as they do not have any compelling incentive to focus only on the profits. The public sector is usually obligated to maintain better standards of transparency than private sector, despite possible political considerations. The regulator's access to information will be more reliable, when it is from the public sector.

With the presence of public sector banks, if there are difficulties in the system, the whole system will not collapse. There will be this segment of public sector in which people will have faith since it is government that owns public sector. The regulator can use this segment to fight the crisis. For example, in India, when Global Trust Bank (GTB) got into a problem, a public sector bank (Oriental Bank of Commerce) came forward to rescue.

So, presence of public sector banks gives a tool to restrain private sector banks and evades forced exit, if necessary in the interest of system. I am not in favour of monopoly of the system by one hundred per cent public sector banks. In my view, hundred per cent public sector banks are as bad as hundred per cent private sector banks in the system. For efficiency and sustenance of the financial system, there is a need for diversity and we need to have both the public sector and private banks who must contest with each other. We must have contestability and diversity, which add to the efficiency and stability of the system.

SHIFTING GLOBAL POWER AND DIVERSITY

Before I move on to a presentation on global financial crisis, I will touch upon the issue of shifting of global economic power. There is a view that in the post-financial crisis era, there will be huge shift of economic power from the West to East – Asia, especially China and India. My position, on this issue, has been slightly nuanced. India, as a country has a specialisation on how to manage diversity. I always show my friends from foreign countries the fifteen languages in the currency note written in fifteen scripts. In how many countries, the currency note has so many scripts? We know how to adjust to each other despite diversities of race, religion, language, culture, etc. That is also our strength. The world has to learn from India how to manage many diversities. Most likely, the power will shift in future to Asia, but I know where the influence will shift. It will shift only to India. In the world economic affairs in future, India will be disproportionately more influential rather than rich or more powerful.

GLOBAL FINANCIAL CRISIS: REVEALATION IN 2008

Now let me quickly go through the issues related to recent global financial crisis triggered by delinquencies in US sub-prime market.

What happened in 2008? On one fine morning, twenty big financial conglomerates such as Citibank suddenly stopped doing business with each other. They had doubts on each other's solvency and even if there was no doubt on solvency they were suspicious about liquidity. One conglomerate was not sure if the other will have money tomorrow, even if there was no long term solvency issue. These were the big twenty conglomerates dealing with each other in billions of the US dollar for a long time. Suddenly, they lost confidence about each other. It aroused the suspicion that there actually may be something very wrong with all of them.

As these were big institutions, the US Government in coordination with other major countries started pumping money to manage liquidity shortage. Liquidity was injected by lending on an assured basis, at low interest rates and against their illiquid assets and indeed a wide range of assets. But contrary to the expectation, these institutions did not utilize the injected liquidity to lend each other. The liquidity problem continued as these institutions started soaking money themselves rather than lending to each other.

Then the central bankers realized that this may not be a liquidity problem, but a solvency problem. It was felt that these institutions do not have the valuable assets that they were claiming to have. The next action was to infuse capital into these troubled institutions by the central banks and governments. So there were moves for bail out. Thus, initially, the central bank had to buy papers which were worthless to inject liquidity. Then it had to inject equity into institutions to take care of solvency. That is how the financial system was brought back to a reasonably smooth functioning from the threat of a collapse of financial system.

The regulators thought that banks were safe because they were regulated. But they were regulating the banks based on the information banks chose to give. More importantly, the regulators were regulating the banks. But, the banks created non-banks. They did the risky business through non-banks. But when these non-banks created by the banks collapsed, the problem reverted to banks. The banks had also created all exotic financial instruments. These financial instruments were meant to disperse risk. In reality, however, it was realized that final risk rests with the banks only. With the use of higher order of derivatives, it was unclear what were the underlying assets and what were they worth? On the one hand, some of the non-banking institutions were insolvent. On the other, the financial instruments created to manage risk were misleading.

Countries like Singapore, South Korea which needed liquidity in their markets were demanding more US dollars from the Federal Reserve. People still demanded more US dollars, despite the US being the troubled country because, dollar is the international reserve currency. Here was a situation where a currency of a country is in highest demand when it is itself in the most serious problem.

As far as other countries are concerned, for many countries, particularly the developing countries, they were affected by contagion and their financial sector proved to be less vulnerable than developed economies. Many of them did not understand the complex technicalities behind the exotic derivatives and hence their financial sector was dominated by traditional banking. At a macro level, many of them did not have current account deficits. They were living within their means, by and large. Many of them had comfort of substantial reserves of foreign exchange. So, the global financial crisis was initially limited to developed countries, but there was transmission through what may be termed as the trade channel. The troubled advanced economies affected economies of the developing countries through fall in economic activity, especially export-import trade. Adverse sentiments on account of the crisis in advanced economies added to the contagion in economic activity.

In view of the close economic and trade linkages between economies of countries, there was a need for coordinated action among them to manage the crisis. Every country got into the act and provided liquidity so that there is a global coordination to make the financial sector run smoothly and to avoid collapse in financial sector.

As part of injecting globally coordinated stimulus, monetary stimulus was aimed at providing more amount of liquidity, when people were hoarding but not using cash. More liquidity was believed to make people more confident to spend and to boost aggregate demand. Similarly, fiscal stimulus was also provided so as to augment aggregate demand, maintain the level of output despite the impact of the crisis and address the issue of unemployment. Through a globally coordinated action, economic depression is believed to have been averted, though global slowdown and in many countries recession may become inevitable.

RECOVERY FROM CRISIS

After the collapse was averted in financial sector, many thought that there would be economic recovery. The recovery has happened but has been uneven in different ways in different countries. For some countries, it was V-shaped – a sudden and enduring recovery. This happened in many of the Asian economies and perhaps in India also. The other is U-shaped. The economic slowdown and distress remained for some time, before recovery, like Russia for instance. There was another variety, L-shaped, in which the economic activity was depressed, stays there and does not go up at all, like Japan. Another one is W-shaped, a double deep recession situation. The recession can also take the shape of an elongated tick-mark. After the recession, it takes a long time to gradually recover. Further, the resilience of the recovery was also different in different countries. Thus, there was overall recovery but it was uneven, and perhaps somewhat fragile in global economy as a whole.

After the stimulus, people started to talk about the exit strategy. As you gave stimulus, at some stage you have to withdraw such steroids. The issue was if you do not withdraw in time, there will be problem. As mentioned, different countries were having different patterns of growth and recovery. So, different countries were having different policies for exit. Global coordination of policies became difficult for exit since different countries were at different stages of recovery. Further, there are persisting differences in sequencing of stimulus; as for example between monetary and fiscal measures.

As some recovery was noticed, there was a falsely assured security about the robustness of economic recovery. In global financial architecture, there was very little change after the crisis. The economic imbalances continue. Regulation of the financial sector is seeing some but not significant changes. But, few people were willing to notice it. People were happy because the financial markets were doing well. The equity markets were doing well, debt markets were not bad, and currency markets not unstable. But, very few bothered that unemployment was increasing, and fiscal position of many advanced economies deteriorated. Nobody bothered about economic consequences of the crisis and nature of the stimulus.

It was believed that through globalization of finance, poor countries will get money from rich countries and that the poor countries will develop with the capital available with the rich countries. But it was suddenly realized that the rich countries are consuming more and saving less. Poor countries like China are consuming less and saving more, and building forex reserves. Actually, China was lending to America to consume more. China became the great money lender of the world. We found a situation where poor countries of Asia are financing a rich country. The rich country is in trouble. Its currency is the global currency.

Thus, the recent global financial crisis was caused by several factors. These include apart from financial sector problems, economic imbalances. There was high current account deficit in some countries and high current account surplus in some other countries for too long. That in economics is described as global economic imbalance. With continuing current account deficit in some countries like the US and sustained surplus in countries like China, both lenders and borrowers got jittery.

It was observed that major economies like the US overestimated the recovery and they did not solve the economic imbalance. China continued to have more trade surplus, the US continued to have more fiscal deficit. While the financial sector got over the immediate problems, it was not reformed. Financial sector witnessed some agreement about the reform. But much of it is expected to be implemented in 2019. In lighter vein, we can say that we are assured that there will not be another financial crisis after 2019; and before that you can have crisis. So, current financial sector problems had been solved, but the permanent solution is still not being implemented, in a global perspective.

A mini crisis has therefore emerged in 2011. In Euro zone, there is no agreement on resolving the sovereign debt crisis in countries in Sothern region. There has also been downgrading of sovereign debt of the USA. 2008 crisis was a revelation that we did not know that there were very serious problems. Now, it is a realization in 2011 that in reality that nothing much has changed, and recovery was not really robust. The current downgrading of US sovereign rating by S&P may not be justified. America is not likely to default since the world reserve currency is US Dollar and there may not be any technical limit on the US to print US Dollar consistent with the US national priorities. So, technically, there may be no default. But, there are several other complex problems with the US. These complex problems relate to intellectual disagreement on appropriate policy and lack of political agreement on sharing of burdens. So, it was a wake-up call that the substance of problems in the US economy and Europe has not changed since 2008.

INDIAN CASE: RANDOM THOUGHTS

We do not have a serious problem of economic imbalance in India. In India, we started with a reasonable external balance in the sense that we had moderate current account deficits though we had large fiscal deficits. The financial sector continues to be reasonably safe. Some stimulus was required both on monetary and fiscal side to counter the impact of global disruption in financial markets, especially in (a) providing temporary liquidity, (b) countering loss of demand due to disruption in global trade and (c) to boosting positive sentiments.

However, we have several vulnerabilities in 2011 and these pertain to the fiscal position, the external sector, and inflation. The fiscal position is weaker, compared to 2008. There was fiscal consolidation before 2008, and the Government did an excellent job in improving the quality of fiscal position. After 2008, there has been a significant deterioration in the fiscal position and in the quality of fiscal adjustment as compared to the pre-crisis period. Secondly, in other countries fiscal stimulus was in the form of investment. Investment is productive. In our country, it was in the form of consumption. So about this weakness, we have to be careful.

In the external sector, we continue to have current account deficit but it increased to two to three per cent of GDP from about one per cent. But our economy is not terribly dependent on exports. Our fiscal position is bad, but we are not in a serious problem in managing it. But when we get into problems, our capacity to face the problem is less. But if the fisc is weak, our capacity to handle problems is less. Therefore, we should be careful.

In the external sector, the deficit of 2.5 per cent of current account deficit means that we are dependent on the rest of the world only to the extent of 2.5 per cent of GDP. More than 90 per cent of our investment resources are generated domestically. People may think that we are dependent of foreign investment. In fact, foreign investment constitutes only 5 per cent our requirements and 95 of our investments are domestic. One lesson from global crisis is that one should not depend on other countries excessively for a prolonged period. Further, the level of forex reserves remains about the same as in 2008, but our external debt has increased significantly and the share of short term debt even more.

We will continue to get capital to finance current account deficits, even if we are weak at this stage in 2011 compared to 2008, since many others are appearing weaker. But if there is a disruption in global economy, we are not sure of the impact on us. If we compare with advanced countries, our external position is better. But our position is weaker compared to many Asian countries.

There are more uncertainties in the global economy, as explained earlier. There will, therefore, be more volatility both in financial and commodity markets at the global level. Therefore, we in India have to be extremely careful about how we manage our economy though our financial sector continues to be resilient and our external sector vulnerable, in view of our weaker position in fiscal area and the uncertainties in the global economy.

SOME LESSONS

First, there has been intense debate on the relationship between the financial sector and the non-financial sector. Earlier, it was thought that if financial sector grows. It will always be good for the economy. Now, after the crises, we have found that the financial sector has the capacity to multiply itself to corner benefits disproportionate to itself. Therefore, there is a need to be careful. The financial sector cannot lead economic growth; it can only facilitate economic growth. Finance is the means, not the end.

Second, finance has significant externalities in the sense that its functioning affects many who may not be directly dealing with the financial sector. Hence, there is a need to have special regulations. Finance attracts most intelligent and it attracts most crooked people also, because remuneration can be large in short time. So regulation has to have the intelligence and skill to understand the intelligent fellows who go to the financial sector, and must have the integrity to catch the crooks also.

Third, there is the issue of coordination versus conflict of interest in financial sector. Earlier the wisdom was: if the government owns the banks, there could be conflict of interest for a central bank as the regulator which is also owned by the Government. But, if banking is left to the private sector alone, and regulator is independent, it will be best for the system. There was also a view that there are economies of scale and economies of scope to have financial conglomerate in private sector. Now it has been realized that having financial conglomerates is full of conflicts of interest. They can manipulate many things and use insider information. When public policy is compartmentalized, it creates problems of effectiveness. So, everywhere in the reform of the financial sector, whether in the US or the UK, there is greater emphasis on coordination of public policy.

Fourth, the relative roles of the state and market are being reviewed. Earlier, everybody thought market will correct itself and the Government should not interfere. Current thinking is nuanced; not that markets do not correct, but if they don’t correct smoothly, who will pay the price? Further, if they do not correct themselves, what is the role of the State and who pays the price? So there is now a review of role of the State and markets; and also their interrelationships, particularly in the financial sector.

Fifth, Mr. Mervyn King, the Governor of Bank of England made a statement that “global banks are global in life and national in death.” In life, they operate globally, but when they are dying, the national government will often give money to revive them. So, ultimately all people and institutions look up to the national government. In such situations, the national government should have the power to take care of the people. The national government should have the power to protect itself from what happens to the rest of the world. So there has to be reconciliation between globalization and national interest.

Finally, I will conclude with asking a question. What happened in the US and perhaps in the UK was that the financial sector got into problem. The government or the sovereign, being the ultimate risk bearer realized that the financial sector was collapsing and the Government must save it. So, the Government took over the risk to the government's and central banks' balance sheets in bailing them out. In the process, the governments of the US, the UK and others got into too much debt. Now the issue to ponder about is who saves the sovereign that saved the financial sectors by bailing them out?

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Taking Stock of Commodity Derivatives and their Impact on the Indian Economy

V. Shunmugam[1] and **Debojyoti Dey**[1]

Coming in to operations since 2003, the National Online Electronic Commodity Derivatives Exchanges have grown impressively in the last 8 years. Despite its impressive growth, the national online exchanges have been at the receiving end of the allegations relating their existence to increasing commodity prices and not to any other major benefit which can outweigh the same. However, a lot of academic research had been done since then which have from time to time had proven that these allegations do not hold any solid ground and the stakeholders and the commodity ecosystem is benefiting from the same. This paper attempts to collate all such research studies and provide a comprehensive view of all the researchers that have contributed to the study of commodity derivative markets especially from the point of their impact on spot markets and the ecosystem. We conclude that the commodity derivative markets have performed their intended role and reached out its benefits to a number of stakeholders. However, to make its impact widely felt, it is time for the policy makers to take policy and institutional reforms ahead.

INTRODUCTION

Trading of commodity derivatives, restricted only to plain vanilla futures, was allowed by the government in 2003 after nearly a four-decade long ban. Three national exchanges – MCX, NMC and NCDEX, later joined in by two more, sprung into action immediately and began offering futures contracts on multiple commodities. The organized commodity derivatives market, in its new avatar as a pan-India market for multiple commodities being traded through regulated futures exchanges, has just completed seven years. The response to multiple products traded and cleared on an electronic exchange compared with their earlier regional floor-traded versions, translated into a remarkable growth story in commodity derivatives in terms of traded volumes of the market (annualized CAGR of over 40 percent) proved that the market has been growing to fulfill the long unmet demand of multiple stakeholders in the economy.

In this regard, it is pertinent to examine the published research studies to throw light on: What are the benefits that this market had bestowed on the market stakeholders and the economy? What are the criticisms against this market and how valid are they? What is the path ahead for commodity futures market to ensure that its benefits penetrate to the maximum extent i.e. to all sections of the economy?

The answers to these questions are varied and documented across a wide spectrum of studies by academicians, researchers, and industry practitioners, despite the very short period in time of its existence. There has not been an attempt to compile and have a critique in terms of the strength of their answers both on the wrong side and the right side of the markets. Given that organized national level commodity futures in India have had a relatively short history, compared

[1] The authors were Chief Economist and Economist respectively at the Multi Commodity Exchange of India Ltd. Dr Shunmugam is currently with the MCX Stock Exchange of India Limited as their Chief Economist. Views are personal.

to, say, the capital market or the commodity futures market in developed countries, many of these studies are mainly constrained by absence of long time-series data but had their robust methodology and innovative approach take care of any issue arising out of data robustness. Further, the commodity futures market is also hampered by less-than unhindered play of market forces as the government has intervened and continues to intervene in this market through numerous means. The intervention could either be structured - in the form of price support through assurance of minimum support prices for many commodities, or be *ad hoc* – in the form of banning the futures market for some 'essential' commodities which display unrestrained rise in prices.

Be so as they may, even with these lacunae, various research papers have studied this market from multiple angles to fully understand its operations, shortcomings and suggested ways to make the market more efficient in order to unleash its full potential to the economy. This paper tries to view the benefits and shortcomings of the market through the lens of some of the papers that have already been written by experts over this short history of seven years. In doing so, it also attempts to review the papers in their analysis.

COMMODITY FUTURES: THE BENEFITS

One of the biggest benefits of the futures market is that an efficient futures market leads to efficient (future) *price discovery* of traded commodities. Futures prices empower producers, consumers and other participants to know future prices and, thus, are able to decide when to buy, how much to produce of what or when to sell. Availability of prices for the upcoming months helps the producer know the best time to sell and thus provides him with the opportunity of adding value to his produce. National prices and nationally accessible markets lead to high correlation between spot and futures prices, which means that farmers get these prices on the spot markets even if they do not participate in futures trading. How efficient has been the price discovery process and outcomes in practice? Karande (2007) found significant evidence of efficiency in the price discovery process. He used cointegration analysis to investigate the price linkage between castorseed futures and spot market. The results showed that the futures and spot market at Mumbai and Ahmedabad as well as the futures market at Mumbai and Ahmedabad were mostly cointegrated. There was causality and information flow from futures to spot market at both Mumbai and Ahmedabad and reverse information flow, as well, for some contracts and periods. However, the extent of cointegration was different for different markets, contracts and time periods indicating the role played by geographical location, harvest and futures trading volume in influencing price discovery.

Bose (2007), on the other hand, considered the extent to which futures market impacts and determines the future spot prices. She took multi-commodity indices and agri-indices across multiple exchanges in India. The findings of her study, based on the movements of the existing commodity spot and futures indices, *'indicated an important informational role of the futures market'* (*sic.*). She concluded that price formation in the spot and futures market does not take place in isolation but is closely related, though to a lesser degree, in the case of agricultural commodities. The futures indices provide more or less accurate indications of the future spot price at least a month ahead. Only for the agricultural commodities group, the futures price index seemed to indicate the future spot price best when looked at about a week to a fortnight prior to the date for which the spot price is of interest. The divergence between the results for agricultural and non-agricultural commodities is explained by Bose by arguing that spot prices of agricultural commodities are vastly different across the nation and it takes time to assimilate information on these prices. This is reflected in the lower correlation of the agri indices as compared to the multi-commodity indices that include mostly metals and energy items or the agri subindex with mostly commercial crops, whose spot prices are much more evident and open for international comparison.

These findings are somewhat mirrored in Roy (2006) who finds that wheat spot markets in India are cointegrated and LOP (law of one price) rules at intra state level market structure. But when he tested for LOP at the national level, he found inter-state markets cointegrated only in the long run and that LOP does not hold. Like Bose, Roy too found the explanation for this in fragmented agri-market in India, poor transportation and storage infrastructure, restricted interstate movement of essential commodities and lack of ICT (Information and Communication technology) to disseminate the prices across nation. He, then, analyses the efficiency of Indian wheat futures market through one wheat contract and found that that contract fundamentals were not cointegrated with spot market in the short run. The reason for this inefficiency could be the regulated wheat market and absence of free playing market. One may add to Roy's conclusion that the futures market is only in the process of gradual evolution and that unless the inefficiencies in the cash market are removed, the full efficiency of the futures market cannot unfold themselves. Yet, the inefficiency of the market at national level is visibly weaning away thanks to the efficient flow and processing of information that is brought about by the futures market.

The efficiency of the market is studied by Sahi *et al* (2006) too by posing the simple question: does the commodity futures market fulfill the tenets of the Efficient Market Hypothesis? Their study finds futures market to be weakly inefficient for wheat. This is contradicted by Kaur *et al* (2010). Their study examines the random walk hypothesis and tests the weak form efficiency of four major agricultural commodity futures traded using daily data of trading price for the period of 13 months. Two different statistical tools, namely, serial correlation test and run test were used in their study to test commodity market to investigate the random walk hypothesis. The empirical results of the study led to acceptance of the hypothesis that the commodity futures markets are weak form efficient.

Interestingly, Naik and Jain (2002) analysed the efficiency of futures markets for 6 commodities prior to launch of national commodity exchanges. Their study found that the futures market was inefficient due to a host of reasons, all of which were addressed by the launch of the national commodity exchanges after 2003. In particular, the study found that the performance of Indian commodity futures markets varies across commodities, exchanges and contracts. However, the market also revealed the *potential for performing the functions of price discovery and risk management* (*sic*.). The markets were found deficient in several aspects such as infrastructure, logistics, management, linkages with financial institutions, reliability and integrity, dominance of speculators, and efficient information system, which discourage market players from trading in these markets. Reading the writing on the wall, they concluded that "*with the expected increase in price risk in the coming years it would be essential to address these issues to make futures markets for commodities useful mechanisms of risk management and price discovery*", which was fructified post-2003.

On market efficiency, Ahuja (2006) was apprehensive whether too many exchanges would fragment liquidity and rob economies of scale, leading to development of illiquid markets. Exchanges split volumes which could make some exchanges unviable. His concern was liquidity in whose absence, price risk management and price discovery would be weak. Hence, he argues for consolidation of some exchanges to address this problem. Chakrabarty (2005), however, feels that the market itself would take care of such inefficiencies. He maintains that faced with competition from nation-wide exchanges, regional exchanges would have to improve their technology, transparency and methods of operation in the short run if they are serious about staying in business. Besides, with the continued acceptance and popularity of institutionalized commodity futures trading, the bulk of informal futures trading would gradually be absorbed in the regulated, exchange-level trading as the price and liquidity benefits outweigh the added transaction costs. In any case, with the benefit of hindsight, we may comfortably say that the apprehensions of these writers raised five years back, have effectively been resolved with national exchanges clearly replacing all regional exchanges in derivatives market.

The second benefit of the futures market is in its enabling of *dissemination of future prices*. This, in turn, has led to integration of the fragmented spot markets in India. As price information for the same quality and grade of a commodity is available on the same national-level platform and gets disseminated across different *mandis,* this creates a benchmark reference national price for all stakeholders in the industry. Besides, as exchanges have trained farmers and traders on aspects of grading and standardisation for making deliveries on exchanges, this has led to better awareness on grading and standardization across *mandis* and improvement of post-harvest farm practices. This has been confirmed by Ahuja (2006) who contends that price dissemination by exchanges actually helps farmers decide which crops to grow. Similar was the finding by Ranjan (2005) who holds that futures market of the commodity sector can be an effective tool for shaping emerging cropping patterns of the farmers, apart from being able to provide them with price hedges to improve their income levels and improve holding power. He analysed multi-period data on Soy oil prices and area under Soybean cultivation in the pre-futures and post-futures period and compared the two. The correlation between the same sets of data for the two periods revealed that the relationship between them has become much stronger during the years with futures trading than in absence of it. Correlation between Soy oil prices and area cultivated under its parent crop was mere 0.23 in absence of futures trading, i.e. 1991-2000. It, however, increased to 0.37 during 2000-2004, thereby proving that dissemination of futures prices has had a positive effect on decision to sow by Soybean farmers.

Murthy (2007) took a different angle of view to test whether wheat futures has any implication on prices and acreage, and from these on the overall food security of the nation. He concludes with the opinion that agricultural policy needs to tap the potential of the futures market by creating the necessary price incentive and the information processing mechanism of the market so as to ensure long-term food security. An efficient commodity futures market along with removal of restrictions may be the right long term strategy for India's food security, provided certain assumptions necessary for efficient functioning of this market is met.

The third important benefit bestowed by the futures market is its ability to provide the cost-effective and efficient device for the commodity market stakeholders to *hedge against price volatility*. This has been attracting large interest of late, thanks to the surge in volatility witnessed in commodity prices over the last couple of years. Ahuja (2006) is convinced of the efficiency in hedging that futures provide, pointing out that this market enables the spread of risks from risk-averse hedgers to risk-taking speculators.

Ramaswami *et al* (2006) contend that market efficiency is the outcome of a no-arbitrage condition. In the context of commodity futures, no-arbitrage is defined when the futures and the spot price move in tandem. They examine the Soy oil futures contract for hedging purposes, using the same principle of no-arbitrage conditions being satisfied and find that there are very low arbitrage opportunities in this market. Despite the lack of key market institutions such as certified warehouses and centralized spot prices, Soy oil contract was found to compare well with mature exchanges in evolving as an efficient hedging device.

Significantly, the success of the Soy oil contract is exceptional when seen against the failure of contracts in soybeans and soy meal. The small size of the Soybean harvest (relative to processing capacity), the short marketing season and the fact that most output is purchased locally (as almost all Soybean crushing plants are located within the production region) have limited price volatility and encouraged long duration storage while promoting long-term relationships between brokers and processors, Thus, contend the writers, *"It is conceivable that the development of futures exchanges could precede that of spot markets in developing countries"*.

Thomas (2007) too explores no-arbitrage opportunities in five agri-commodities: wheat, guar seed, pepper, chana and jeera. The results of her study arrive at varying hedging prospects for the five commodities, the best being for guar seeds. An analysis of the results indicates various reasons behind this divergence of hedging prospects but finds 'varying liquidity' as the prime reason.

In another much-quoted paper, Kumar *et al* (2008) report hedge ratios of three futures - Nifty, Gold and Soybean. They do this from four alternative modeling frameworks, namely, an OLS-based model, a VAR model, a VECM model and a multivariate GARCH model and compare the hedging effectiveness of the contacts using these models. Their results show that futures and spots prices are co-integrated in the long run. Besides, among constant hedge-ratio models, in most of the cases, VECM performs better than OLS and VAR models.

Kumar *et al* (2009), in another paper, examine the hedging effectiveness of four agricultural (Soybean, Corn, Castor seed and Guar seed) and seven non-agricultural (Gold, Silver, Aluminium, Copper, Zinc, Crude oil and Natural gas) futures contracts traded in India. Going a step further from the 2008 paper, they apply VECM and CCC-MGARCH model to estimate constant hedge ratio and dynamic hedge ratios respectively. Their results display that agricultural futures contracts provide higher hedging effectiveness (30-70%) as compared to non-agricultural futures (20%). However, they also find that in the more recent period, the hedging effectiveness of Indian futures markets has increased. When hedging effectiveness of non-agricultural Indian futures contracts with the world spot markets (NYMEX and LME) was analyzed by them, hedging effectiveness increased dramatically, *indicating that Indian futures contracts are more effective for hedging exposures to global prices.* The inadequacies, contend the writers, are "expected birth pangs for a nascent futures markets in an emerging economy"

How does the commodity futures market measure up in terms of offering an *investment avenue* to investors? The answer is often sought in the light of the ability of the market to generate portfolio diversification avenues for investors. Mishra (2008) finds that as the factors that drive commodity prices are different from the factors that drive equity prices, commodities should be naturally perceived to be effective diversifying agents. His study explores the advantages of adding commodities to a portfolio of equities in Indian context based on empirical data and quantifies the diversification benefit and downside risk protection the commodities offer in portfolio context. True to his conjecture, the study concludes that the less than-perfect or negative correlation of commodities with equities makes them an excellent candidate for diversification. This diversification benefit is demonstrated in two ways. First, it is observed that adding commodity futures to a portfolio of equities enhances the risk-adjusted return of the portfolio. Second, adding commodity futures to equity portfolios provides a significant downside protection and enhances skewness and kurtosis of the return distribution. Besides, commodities as an asset class also provided a great hedge against inflation. However, the study suffers from the shortcoming of using data over a few years only, especially as some commodity futures were introduced only 2-3 years before the study was mounted.

CRITICISMS AGAINST FUTURES MARKET

On the widely-debated aspect of **speculation** in futures markets, that speculators are required for efficient functioning of the market is now widely acknowledged. Ranjan (2005) holds that the growth of futures market in India hinges on its liquidity. Unless hedgers, arbitrageurs and speculators all play significant role in the market, it is very difficult for any derivatives market to create and sustain volumes on the market platforms. Hence, he opines that the process and entry level restrictions should be simplified and removed wherever possible to increase liquidity. *Liquidity can be increased by allowing financial intermediaries like mutual funds, banks who have no underlying physical exposure to the commodity* to participate in futures trading as principals as a business by itself and not for hedging.

The second issue attracting controversy is the role of futures market in increasing, rather than arresting commodity *price volatility*. Ranjan

(2005) finds that futures trading can have substantial influence on reducing the seasonal fluctuations of agricultural commodity prices. His study finds that the prices of Soybean oil in ready market varied less sharply during the years with futures trading than during the period when there was no futures trading in Soy oil. This smoothening effect of the futures market on volatility was also found to be carried to intra-week and intra-month prices of Soy oil.

Similarly, Karande (2007) studies the impact of castorseed futures market on spot price volatility for castorseed in India, at both Mumbai and Ahmedabad, to get insight into the influence of futures trading on the underlying spot market. He uses both the traditional regression technique as well as GARCH analysis in making this comparison. The results show that the introduction of castorseed futures market at Mumbai and Ahmedabad has had a beneficial effect on the castorseed spot price volatility in the early futures period.

Nath *et al* (2008), however, arrive at different set of conclusions. They analyse whether futures market has had any impact on increasing volatiltites or absolute levels in prices of primary commodities. Their study uses simple linear regression, correlation and Granger Causality test to find whether the seasonal/cyclical fluctuations in these commodities prices have been affected by the introduction of futures in those commodities. Their results find that future trading in the selected commodities has apparently led to increase in prices of commodities like *urad* but not necessarily for other commodities. However the study finds that introduction of futures in selected commodities has not helped in reducing seasonal/cyclical fluctuations in prices. This set of results is refuted not only by the above two studies mentioned above, but also another robust study mounted and published by the Reserve Bank of India in its Annual Report (2009-10). Besides, empirical analysis of most markets in India for Urad in the period after it was delisted from futures trading also squarely refutes this conclusion.

The third criticism is the prevalence of *cash settlement* in lieu of physical deliveries. The restrictions on movement of goods and absence of a well-developed warehouse receipt system many a time force this substitution. Besides, the evolution of commodity derivatives market in the developed world has led to gradual substitution of an inefficient physical delivery to cash settlement over time – not due to any constraint, but out of choice exercised by market players. Ahuja (2006) argues that it is probably due to the inefficiencies in the present warehousing system that only about 1% to 5% of the total commodity derivatives trade in the country are settled in physical delivery. However, Thomas (2007) finds that the results of her study on market efficiency would suggest that cash-settled contracts tend to be more amenable to no-arbitrage conditions than physically settled contracts.

DRAWBACKS OF FUTURES MARKET

Having known the benefits of commodity futures market , as studied by experts, as well as some of its oft-repeated drawbacks, it is apt to see what the experts perceive as the real drawbacks of this market, which need to be addressed.

Nair (2004) finds that the major stumbling block for the development of commodity futures markets in India is the fragmented physical/spot market. As is well recognized, a national level derivatives market cannot be founded on fragmented, localised cash markets. There are still several barriers to free movement of commodities in the form of physical restrictions (under the Essential Commodities Act, APMC Act, Licensing restrictions, etc.) and fiscal hurdles (differential taxes, stamp duties). Further, warehousing related issues such as the absence of quality, gradation, standardisation and certification facilities and transferability, negotiability and de-mating of warehouse receipts stifle the physical markets. The latter set of obstacles would hopefully be removed by an active Warehousing Regulator expected to function under the WD(R) Act, 2007.

Ahuja (2006) sees the absence of freer play of market forces in the economy to lead to stakeholders looking for efficient sources for managing risks, which they find in futures market. However, while the market has made enormous progress in terms of technology, transparency and the trading activity, this has happened only after the government protection was removed from a number of commodities, and market forces were allowed to play their role. Hence, according to him, this should act as a major lesson for the policy makers that *pricing and price risk management should be left to the market forces rather than trying to achieve these through traditional mechanisms such as administered price policy.* The management of price risk is going to assume even greater importance in future with the promotion of free trade and removal of trade barriers in the world, forewarns the researcher.

Even the Habibullah Committee (2003) mandated to advise the government of India on convergence of securities and commodity derivatives market holds that the development of commodities derivatives markets is impeded on account of some of the policies relating to cash markets, '*which have the effect of distorting the market forces of demand and supply'(sic.)*. These policies include Minimum Support Price, Monopoly Procurement Scheme, APMC Act, Black Marketing Act, Differential Sales Tax, differential Stamp Duties and entry taxes and permits imposed by various State Governments. These market-distorting and fragmenting policies need to be corrected expeditiously. It also recommends that the restrictions on participation of banking institutions in commodities markets, at least for hedging purpose, should be removed by amending section 6 of the Banking Regulation Act. and that a new legal framework should be evolved which widens the scope of futures markets to include the intangibles related to the commodity sector, such as commodity indices, spreads and basis contracts, weather, electricity, and freight. Restrictions on the participation of Mutual Funds and Foreign Institutional Investors also need to be removed by changing the relevant regulations of the SEBI, contends the Committee.

Both Ahuja (2006) and Ranjan (2005) strongly advocate for the introduction of options in futures markets as the market for commodity derivatives cannot be called complete without the presence of this important derivative. Similarly, Chakrabarty (2005) advocates the introduction of weather derivatives in India. This is a category of futures that are extremely popular in developed countries should make their appearance in India too. If properly designed, futures in such weather related indices can help farmers hedge the climate and rainfall related risks that are concomitant with Indian agriculture, argues the researcher.

THE REGULATORY REGIME

Most writers have had words of praise for the regulator, but not the regulatory regime that governs the commodity futures space in India. This stems primarily from the appreciation that the regime which functions under an archaic Act of the parliament is hardly reflective of the realities and requirements of today. Ahuja (2006), for instance, finds that it is imperative for the government to grant more powers to the FMC to ensure an orderly development of the commodity markets. He argues that the SEBI and FMC also need to work closely with each other due to the inter-relationship between the two markets, which has already taken institutional shape in terms of membership of both regulators on the High Level Coordination Committee and an understanding to be on each other's boards.

Nair (2004) takes a slightly different view and advocates for some form of regulatory convergence between SEBI and FMC. The government had announced its intention to integrate the securities and commodity derivates markets in the Finance Minister's Budget Speech for 2004-05. This announcement is seen by the author as having multiple implications: firstly, it underscores the importance of the commodity derivatives markets in the emerging scheme of things and, secondly, the need for nurturing this sector for the overall benefit of the commodity economy within a proper regulatory environment. However, while convergence of markets may be an answer to some of the issues of regulation, the need for strengthening the regulatory capability of the commodity derivatives side is of primary importance, agrees Nair. In his view, for effective regulation of markets, whether financial or physical, in the absence of a super regulator, an institutional structure of coordination among the various regulators is required. The limitations of the commodity markets have to be removed to facilitate seamless integration of physical and futures markets as well as between the markets for physicals and financials. *"The ultimate objective of all these initiatives should be to reap the economies of scale and scope not only for its own sake but also to face the challenges thrown up by a "borderless" global market. The market participants and the regulator(s) have to brace themselves to face the challenges thrown up by the global developments of ever growing exchanges and integration of markets",* contends Nair.

Agrees, the Habibullah Committee (2003), which makes a strong case for strengthening the regulator. Even in the early days of national commodity derivatives market, the Committee realizes the importance of an empowered regulator for orderly development of the market. The structure of the Forward Markets Commission set up in 1953 as a recommendatory body is not fully suited to the challenges of the emerging market. It points out that the regulator must possess '*capabilities in terms of expertise, resources, empowerment and operational flexibility to meet the challenges. The structure of this Commission will need to be totally overhauled to provide it the autonomy and the resources as done in case of many regulators set up in recent time* (*sic.*).

CONCLUSION

As may be evident from the above discussion, most experts believe that the commodity futures market had performed its intended beneficial role in both direct and indirect ways to both the stakeholders of the markets and to the country's economy as a whole. The next leap would require institutional support in the form of permission to allow new products such as options, indices and other intangibles which might attract those who are risk averse and keeping away from the markets and help them mitigate the sources of risks other than price risks at their origin. Also new institutions such as banks and mutual funds shall be allowed to participate freely to spread the benefits at the grassroots level. These changes, under the regulatory control of an autonomous regulator have the potential to alter the face of the commodity derivatives economy, for the long-term benefit of all sections of the economy.

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Scanning the Business Environment of Japan: An International Perspective

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This comprehensive study discusses the demographics, freedoms, culture, foreign trade practices, political environment, and potential for investment in the land of the rising sun. At the crossroads between the East and West, Japan is positioned to reap tremendous rewards as the East Asian economic community booms. However, it will have to overcome obstacles associated with its decreasing population, a new political party in power, and continuing global economic uncertainty. Will Japan's world-renowned innovation and business sophistication be enough to pull it out of this recession? With its "Lost Decade" in recent memory, Japan will have to strengthen its ties with China to avoid being left in China's economic shadow.

BACKGROUND

Japan's nickname, the 'Land of the Rising Sun', comes from its location on the edge of the eastern hemisphere and is an appropriate analogy for its economy. At several times throughout its history, Japan has risen to the level of a major economic world power. Due to its dramatic post World War II growth, Japan's industrialized free market economy is the third largest in the world; however, Japan has suffered due to recent global economic conditions (*CIA-The World Factbook*, 2009). When worldwide demand for its exports decreased dramatically in 2008, Japan entered its first recession in six years. Real GDP growth, as reported by the Bank of Japan, was -1.8% in 2008 and -5.2% in 2009. Forecasts for 2010 call for minimal growth (*U.S. Department of State,* 2009). With a new political party in power, can Japan live up to its nickname and be a rising sun on the economic horizon?

History

Legend says that Japan was founded in 600 BC by the Emperor Jimmu, but its first recorded contact with the West occurred around 1542 AD, when a Portuguese ship accidentally landed in Japan on its way to China. Traders from the Netherlands, England, and Spain, along with Jesuit, Dominican, and Franciscan missionaries, soon followed. Suspicious of the foreigners, Japan's shogunate, the military dictatorship, barred nearly all relations with the outside world. Two centuries of isolation followed, and stability in Japan allowed its indigenous culture to blossom (*GlobalEDGE*, 2009).

In 1854, U.S. Commodore Matthew Perry negotiated the opening of Japan to the West, and the country entered a period of intense industrialization. Western institutions were adopted and modern social, educational, and economic systems were created. In just a few decades, Japan became a world power. In the early 20th century, it defeated the forces of China and Russia, and occupied Korea, Taiwan, and Manchuria. Japan allied with Nazi Germany in World War II, in which it invaded China and attacked the U.S. at Pearl Harbor. After years of war and three million Japanese lives lost in the bombings of Hiroshima and Nagasaki, Japan surrendered and lost all of its overseas possessions (G*lobalEDGE,* 2009).

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After World War II, Japan was placed under international control of the Allies, who hoped to transition it to a state of peace and democracy. Political, social, and economic reforms were initiated, and all citizens were given the right to vote. Through economic resources from the Allies and the World Bank, Japan began its post-war reconstruction, targeting electric power generation, the automobile and manufacturing sectors, and roads and transport infrastructure (*World Bank Tokyo Office*, 2009). The Liberal Democratic Party (LDP) took office in august of 2009 and created the developmental state, an "alliance between government and business to direct industry and set economic priorities" (*The Economist*, 2009). Japan experienced real economic growth rates of 10% in the 1960s, 5% in the 1970s, and 4% in the 1980s (*CIA-The World Factbook,* 2009*)*. This "bubble economy" collapsed in the early 1990s, creating a decade long period of stagflation known as Japan's "Lost Decade"; however, the Japanese economy rebounded in the early 2000s (*World Trade Organization,* 2009).

Demographics

Over 127 million people live on the archipelago of Japan, making it the tenth most populated nation in the world. It has roughly one tenth the population of its neighbor to the west, China, and less than half the population of the U.S. (*GlobalEDGE*, 2009). Sixty-four percent of its people are between the ages of 15 and 65, with a median age of 44.2. This means its population is slightly older than the neighboring populations of China, Taiwan, and the Koreas, all of whom have median ages in the mid-thirties. Its aging population could be correlated to the population growth rate of -0.2%. According to a 2009 estimate, there are 9.54 deaths for every 1000 people, but only 7.64 births, causing the population to shrink slightly (*CIA-The World Factbook,* 2009).

Japan's PPP-based GDP for 2008 was estimated at \$4.39 trillion, or \$34,000 GDP per capita. Its shrinking GDP rate of -0.7% (*CIA-The World Factbook,* 2009) caused it to lose its longstanding rank as the second-largest economy in the world. By comparison, China has experienced GDP growth rates between 9% and 13% in recent years which has allowed China to surpass Japan as the world's second largest economy. China's PPP-based GDP was \$7,973 trillion in 2008. Japan's GNI per capita was estimated at \$37,670, showing strong net financial inflows from firms and workers based abroad (*CIA-The World Factbook,* 2009).

Work Force

Japan has a strong base of skilled and knowledge workers. Over 99% of the population is literate, and the average student spends 15 years in school (*Encyclopedia of Nations*, 2009). There are 95 national universities, four of which are in the top 100 universities in the world (University of Tokyo at #19 and Kyoto University at #25) (*The World Factbook*, 2008). The estimated public expenditure on education was 3.5% of GDP (*Encyclopedia of Nations*). Japan's reservoir of industrial leadership and well-educated technicians is a key strength of its economy.

Four percent of the labor force in Japan was unemployed in 2008, with 47 countries having a lower unemployment rate (*GlobalEDGE,* 2009). Its 66.5 million-person labor force, 40% of whom are women, is the ninth largest in the world. Over two thirds work in the services sector, with most of the rest working in industries such as machinery and equipment, metals, autos, and electronic equipment. Japan is an urban society with only 4% working in agriculture growing rice, vegetables, and fruit. Farmers and fisherman often supplement their incomes with jobs in nearby cities (*World Trade Organization,* 2009).

The income of Japan is moderately dispersed, with the lowest 10% of the population accounting for 4.8% of the income and the highest 10% of the population accounting for 21.7% of the income. Its Gini index, the inequality indicator ranging from perfect equality at 0 to absolute inequality at 100, is 38.1. This means that the distribution of family income in Japan is more evenly dispersed than in the U.S. (Gini index of 45.0) and in China (Gini index of 47.0) (*CIA-The World Factbook,* 2009). Tokyo is the wealthiest city in Japan, 20th in a world-wide ranking of cities based on personal net earnings in 2008 (*The World Factbook,* 2008). No applicable percentage of Japan's population lives below the poverty line (*World Trade Organization,* 2009).

Living Costs

According to the U.S. Department of State's *Quarterly Reports for Living Costs Abroad* (2009), it is slightly more expensive to live in Japan, especially in Tokyo, than in the U.S. Indexes in the report indicate that an American temporarily living in Japan would spend 1.78 times the amount he would spend living in Washington D.C. Allowances available for housing vary significantly between regions, from a $32,700 allowance in Misawa to a $104,400 allowance in Tokyo. Although the cost of living is higher in Japan, it is not a risky country and there is no hardship differential determined by the U.S. Department of State (*U.S. Department of State*).

At the time of this writing, the Japanese Yen (¥) was worth 1.12 U.S. cents or $1 U.S. was worth ¥88.64 (*X Rates*, 2009). Because of the Japanese economy's dependence on exports, it is important for the yen to remain weak. When it rose to a 13 year-high against the U.S. dollar in January 2009, Japan's largest automakers were forced to shift production overseas in order to remain competitive (Mnyanda & Seki). Japan's inflation rate in 2008 was 1.4%, which is low compared to the U.S. rate of 3.6% and Chinese rate of 5.9% (*CIA-The World Factbook,* 2009). However, Japan's low inflation rate has recently raised fears concerning a new period of deflation, as consumer prices in May 2009 fell 1.1% compared to the same period in 2008 (*BBC*, 2009).

HUMAN RIGHTS, FREEDOMS, AND ETHICS

Freedom

According to Freedom House's Annual Global Survey of Political Rights and Civil Liberties (2008) Japan is considered a free country. Freedom House uses a scale of one through seven, with one being highest, to determine the level of political rights and civil liberties. Japan scored a one on political rights and a two on civil liberties.

The U.S. Department of State (2008), reports that Japan's citizens enjoy many of the same rights as United States citizens. Japan is a democracy with elections of leaders that are considered to be fair and well managed. The Japanese citizen enjoys freedom of religion, press, and assembly. They are able to have free correspondence in all forms including Internet usage and have freedom of movement similar to that of U.S. citizens.

The most predominate religion in Japan is Buddhism with a reported 96% of the country practicing this religion. The remaining four percent is made up mostly of Catholics, Protestants, Muslims, and Jehovah Witnesses (*Nationmaster*, 2008). The U.S. Department of State (2008) reports that there appears to be no infringement on the rights of Japanese people to practice their chosen faith.

Human Rights Issues

While on the surface it seems that Japanese and American citizens enjoy the same freedoms and human rights, the countries are very different in these areas. In many cases, there have been clear indications of the Japanese government's inadequate protection of the rights of some citizens. Although Japan is working on these issues, further research shows that the government has been slow to respond to some problems, such as prisoners' rights, human trafficking, and child pornography (*U.S. Department of State*, 2008).

Prisons are a place where human rights are lacking. Some prisons are without a means of heating and cooling which results in health problems and sometimes death. Even prisons with heating systems have been found to not utilize heat during the night hours. There is also documentation of inadequate medical care and nourishment in some facilities (*Bureau of Democracy*, 2008).

Japanese citizens also have the right to a fair trial; included in this is the defendant's right to have representation, bring forth evidence, and cross examine witnesses. As in the U.S., these individuals also have the right to avoid self-incrimination. While Japanese law indicates that all are innocent until the courts find them guilty some question if this is actually practiced (*U.S. Department of State*, 2008).

It has also been noted that while warrants are required for police action they are easily issued. One does not need to have compelling evidence in order to receive a warrant. Defendants are often held for extensive periods of time and lawyers, while allowed to counsel with clients, are not present during interrogation. Officials do at times utilize recording equipment to solidify the confessions of prisoners; however, they typically do not record the interview in its entirety. Also, officers are given much leeway in extracting confessions from prisoners. While regulated to some degree, many of the interrogation techniques are unconventional. Such practices include sleep deprivation, long interrogations lasting from morning into the night, and forcing suspects to stand or sit without movement for long periods of time (*Bureau of Democracy*, 2008).

An area that is clearly in need of attention by the Japanese government is that of human trafficking. While human trafficking is illegal in Japan, an actual and widespread problem does exists. Individuals of all ages are trafficked into Japan each year and exploited in the sex industry and as laborers. Victims are lured to Japan for the possibilities of making money. Unfortunately they are forced to work to pay off the debt incurred to get to Japan. The "employer" will inform them when they have paid the debt and then they will be free to find other employment. Some indicate that they are virtual prisoners as their movements are monitored at work and at home (*Humantrafficking.org*, 2006).

Japan has increased efforts to end human trafficking, although the penalties for violators are not considerably harsh. The Japanese government has printed and distributed brochures in multiple languages to let those that are in these situations know that there is help available. Thailand for example will assist citizens of their country to get home, however if victims cannot prove their citizenship they are left without many options. This situation can be complicated as personal information such as passports have most likely been confiscated by employers (*Human Rights Watch*, 2000). The U.S. Department of State has made recommendations to Japan that a more proactive approach is needed to eliminate the problem (*Humantrafficking.org*, 2006).

An especially disturbing violation of human rights involves child pornography. The majority of child pornography was legal as recently as March of 2008 (*UNICEF,* 2008). While there are indications that Japan was working on a law banning the possession of these items it was uncertain whether that law was ever passed. At that time, Japan was the only G8 country that did not have laws against the possession of child pornography (McCurry, 2008).

While Japan may have to improve policy on some human rights issues, one would have to believe that these situations will be corrected. In each of these issues, Japan appears to be under considerable pressure from other countries to take care of these injustices.

Culture Distance

America and Japan are an odd couple; a continent and an island, strikingly different in size, geography and culture. One is young while the other is very old. One is founded on rational principle and the other is founded in mythic story. One is a salad bowl of diverse peoples while the other is homogenously exclusive. Yet, both have a high regard for qualities such as honesty and efficiency. Both have a strong middle class and enjoy formal education. Both have a love of designer clothes, technological advances, and big cities. The outward similarities make the subtle inward differences difficult to recognize – especially in business. Whole books have been written documenting the subtle and seemingly contradictory differences of Japanese culture. This continued belief of Japanese 'contradictions' is based on outsider expectations and on others' cultural backgrounds.

Hofstede's Five Dimensions

The five separate dimensional scores that make up Professor Geert Hofstede's "cultural distance" are power distance, individualism, uncertainty avoidance, masculinity, and long-term orientation. The first dimensional score, the power distance index score (PDI) is associated with the degree of inequality among a country's society. The PDI score in Japan is 54, compared to the U.S. PDI score of 40 (Hofstede, 2009). The Japanese score falls somewhat between low and high PDI. In lower PDI cultures such at the U.S., managers often accept blame as their responsibility and socialize after hours with their employees. In high PDI cultures, subordinates show respect for superiors through language and elaborate codes of behavior (Kwintessential, n.d.).

The second dimensional score, the individualism score (IDV), focuses on how much the culture values the importance of the individual rather than the group. Japan's IDV score of 46 issignificantly lower than the U.S. score of 91, which indicate that Japan has group bonds and values (Hofstede, 2009). The group and conformity is stressed in relationships and individual needs are put aside for the good of the many. Rules providing stability, order, loyalty, and obedience are perceived as positives. When businesses decide to deal with countries with low individualism scores, it is important to remember that praise and reward should be directed toward teams, not individuals, to lessen any chance of embarrassment. It is the country with high individualism scores that promotes personal performance and achievement over experience and seniority (Kwintessential, n.d.).

The third dimensional score, the masculinity score (MAS), focuses on how strongly a culture reinforces the traditional roles of males and females. Japan's MAS score of 95 is significantly higher than the U.S. score of 62 (Hofstede, 2009). Japan's high MAS score indicates its sharp demarcation line between the gender roles. A lower score would indicate less segregation and less inequality. The Japanese male role dominates with the major share of societal power structure. When businesses deal with countries with high MAS scores, they need to "live at work" in order to succeed. The most effective communication style is direct and unemotional. Professional identity is the norm as opposed to personal reputation (Kwintessential, n.d.).

The fourth dimensional score, the uncertainty avoidance index score (UAI), concerns the level of tolerance a culture has for uncertainty and ambiguity. Japan's UAI score is 92, much higher to the U.S. score of 46 (Hofstede, 2009). Cultures with a high UAI score, like Japan, usually have a long history with a single culture. Risk is to be avoided and change is difficult to bring about. The low ranking of the U.S. suggests a society that is less rule-oriented and restrictive. It allows for a greater tolerance of individual ideals and beliefs, and new ideas with greater risk are accepted as typical. When doing business with a country with a high UAI score, be prepared to back up a business proposal with facts and statistics. Unless people feel in control of the situation, the element of the unknown can slow the decision making process (Kwintessential, n.d.).

Lastly, the long-term orientation score (LTO) as reported by Hofstede, looks at attitudes toward time, persistence, order by status, protection of face, respect for tradition and reciprocity of gifts and favors (Hill, 2009). Japan's LTO score of 80 is significantly higher than the U.S. LTO score of 29 (Hofstede, 2009). Japan's high LTO score indicates a country that values discipline and saving for the future. The low LTO score of the U.S. indicates a country that expects quick results, has small personal savings, and has the mind set of *keeping up with the Jones*. When businesses deal with cultures with high LTO scores, it is important to remember that short term sacrifices will be made for long term gains. This slower mode of business results in the capture of large market shares and a stronger competitive hold on future returns (Hofstede, 2009).

Japanese Business Etiquette

In Japanese society, face is a positive social value; it can be lent, earned, or even lost. It is an accounting of personal prestige, dignity, and honor within one's societal group. Trust in non-verbal messages, as opposed to spoken words, ensures group dependence and harmony. The Japanese rely on facial expression and tone of voice to tell them what another's intentions are. Avoidance of eye contact allows the Japanese a sense of personal privacy in stressful situations. As most Japanese keep an unemotional expression when speaking, non-verbal communication is vital (Kwintessential, n.d.).

Because the Japanese are non-confrontational and have difficulty saying no, observing their non-verbal communication becomes vital. Questions should be phrased so that they can be answered with a simple yes. Group decision making and agreement are important in order to align common interests. Because the Japanese remain silent for long periods of time, patience is important. Flexibility through broad agreements and mutual understanding is the key to handling problems as they arise. The Japanese rarely grant concession, so businesspeople should never lose their tempers or raise their voices during negotiations. The Japanese expect both parties to present their best offers at a meeting. Japanese contracts are not considered final agreements, leaving open the opportunity to renegotiate at a later date (Gorrill, 2007).

In order to schedule a meeting, it is best to request a business appointment by telephone. Promptness to the appointment is important. No matter how difficult or non-profitable it may appear, a businessperson should never refuse a request, as the Japanese are looking for long-term relationships. The businessperson should also offer a package of literature about his or her company the first time they meet. In Japan, the giving of gifts is ritualistic and meaningful so it is polite to offer a small gift as a token of respect to the most senior member of the meeting (who will be seated furthest from the door). It is a ceremony of presentation, and the way the gift is wrapped is important. However, gifts are not opened when received. It is the thought behind the gift – not the cost – that is important (Gorrill, 2007).

Status in Japan is both vertical, meaning superior vs. subordinate, and horizontal, meaning those who are familiar with each other in a group and those who are not. *Uchi/soto,* which translates to “inner/outer”, refers to relationships within the group. Upon meeting someone for the first time, a person’s position is outsider (*soto*) even if both people work for the same company. The distance shown to the *soto* is one of respect and does have some advantages over that of insider (*uchi*). As *soto*, a person is expected to follow strict rules and behaviours, while a person who is *uchi* is more relaxed (Gorrill, 2007).

Greetings in Japan, for both *uchi* and *soto* people, are formal and ritualized. Foreigners may shake hands but in general the traditional form of greeting is still the bow. Depending on one’s relationship to another person, the deeper the bow, the greater showing of respect offered. The foreign visitor ('gaijin') may bow the head slightly, as they are not expected to understand the subtle nuances of bowing. It is important to show the correct amount of respect based on status since the Japanese culture reveres and honors both status and age. If possible a person should wait to be introduced as it is considered impolite to introduce one’s self (Kwintessential, n.d.).

Introductions usually include the exchange of business cards. Therefore, business cards (*Meishi)* are exchanged frequently and with ceremony. Western businesspeople should invest in quality cards that have one side partially translated into Japanese. The received business card should be treated with the utmost respect. Business cards should include the individual’s title, so that Japanese colleagues know his or her status within the organization. They are given and received with both hands and a slight bow and each should be examined with great care. During a meeting, the business cards are placed on the table in front of each person in the order people are seated. When the meeting is over, the business cards are put in a business card case (Kwintessential, n.d.).

Doing Business in Japan

Japan is a land of peace, harmony, tradition and modernization. Many of the societal and business practices today were formed from the past to reflect strict levels of hierarchy, honor and protocol. The concept of harmony, or *wa*, is the most valued principle in Japanese society today. The ideal of social harmony dates back to the first constitution in 604 AD and the joint effort needed for living and working on cooperative farms. In business, *wa* is the avoidance of individualism for the preservation of relationships. Another important concept is *kao*, meaning that "face" forms the basis of personal pride, reputation and social status. Preservation of face involves avoiding confrontations and direct criticism when possible. In Japan, causing someone to lose face can be devastating for a business relationship. Lastly, *omoiyari* means "to imagine another's feelings." This sense of empathy and loyalty is practiced in Japanese business culture (Gorrill, 2007).

When a company decides to participate in Japanese business, it should be prepared to use an agent or distributor. Establishing a direct presence in Japan can be difficult and expensive, so the use of agents and distributors is a more realistic first step. Distributors in Japan usually cover a specific territory or industry, and the Japanese Fair Trade Commission has guidelines to make the transition easier. U.S. firms are cautioned against "cold calls" on prospective agents. The Japanese prefer to do business with someone after they have properly met face-to-face. The U.S. Commercial Service in Japan helps U.S. companies identify prospective Japanese business partners. Once an agent / distributor agreement is signed and the U.S. company's products gain a foothold in the Japanese market, the U.S. company may want to consider establishing a representative office in Japan (Kwintessential, n.d.).

Whether considering franchising, direct marketing, or selling to the government, U.S. business should extensively research the following topics (Kwintessential, n.d.): joint ventures / licensing; distribution/sales channels; selling factors / techniques; electronic commerce; trade promotion and advertising; pricing; sales service/customer support; protecting your intellectual property; due diligence; local professional services; and Japanese culture overview.

Researching these topics will help a business reach an informed decision before making the leap into a new foreign business venture.

FOREIGN TRADE BACKGROUND

Imports vs. Exports

The Office of the United States Trade Representative (2009) reports that Japan is the United States' fourth largest trading partner. In 2008 two way trades between Japan and the U.S. totaled $204 billion. The United States exports many products to Japan including agricultural products, medical products, and machinery. Japan in turn is a leading supplier to the U.S. of vehicles, machinery, and organic chemicals. In July of 2009, the U.S. and Japan announced a Regulatory Reform Initiative had been entered between the two countries. The goal of this initiative is to improve trade opportunities with Japan. Key areas included approving food additives that, while approved in other nations, are not approved in Japan. The initiative also indicated that steps need to be taken to secure trade of U.S. beef into Japan *(Office of the U.S. Trade Representative, 2009).*

Japan is heavily dependent on imports – in particular raw materials and fuel *(CIA-World Fact Book, 2009)*. GlobalEDGE reports that Japan produced 4.85 billion cubic meters of natural gas in 2005 but consumes a much larger 83.67 billion cubic meters. Japan does have some oil production with approximately 125,000 barrels per day produced in 2006. In 2004, they exported 94,830 barrels per day and imported 5.353 million barrels per day (*CIA-World Fact Book*, 2009). Industry Week (2008) reports that Toyota Motor Corporation has the fourth highest revenues of all publically traded companies worldwide, which moves it up one position from 2008. While American auto manufacturers are struggling with low stock prices, Yahoo Finance (October 8, 2009) reports that Toyota per share price is currently \$78.81 compared to Ford Motor Co. at \$7.81. In 2007, CNN Money reports that in the first quarter of that year Toyota beat General Motors in worldwide sales selling 2.35 million cars and trucks (*CNNMoney*, 2007)

Current Trade Environment

Japan is the third largest economy with a GDP in 2007 that was equivalent to 4.38 trillion U.S. dollars (Corwin & Puckett, 2009). The A.T. Kearney's 2007 FDI Confidence Index Survey ® ranks Japan number 15, which is unchanged over the prior year's survey. This survey tracks political, economic, and regulatory changes in regard to Foreign Direct Investment. Kearney receives responses from executives around the world in six countries and 17 industries.

Japan is ranked 15th in the World for ease of doing business and the United States is ranked number four. Economies are ranked on their ease of doing business, from 1 – 183, with first place being the best. A high ranking on the ease of doing business index means the regulatory environment is conducive to the operation of business. This index averages the country's percentile rankings on 10 topics, made up of a variety of indicators, giving equal weight to each topic. As the world's third largest economy, Japan is taking steps to become more competitive and make it easier to do business in their country (*World Bank,* 2010*).*

National Trade Strategy

In April of 2009 the International Trade Administration of the U.S. Department of Commerce published a paper by Corwin and Puckett. This paper titled "Japan's Manufacturing Competitiveness Strategy: Challenges for Japan, Opportunities for the United States" discusses Japan's commitment to increase competiveness. The authors indicate the following themes involving the effort:

- Japan is engaged in a cohesive "innovation program" at all levels – academia, government, and industry.
- Japan's science and technology and its manufacturing competitiveness strategic roadmaps are inextricably linked and well-funded.
- Japan's key to global competitiveness will be to develop its human resources.
- Japanese industry is moving forward with an aggressive competitiveness strategy without direct government support or intervention.
- Japanese leaders are thinking about how to advance the country's strategic and commercial relationship with that of the United States (Corwin & Puckett, 2009).

It is clear that the authors were diligent in gaining an understanding of the national trade strategy involved. Japan had several years of economic downturn and now they are setting out to gain ground. Innovation is one of the key factors along with what the author's suggestion of 'an open attitude'. As Japan moves forward, it is clear that there is a need to increase the effectiveness of human capital. A key goal is to invest in young people and encourage young people from other countries to come to Japan to share their talents. The authors also indicate that Japan sees a need to become a more English speaking society. Increasing this ability will increase Japan's competitiveness in the international marketplace (Corwin & Puckett, 2009).

POLITICS AND POLITICAL ECONOMY

Political System Overview

Japan's political system is a constitutional monarchy which was adopted after the country's defeat in World War II. Its democratic constitution (1947) was a ridged document renouncing the right to wage war and limiting Japan's armed forces. It was based on the British parliamentary form of government and not the political system of the United States. Since its construction, no major amendments have been made to it. Once regarded as a divine entity, the new constitution defined the emperor as the powerless symbol of the unity of the nation (Darlington, 2009).

Supreme political power was assigned to a bicameral structured Diet where decisions are made on a majority vote. Two houses were created: the House of Representatives and the House of Councilors. The House of Representatives has 480 seats with each member serving a four-year term and the House of Councilors has 242 seats with each member serving a six-year term (Darlington, 2009).

A Prime Minister is chosen for a term of four years with the majority vote of the Diet signed in a single ballot between the two houses. The Prime Minister chooses the Cabinet members. There are 14 regular members with the possibility of three special members and at least half of the Cabinet must be members of the Diet. Family connections influence Japanese politics as many members are the children or grandchildren of former Diet members (Darlington, 2009).

Founded in 1955, the conservative Liberal Democratic Party (LDP) held the dominant position for more than 50 years until the formation of the Democratic Party of Japan (DPJ) in 1998. After the elections of August 2009, the DPJ now holds the dominant position. As the largest party, the DPJ now controls both houses and profound changes are expected in the government's future (Darlington, 2009).

The World Trade Organization (WTO) deals with the policy of trade connecting nations at a global level. Most Favored Nation (MFN) status is awarded when a nation enjoys trade advantages such as lowered tariffs and trade barrier reductions granted all other members of WTO. MFN is also known as permanent normal trade relations. Developed nations, as members of the WTO, must give the same trade benefits to all other members of the WTO. Japan has been a WTO member since January 1995 and enjoys MFN status (*World Trade Organization*, 2009).

Tax Rates

Japan's maximum corporation tax rate of 42.8% is the highest of the OECD countries (Hodge, 2008). The three components of this rate are the corporation tax of 30%, the inhabitant tax of 6.2%, and the enterprise tax of 11.5%. This total surface tax of 47.7% becomes an effective tax of 42.8% after considering available deductions. Japan also has a value-added tax of 5% that is embedded in its 11.5% enterprise tax (*Grant Thornton*, 2008). The Japanese average combined local and federal tax rate of 39.5 % is nearly equal to the average combined state and federal tax rate of 39.3% in the U.S. (*Hodge*, 2008). Japan taxes foreign corporations on any income or capital gains from Japanese sources and all corporations with a branch in Japan are subject to taxation on any income or capital gains attributable to that branch (*Grant Thornton*, 2008).

Two of Japan's most important competitive advantages, its innovation and knowledgeable workforce, are reinforced through tax credits. For 2008 through 2010, corporations receive a credit of up to a 20% against their income taxes for research and development expenses. The Human Resource Investment Tax Credit reimburses corporations for training expenses from external instructors, training materials, and fees for external training courses. If corporations have increased training expenditures over the previous two years, they are eligible to receive a credit of 10% of their corporation tax (*Grant Thornton*, 2008).

Japanese individual federal tax rates of 5% to 40% are higher than American tax rates of 10 to 35%. However, the addition of significant local taxes makes Japan's effective tax rate one of the highest in the world. Like the American tax system, taxation of income in Japan is progressive; meaning that as income increases, the tax rate also increases. Permanent residents are taxed on income earned in Japan and abroad, while non-permanent residents are taxed only on income earned in Japan (*Worldwide Tax, 2009*).

DIRECT INVESTMENT AND LABOR COSTS

U.S. Crisis Affects Japan

The United States' economic and financial crisis not only had harsh domestic impacts but also international ramifications. In order to stabilize the nation and minimize global impact, U.S. authorities enacted policies to help domestically and abroad. The Financial Stability Plan contains a number of polices, such as capital injections, debt guarantees, and stress tests, that have contributed to great improvements in present financial conditions (*International Monetary Board*, 2009). However, a close watch needs to be kept in order to respond to any vulnerability that develops.

One priority will be to develop exit strategies to undo the extreme interventions made during this crisis. International Monetary Fund (IMF) Directors also stress that resuming private securitization will be essential to restoring healthy credit flows. To do this, some key steps include: improving disclosures about credit quality and rating processes; vary ratings for securitized goods; toughen bundler liabilities to increase their accountability; and establish market codes of conduct (*International Monetary Board*, 2009).

Even though Japan was not in the epicenter of the current global crisis, the subsequent financial spillovers and collapse in external demand has caused a severe economic recession within Japan. Currently, Japan is focusing on short-term policies to support economic growth and preserve financial stability within the country. Stimulus packages are giving some support, but more will need to be done if the recession continues or worsens. The various measures already taken have helped stabilize Japan's financial system. IMF Directors approve of what the Bank of Japan (BoJ) authorities have done thus far and believe they have the ability to make an organized exit from stabilizing programs when the recession comes to an end (*International Monetary Board*, 2009).

The challenge will be the timing and determining the 'how' and 'when' to exit. The targets for lowering the debt ratio and debt management will more than likely call for tax reform and spending cuts. IMF Directors encourage the BoJ authorities to make structural reforms, such as deregulating the service and agricultural sectors, improving the flexibility of product markets, continuing to develop financial markets, and promoting inflows of foreign direct investment. These reforms will help rebalance Japan's economic growth toward domestic demand, which will in turn help Japan adjust to any structural shifts in the global economy (*International Monetary Board,* 2009).

Current Economic Issues

In addition to the global economic situation, Japan's recession has other contributing factors. A decreasing population is a problem facing Japan and may be the result of low-birth rates and adverse immigration policies. Having a declining population means lower labor input per person, which in turn leads to lower income per capita. Adding to this problem is the compulsory retirement age of 60 in many companies while, at the same time, Japan has the highest life expectancy in the world; slow female integration into the labor force; and "freeters" (youngsters that make a living on odd jobs or are unemployed) from the economic crisis in the 1990s. These circumstances all have a negative impact on Japan's GDP growth rate contributing to the current recession. In an effort to counteract declining labor input, companies have invested heavily in physical capital. However, this has led to high depreciation rates, which means low returns on investments. Evidently, heavy capital investment has led to economic inefficiency—a negative impact on GDP growth (*Deutsche Bank Research*, 2006).

One thing helping Japan's GDP is their increase in human capital including a worker's access and tenure at high quality education. Japan has a fairly efficient education system in that it is relatively inexpensive to obtain a high-quality education. This education system is one of the main reasons why Japan is still highly innovative. Yet innovation could decline if Japan does not change its closed economy. In fact, most of Japan's economic problems are a result of their closed economy, especially in the agriculture sector. An open economy would allow an inflow of international ideas that could greatly reduce inefficiency and lower foreign direct investment. It even has the potential of increasing population or at least immigration. Overall, major reforms in

Table 1

FDI flows (In millions of Dollars)	*1990-2000 (Annual average)*	*2005*	*2006*	*2007*	*2008*
Japan					
Inward	3,149	2,775	-6,506	22,549	24,426
Outward	25,409	45,781	50,266	73,549	128,020
United States					
Inward	109,513	104,773	237,136	271,176	316,112
Outward	92,010	15,369	224,220	378,362	311,796

Japan's economy are needed for a chance at a positive GDP growth in the future (*Deutsche Bank Research*, 2006).

Foreign Direct Investment

In the past decade, Japan has started to open up its economy to increase foreign direct investment inflows by establishing trade agreements. Japan has already made free trade agreements and/or economic partnership agreements with Chile, Mexico, and Switzerland. Currently, Japan is negotiating agreements with Peru, India, and Australia. Negotiations involving the resuming of an economic partnership agreement with the Republic of Korea are also taking place. Japan is also involved in trade agreements that could become a free trading bloc in Southeast Asia. The Association of South East Asian Nations (ASEAN) was established in 2008 between eleven Asian countries. Before the countries can participate in the agreement, however, they have certain domestic procedures to fulfill. The countries that have ratified these procedures are Japan, Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. These countries are still waiting on Cambodia, Laos, and Myanmar to complete their own procedures. The ASEAN agreement covers areas of trade in goods and services as well as investment and economic cooperation (*Ministry of Foreign Affairs of Japan*, 2009).

Have these new trade agreements made any difference in foreign direct investment inflows? Perhaps. The World Investment Report for 2009 produced by the United Nations Conference on Trade and Development shows the following foreign direct investment (FDI) flows for Japan and the United States:

The low FDI inflows to Japan compared to that of the U.S. suggest an unfavorable foreign investment environment and strict regulations in Japan, while the U.S. economy typically favors foreign investment. Japan appears to show much more interest in investing in other countries, though the FDI outflows are still low when compared to the U.S. in the past three years. The U.S. FDI outflows fluctuate from year to year, suggesting indecision and possibly a lack of confidence while Japanese investors seem sure in the decision to invest in other countries.

The A.T. Kearney's 2007 FDI Confidence Index® survey keeps track of the impact that possible political, economic, and regulatory changes on the foreign direct investment preferences and intentions of top company leaders from around the world. Executives across six continents and 17 industries responded to this survey. It uses a zero-to-three scale to rank the top 25 countries in the world. Japan comes in at 1.63 and is the 15th country (the U.S. is third at 1.81). It is also good to note that investors in developed countries consider Japan to be the 14th most attractive destination for first-time investments. To attract foreign investment, Japan has passed reforms such as triangular mergers, which is when a Japanese subsidiary of a foreign company uses the parent company's shares to purchase a local company. However, Japan's keiretsu system—a system of interlaced business relations and shareholdings—can still act as an obstruction to foreign investment (*A.T. Kearney*, 2007).

Manufacturing Costs

Part of what attracts foreign investment to Japan is the country's low manufacturing costs. According to the Bureau of Labor Statistics, the hourly compensation cost for production workers in manufacturing (in U.S. dollars) in 2006 is $23.82 in the U.S. and $20.20 in Japan. The average annual growth rate for these hourly compensation costs is three percent (3%) in the U.S., while Japan has a negative one tenth of one percent (-0.1%) rate. This means that as manufacturing costs in the U.S. increase, manufacturing costs in Japan are decreasing. Japan has a slight competitive advantage over the U.S. when comparing these numbers (*Bureau of Labor Statistics*, 2009).

These low manufacturing costs—and high quality products and educated workforce—could be part of the reason why some of the top Japanese multinational companies (MNCs) are doing relatively well. Toyota, Honda, Nissan, and Panasonic, all MNCs in Japan, made Fortune magazine's list of the World's Most Admired Companies in 2009. Hitachi, another Japanese MNC, made the contenders list. Whether they will be able to maintain that status in the future remains to be seen. Toyota Motor has been showing growth over the past few years, with record earnings in 2007 and 2008. However, this growth is not sustainable as the 2009 earnings show, with an actual net loss for the first time in 70 years. Honda Motor has also been showing growth over the past few years until 2009. They did not suffer a net loss, but net earnings were substantially lower than the previous year (*CNN Money*, 2009).

Nissan Motor has had steadily increasing sales until 2009. Net income started declining in 2006, with net losses in both 2008 and 2009. Panasonic also had sales growth until 2008 and increasing net income until 2009, when there was a net loss. Hitachi, on the other hand, is unusual in that in the past few years they have experienced increasing revenues, but decreasing net income, with losses in 2007 and 2008. In 2009, revenues went down, with the net loss taking a deep plunge. With the current global economy, it comes as no surprise that the sales growth these companies have been enjoying for the past few years has now come to an end (*CNN Money*, 2009).

The Yen

Since these MNCs do a large amount of business in the U.S., a comparison of monetary values should be contemplated. Suppose that a U.S. firm needed to make a payment totaling $1,000,000 USD in Japanese Yen 90 days from now. The firm needs to decide whether to use the spot or forward exchange rate to buy yen now or in three months. Which rate the firm chooses will depend upon whether the dollar appreciates or depreciates against the yen. For example, on October 7th, 2009, the Sauder School of Business recorded the spot and 90-day forward exchange rates on the New York FXmarket to be $1 = ¥88.64 and $1 = ¥88.57, respectively (*Pacific Exchange Rate Service*, 2009). Therefore, $1,000,000 would be worth ¥88,640,000 on October 7th, 2009, and ¥88,570,000 at the beginning of January (in 90 days). In this case, the dollar depreciates against the yen. This indicates that the firm should buy yen now so that they can get a discount in the future. However, the time value of money must also be considered.

Another way currency can be compared is by looking at the purchasing power between two currencies. On July 13, 2009, the Big Mac Index listed the Big Mac price in the U.S. at $3.57. In Japan, the Big Mac was at ¥320, which translates to $3.46 in the U.S. Based on these prices the purchasing power parity of the U.S. dollar is 89.6. However, taking into account the actual exchange rate at that time, the purchasing power parity should have been 92.6. This means that the Japanese yen was undervalued at about 3% against the U.S. dollar (*The Economist*, 2009).

CONCLUSIONS

Strengths

According to the 2009 World Competitiveness Rankings issued by the World Economic Forum, Japan is the 8th most competitive country in the world. Japan enjoys a comparative advantage due in part to its world-class business sophistication and innovation. Its business sophistication is a product of Japan's value chain breadth, control of international distribution, and product process sophistication, each of which are considered the best in the world. Japan's capacity for innovation comes from its reservoir of scientists and engineers as well as high company spending on research and development. Japan is ranked second in the world in each of these categories, trailing Finland in availability of scientists and engineers and Switzerland in spending on research and development (*World Economic Forum,* 2009).

The strength of Japan's workforce is not limited to its scientists and engineers. The group-orientation of the Japanese people lends itself to employees that are loyal and dependable. There is an especially high cultural fit with manufacturing which is evident in Japan's 18.3% share of the manufactures imported into the U.S. (*World Trade Organization*, 2009). Masao Hirano, a Director of Japan's McKinsey & Company, describes the manufacturing industry as "organic, holistic, frontline, team-driven" (*World Economic Forum*, 2006).

The Ease of Doing Business Report 2010, a co-publication of the World Bank and the International Finance Corporation, ranked Japan 15th out of 183 countries. Japan was among the top twenty countries for the areas of getting credit, protecting investors, and trading across borders. Japan was ranked first for ease of closing a business, with an average recovery rate of 92.5 cents on the dollar and time required to close of 7 months (*The World Bank Group*, 2009).

A potential strength is Japan's close ties to the two economies that are currently the largest in the world. Japan's relationship with the U.S. dates back to post-World War II when General MacArthur restored the Japanese economy through the Marshall Plan (*U.S.-History.com*, n.d.) Another heavy western influence came from Dr. W. Edwards Deming, the American statistician who, with his innovative ideas about quality control, helped create the Japanese post-war industrial revival (*Leadership Institute Inc*., 2005). While trade between Japan and the U.S. remains strong, Japan is strengthening its ties with China. Li Rongrong, director of the China's Assets Supervision and Administrative Commission, believes the economies of China and Japan are complementary, and that together they can contribute to the recovery of the world economy (*China Daily*, 2009). As a crossroad between the east and west, Japan has the potential to reap substantial benefits as the East Asian economic community booms.

Weaknesses

Japan's overall competitive performance is adversely affected by its macroeconomic weaknesses. Its consistent annual budget deficits have built up into one of the largest public debt levels in the world. In 2008, Japan's public debt was 196.29% of GDP, or $8.63 trillion. The soundness of Japanese banks is also an issue, as economists estimate as much as one trillion dollars in bad debts on the banks' books. The banks are reluctant to call in these bad loans, and the government is reluctant to force the issue (Kerr, 2009).

Another weakness of the Japanese economy is inefficient government bureaucracy. Nearly 17% of companies who responded to the World Economic Forum's survey noted inefficiencies of government as the most problematic factor of doing business in Japan (*The World Bank Group*, 2009). The strong association between the government and business leads to policy instability that increases the cost of doing business in Japan. Another factor increasing the cost of business is the high corporate tax rate of 55.7% of profits (*The World Bank Group, 2009)*. Only one third of the countries in the 2010 Ease of Doing Business Report had more problems regarding tax regulation than Japan.

Japan has a real need to increase the number of engineers in technology by 10 percent by the end of 2020. The New York Times has reported that Japan is running out of engineers. Fewer individuals are selecting the engineering and technology fields (Fackler, 2008). As a result, Japan is being forced to recruit foreign workers or outsource jobs to Vietnam and India, where there is an ample supply of engineers. Though it was engineering that helped Japan become an economically advanced country, the younger generation prefers the more highly paid professions of finance and medicine. To increase the number of engineer, Japan needs to consider enticing the younger generation to pursue a career in technology, hiring more foreign workers, and building new R&D centers in other countries.

Last, due to its geographical location, Japan has heavy dependence on imports of raw materials and food products. Less than 15% of the land in Japan is arable, so it is the largest market for U.S. agricultural exports (*U.S. Department of State,* 2009*)*. Because Japan has few of the raw materials required in its competitive manufacturing industry, it must import them first from China or the European Union. About 36% of its imports are fuels from Saudi Arabia and the United Arab Emirates; however, Japan has utilized its innovation to become one of the most energy-efficient developed countries in the world. Japan has reduced its dependence on petroleum by using coal, liquefied natural gas, nuclear power, and hydropower (*World Trade Organization,* 2009).

Risks

In the most recent risk assessment by the global trade organization Coface, Japan received an A1, the rating representing the lowest risk. Coface reported that Japan's political and economic situation is strong, its quality business environment has a positive influence on corporate payment behavior, and corporate default probability is very low on average. The A1 rating means that corporate financial information is available and reliable, the legal system provides fair and efficient creditor protection, and the country's institutional framework is good for companies. Other countries with an A1 rating included the U.S., Germany, and the U.K. China's risk assessment was B, the third riskiest rank on a seven-level scale (*Coface*, n.d.).

Investment in the Japanese market holds risk associated with the country's sensitivity to the global economy. In 2008, the economic slowdowns in the U.S., Japan's main trading partner, caused Japanese exports to decline, sending it into a recession. The country's exports were hurt further by economic downturns in Europe and Asia and the appreciation of the yen. The automotive, mechanical, and electronics sectors are most affected by foreign demand, which may decline further in 2010. Also expected to drop in 2010 is household spending, which will hurt sectors that focus on the domestic market as well (G*lobalEDGE,* 2009).

With a new political party in power, continuing global economic uncertainty, and a decreasing population, can Japan rise out of this recession as a major economic power? Japan must utilize its innovation and business sophistication in order to increase its exports. It needs to respond to certain human rights issues and focus on retaining its strong base of knowledge workers. Japan can lower its corporate tax rates and bureaucratic policies in an effort to attract new MNCs and FDI. Japan should harness the innovation evident in its manufacturing sector, and integrate it into other areas of its economy. Without a strategy to increase its business competitiveness, the Land of the Rising Sun will be left in China's economic shadow.

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Redefining Strategic Framework for Financial Prudence-Air Asia: A Case Study

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The airline Industry is suspect able to various risks including financial risk. Among financial risks, Fuel price risks, interest rate risk and foreign exchange risks can cause considerable impact on cost and earnings. These risks are compounded for low cost airlines and efforts are required to hedge against these risks. Air Asia is one of the low cost airlines and it uses various derivatives instruments and operation management to shield from these risks. This study examines financial strategies of Air Asia to highlight how financial prudency was reached by redefining strategic framework.

Keywords— *Hedging, Leasing, derivative instruments, Futures Options, Swap, Export Credit Agencies, term loans.*

INTRODUCTION

The global Airlines Industry is quite dynamic and has witnessed a paradigm shift in the industry landscape since the first decade of the 21st century. A number of events marked this change from the terrorist attack of September 2001, to sky-rocketing fuel prices and finally the ongoing economic slowdown. The airlines industry is susceptible to these events as it is characterized by: Cyclic and seasonal demand, Sensitivity to economic fluctuations, Capital as well as labor intensive, High leverage or High debt ratio, High domestic and International competition, Strict regulatory and safety standards. Due to its intrinsic nature, the Airline industry is exposed to an array of risks like operational risk, financial risks and hazardous risks. While operational risks arise from cyclic demand, regulatory environment, high operating leverage, and intense competition, financial risks can be attributed to general economic trends, high financial leverage, and capital intensive nature of the industry. Airlines' profitability is closely tied to economic growth and trade. The financial difficulties are exacerbated by airlines over-ordering aircraft in the boom years, leading to significant excess capacity. When recession strikes, fixed unit cost increases, revenue falls and it becomes difficult for airlines to service their debts making them financially distressed. Moreover, the tight credit conditions make it difficult for airlines to raise capital for financing aircraft acquisition and other equipments. During these turbulent times airlines resort to capacity cutting, downsizing and securing cash reserves for internal funding.

Hazard risks arises with any likelihood of terrorist attacks, pandemic disease outbreak, and aircraft accidents. The 13th September 2001 terrorist attack proved catastrophic for the airline industry across the globe with many US airlines filing for bankruptcy. In US alone, between 2001 and 2005, the industry posted $35 billion in cumulative net losses, according to the Air Transportation Association. The H1N1 pandemic of 2009 reduced the passenger volume affecting revenues of all major airlines. The advent of Low-cost carriers and

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there consideration to foray into long haul services have magnified worries for legacy carriers intensifying competition as they are able to operate at 40-50% less cost than legacy carriers and are able to offer better price to price-sensitive passengers. The intense competition coupled with other unfavorable developments in the economy has forced many airlines to merge or launch their own low-cost subsidiary carriers like Firefly by Malaysian Airlines, Tiger Airways by Singapore Airlines and Jetstar Airways by Qantas to name a few.

AIRASIA AND ITS BUSINESS MODEL

Business Model of Air Asia

Air Asia was established in 1993 and started its operation on November 18 1996. It was originally founded by a government-owned conglomerate DRB-Hicom and this heavily indebted airline was purchased by a former Time Warner executive, Tony Fernandes's company, named Tune Asia Sdn Bhd for the token sum of one Ringgit (RM1). Tune Air inherited major assets of 2 aircrafts and liabilities of RM 40 millions. By 2002, he not only settled all debt but also turned the company around into a profitable business. Starting with 2 Boeing-737, five destinations in Malaysia and a staff of 250 in 2001, AirAsia has grown to become a truly ASEAN's best low cost airline. As of 2009, the AirAsia Group (including its Thai and Indonesian affiliates) operates a fleet of 84 aircraft and flies to more than 60 destinations in 16 countries with 126 domestic and international routes from hubs in Malaysia and a staff count of 4,593. With its catchy tagline "Now Everyone can fly" it aims to make air travel affordable to the masses. AirAsia received some of the best awards in the industry like 'World's best low cost Carrier' by SkyTrax in 2009 and 'Airline of the Year' by Centre for Asia Pacific Aviation (CAPA). AirAsia X introduced in January 2007 was set up to offer long haul flights to Europe and Australia. AirAsia Berhad holds a 16% interest via redeemable preference shares. Other investors include Richard Branson's Virgin Group, Orix of Japan, Manara of the Middle East, and certain individual founders of AirAsia. It positions AirAsia in direct competition with full service carriers in the region. AirAsia benefits from economies of scale and integrates Malaysian, Indonesian and Thai operations to create a single, seamless structure. Cost leadership is achieved through streamlined operations and through strict financial control of operations and constant monitoring of external environment. AirAsia follows Ryanair's Low cost model which is considered Europe's best Low cost airline and has changed the landscape of Airline industry in Europe. As of 31st December 2009 AirAsia is valued at RM 3.2 billion on Bursa Malaysia.

Strategies Adopted by Air Asia to Achieve Low Cost Model Curve

Key operational strategies that help AirAsia to achieve low cost model:

High Aircraft Utilization, Low Fare, No Frills, Streamlined Operations, Lean Distribution System, Point to Point Network , Of all the financial risks mentioned by AirAsia in its annual report 2009, this study identifies only three, which have a considerable impact on the profitability and sustainability of its competitive advantage as a Low-cost and Low fare carrier. In addition to these financial risks, the study also investigates the aircraft financing approaches employed by AirAsia and the industry which form the bulk of debt on their balance sheets given the constrained global credit supply. These risks are:

a) Fuel price risk

b) Interest rate risk

c) Foreign currency risk

FUEL PRICE RISK

Aircraft fuel forms the largest component of the total expenses of AirAsia. It constituted 40% in 2009, 57% in 2008 and 33.5 % in 2007 of the total cost. The jet fuel price is determined by the commodities market and has been quite volatile since the second half of the last decade. Any unexpected and uncovered rise in fuel prices may increase expenses disproportionately disrupting the low cost model of AirAsia. Therefore, AirAsia offsets this exposure to fuel price risks through various financial derivative instruments and fuel management strategies at operational level.

Table 1: WTI Spot Price of Fuel Price

Year/ Quarter	*Dollars per Barre*
2005.1	55.31
2005.2	56.63
2005.3	66.21
2005.4	61.06
2006.1	66.25
2006.2	73.94
2006.3	62.90
2006.4	60.85
2007.1	65.94
2007.2	70.47
2007.3	81.64
2007.4	95.95
2008.1	101.54
2008.2	139.96
2008.3	100.70
2008.4	44.60
2009.1	49.64
2009.2	69.82
2009.3	70.46
2009.4	79.39

Source: EIA daily energy spot prices - U.S. Energy Information Administration (EIA) Daily Prices, USA

What is fuel hedging and what specific instruments

Fuel hedges are tradable contracts used by airlines and other industries to mitigate their exposure to crude oil or jet oil price volatility. Like many other airlines, Airasia also hedges a portion of its fuel requirements in order to shield itself from extremely volatile fuel prices. The company had hedged 100% of its fuel requirement for the financial year 30th June 2006. It hedged around 50% of its fuel requirements in 2007 while it completely got rid of these contracts in 2008 due to huge losses. As at 30th September 2008, the Group had hedged 35% of its budgeted consumption for Year 2008 and 2009 against upward movement in fuel prices. In 2010, it hedged 37 % of the group's total expected fuel consumption and continues to monitor the oil market. The Group has hedged around 37% of its estimated fuel requirements in 2010 via fixed swaps on Singapore Jet Kerosene/WTI. The hedging strategy makes use of the following two types of fuel derivative contracts –Fuel Options contract and Fuel Swap contract

Year 2008 was a bad year for almost the entire Airlines Industry across the globe from legacy airlines to Low cost airlines and AirAsia was no exception. In 2008 Crude Oil prices sky-rocketed to $147 per barrel before plummeting to $47 per barrel in the last quarter of the same year. This unprecedented volatility in fuel price inflicted huge losses on almost all Airlines as it rendered most of their hedging contracts costly to carry. AirAsia lost RM 678 million in 2008 as it unwound its fuel hedging contracts completely reporting a net loss of RM 496 million and fuel expenses rose to an all time high of RM 1.3 billion. This pulled Airasia's stock price down to RM1.18 and AirAsia had to spin-off all its hedging contracts temporarily. But it was a one-off loss given the sudden spike in fuel prices and AirAsia got rid of all costly hedging contracts only to hedge again in 2009. In fact, it becomes quite important for low-cost carriers to at least partially hedge their future fuel requirements to contain cost. Ryanair which hedged 90% of its

Table 2: Value Creation through Fuel Hedging during the Study Period

Year	*2006 (RM'000)*	*2007 (RM'000)*	*2008 (RM'000)*	*2009 (RM'000)*
Fuel Hedged Position	100 %	50 %	35 %	37 %
Aircraft fuel expense	323,775	443,831	1,389,841	927,795
Net Profit/ (Loss)	88,414	425,700	(496,563)	506,267
Share price	1.56	1.8	1.18	1.21

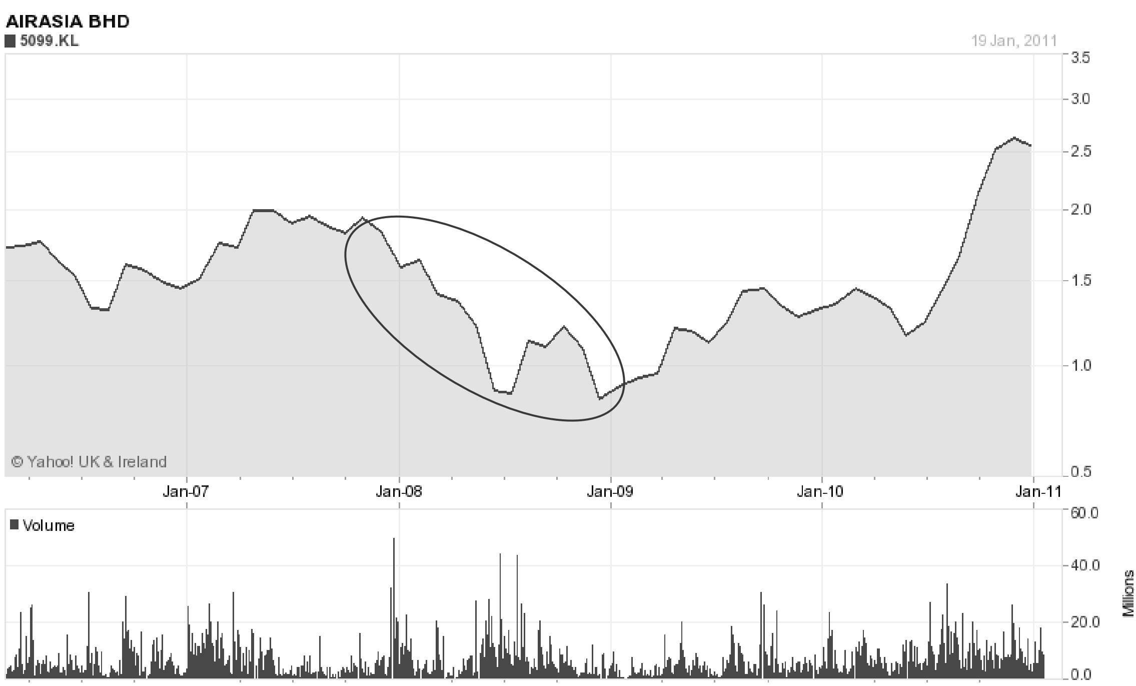
Source: Annual reports, AirAsia & finance.yahoo.com fuel requirements in 2007 cut back to 10% in 2008 and 2009 before resuming to 90% in 2010 as the fuel prices eased. EasyJet, another low-cost carrier from Europe hedged 70% in 2009.

INTEREST RATE RISK

One of the characteristic of Airline Industry is the high Debt ratio which arises due to the high fixed cost requirements of the business like aircraft, engines, airframe purchases, aircraft maintenance etc. AirAsia being a young fleet is still expanding through substantial borrowings for the acquisition of new aircrafts. In 2009, AirAsia's long term debt stood at RM 7,067,696,000 including floating-rate term loan of 5,937,371 which exposes it to the fluctuations in the market interest rate. Any unfavorable movement in interest rate may substantially increase the cost of capital and, therefore, affecting the income and cash flows of the company. Besides these borrowings, the company deposits its surplus funds in licensed

Table 3: Fuel Hedging by other Airlines

Airlines	*Hedged position (%)*	*Hedged Period*
Ryanair	10	June – December 2008
EasyJet	70	April 2009 – October 2009
Singapore Airlines	36	_
Air New Zealand	65	July-September (2009)
Japan Airlines	75	March 2008 – April 2009
Qantas	65	July 2008 – June 2009
Nippon Airways	80	_
Thai Airways	30	_



***Source:** Yahoo Finance, Stock price of AirAsia*

Fig. 1

banks and short term fund management institutions earning interest income. This exposure to interest rate risk is managed by a prudent mix of fixed and floating rate debt and derivative financial instruments.

AirAsia makes use of derivative financial instruments, as far as possible, to generate the desired fixed interest rate profile. About 97.3 % of the total long term debt is covered by these derivative instruments leaving 2.73% at floating rates which are linked to the London Interbank offered rate (LIBOR). EasyJet does not hedge the interest rate on its term loan of £1,010.7 million which is mostly denominated in USD leaving it floating. This is because EasyJet has £ 1,075 million in money market deposits which are denominated in USD. Any loss due to unfavorable movement in LIBOR rate is offset by the gain from money market deposits in USD.

The same cannot be applied to AirAsia though its term loans are also denominated in USD because its term loan of RM 5,937,371,000 is far more than its cash deposit of RM 746 million in banks and the bulk is denominated in Malaysia Ringgit. Therefore, AirAsia has to explicitly hedge its interest rate and the proportion of hedged debt is even more than Ryanair (40%). Table 4 shows the amount of foreign currency payment or receipt hedged by different Airlines:

Table 4

Hedged position	*AirAsia*	*Ryanair*	*EasyJet*
Fixed/Hedged	97.3%	40%	60%*
Floating	2.7%	60%	40%*

** The figures are only for lease payment liabilities and not for debt which are based on floating interest rate.*
***Sources:** Annual reports of AirAsia, Ryanair and EasyJet*

Since these derivative financial instruments convert its existing and future floating-rate long-term debts into fixed-rate debt, it helps the company to predict and manage its future cash flows and cost structure which form the pre-requisite of Low cost strategy by stabilizing its cost of capital. Table 6 shows the outstanding long term debt and the interest expense vis-à-vis profit or loss for AirAsia –

Table 6 shows that the interest risk management by the company has been successful so far. With increasing debt, the interest expense and the net income also increased over years except in 2008 when it suffered a net loss of RM 496 million of which RM152 million were due to the provision for loss on unwinding of interest rate Swap derivatives. In 2008, the company terminated a number of its interest rate Swap contracts in view of the sharp decline in short-term and long-term interest rates. At the same time, the Group has re-

Table 5: The types of derivative instruments used and their remaining terms for 2009 and 2008

Derivative instruments/ Later than 5 Years	*2009 RM'000 equivalent*	*2008 RM'000 equivalent*
Interest rate Caps	768,188	-
Interest rate Swaps	3,409,159	5,205,199
Cross Currency Interest rate Swaps	213,413	245,939
Total	4,390,760	5,451,138

***Source:** Annual report of AirAsia 2008 and 2009*

Table 6: Value creation through derivative financial instrument

Year	*2006 (RM'000)*	*2007 (RM'000)*	*2008 (RM'000)*	*2009 (RM'000)*
Long term debt	787,276	3,419,121	6,146,708	7,067,696
Interest expense on long term debt	21,342	88,286	297,521	371,141
Net income/(Loss)	88,414	425,700	(496,563)	506,267

***Source:** Annual reports of AirAsia*

entered into new hedges via interest rate swaps and interest rate caps at lower rates. Some of the interest rate swaps have been embedded into the relevant aircraft loans to provide fixed rate facilities.

FOREIGN CURRENCY RISK

The Group has subsidiaries and associates operating in foreign countries which generate revenue and incur costs denominated in foreign currencies. The main currency exposures of the Group and Company are primarily in USD, Thai Baht and Indonesian Rupiah. The Group has a natural hedge to the extent that payments for foreign currency payables are matched against receivables denominated in the same foreign currency or whenever possible by intragroup arrangements and settlements. The surplus cash deposited with banks and short-term fund management institutions has a diverse currency profile like USD, RM, Euro, SGD, Thai Baht, Hong Kong Dollar, Chinese Yuan etc. Besides, the company has substantial borrowings denominated in foreign currencies mainly in US Dollar and Euro and their periodic settlement is subject to the exchange rate risk. The currency exposure profile of borrowings is as follows:

The Company enters into *forward foreign currency exchange contracts* to limit its exposure on foreign currency receivables and payables, borrowings and deposits. The forward foreign currency exchange contract is an obligation to buy/sell a specified amount of a currency at a pre-determined exchange rate and pre-determined date. The contract locks in the exchange rate at the time of the deal and reduces uncertainty regarding future cash flows. The contract is binding and hence if the exchange rate movement is unfavorable, it can cause significant loss as well. The settlement dates on open forward contracts are in accordance with the loan installment repayment dates.

As at 31 December 2009, the Group has hedged approximately 52% of its dollar liabilities pertaining to its aircraft, engine and simulator loans into Malaysian Ringgit ("MYR") by using long dated foreign exchange forward contracts.

What value it creates for Airasia?

With forward foreign exchange contracts AirAsia not just shields itself from unfavorable foreign exchange rate movements but also get windfall gains if the Malaysian Ringgit appreciates against US and Euro. In 2009, the Malaysian Ringgit has strengthened against the US Dollar and this has resulted in a translation gain of RM124 million during the year. Table 7 shows the foreign currency hedged, exchange rate and resulting foreign exchange gain or loss.

Table 7: Currency exposure profile of Borrowings

Year	*2006 (RM'000)*	*2007 (RM'000)*	*2008 (RM'000)*	*2009 (RM'000)*
MYR	-	-	593,081	585,347
USD	1,052,636	3,697,671	5,865,631	6,972,039
Euro	-	-	147,847	50,522

***Source:** Annual reports of AirAsia*

Table 8: The currency hedging position for AirAsia, Ryanair and EasyJet for 2009

	AirAsia (Local currency: RM)	*Ryanair (Local currency: Euro)*	*EasyJet (Local currency:Sterling)*
USD	52%	85%	60%
EURO	_	_	40%

***Source:** Annual report of Airasia, Ryanair and EasyJet*

AIRCRAFT FINANCING

Since the airlines Industry is highly capital-intensive with high cost of acquiring aircrafts, airlines always juggle with the options to lease or buy aircrafts each having its own pros and cos. The choice is driven by tax write-off, gearing level, operational risks and flexibility considerations. Leasing is less capital intensive and less risky but put various operational restrictions on the airlines. Buying, on the other hand, increases gearing level, risk and requires huge initial capital outlay. AirAsia had placed orders of 175 A320 aircraft, with an option for 50 more to be delivered by 2014. It has taken delivery of 53 A320s, of which 43 are for Malaysia's operation, while eight and two are for Thai AirAsia and Indonesia AirAsia.

The terrorist attack of September 2001 caused return on investment to tank down for almost all airlines due to poor demand. Besides, the economic slowdown started in 2007 gave a tough time to airlines due to its cyclic nature. Not only the return on investment dropped significantly but the cost of capital also soared disproportionately due to global credit crunch. These developments weighted heavily on the balance sheet debt. Furthermore, it became really difficult for any airline to raise funds to finance aircraft purchasing at favorable terms. This requires airlines to maintain high cash reserves to part finance aircrafts and to meet any contingencies.

Generally airlines use a mix of financing approaches like debt financing (term loans), operating and financial leases, sale-and-lease back and cash generated from operations. Another widely used financing approach is the Export Credit Agency backed financing which offers credit, credit insurance and guarantee or both. The term loans are commercial loans with floating interest rates. The interest rates on these structured Export credit agency backed loans are slightly lower than offered by commercial loans by private banks as these credit agencies are Government backed and assumes a part of risks on behalf of borrowing airlines.

As of 2009, Airasia uses debt financing in the form of term loans, operating and finance lease (Ijarah) and commodity Murabaha finance to finance its existing and new fleet order of Airbus A320. Currently, Airasia owns only 3 Boeing 737 while all others are leased.

On the other hand, Ryannair finances most of its Boeing aircrafts through direct credits (financial support) from Export and Import bank of US, an Export credit agency from USA.

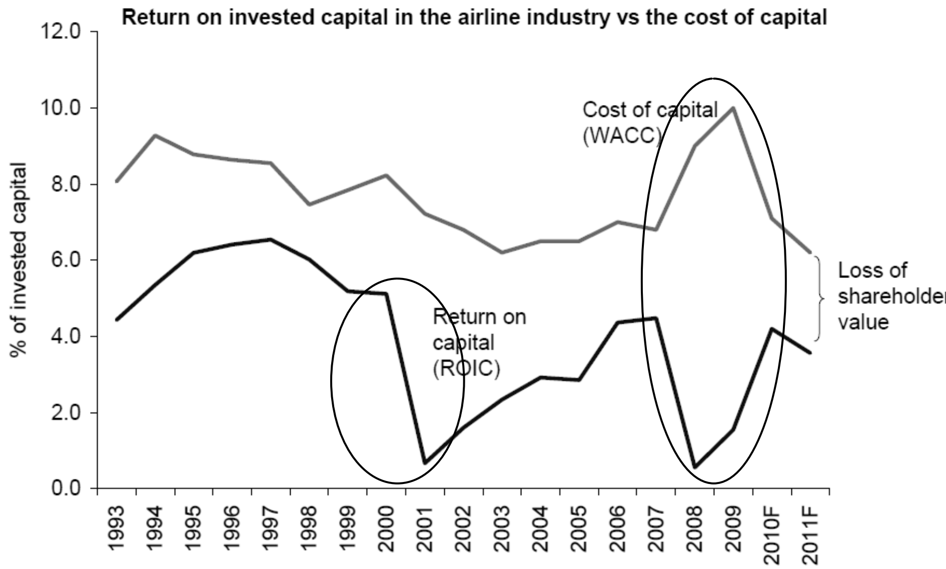
In 2009 Airasia secured financing of 7 A320-200 aircrafts through what is termed as one of the most innovative deal in Islamic finance and received the 'Best Islamic deal of 2009' award from 'The Asset'. It is Sharia-compliant French Single Investor Ijarah financing arranged by BNP Paribas and Natixis Transport Finance which is a kind of financing lease. In the same year, Airasia mandated Barclay's capital to finance 15 of its new Airbus A320-200 worth nearly US$700mil (RM2.5bil) which was guaranteed by the export

Table 9: Value creation through foreign currency hedge

	2006 (RM'000)	*2007 (RM'000)*	*2008 (RM'000)*	*2009 (RM'000)*
Hedged position (in USD)	147,440	3,335,716	4,179,010	4,467,600
Hedged Exchange Rate (RM/USD)	3.70	3.000-3.369	3.000-3.369	3.000-3.369
Market Exchange rate *	3.643	3.397	3.360	3.481
FOREX Gain(G)/Loss(L)	RM2.0 million (L)	RM69.2 million(L)	RM 78.9 million(L)	RM124 million(G)

** The market exchange rate is calculated as average annual rate and may differ from the exchange rate at the time of loan repayment leading to anomaly.*

Source: *Annual reports of AirAsia*



***Source:** IATA*

Fig.2

credit agencies of UK, Germany and France. AirAsia still needs another RM13bil to fund *104 aircraft* orders it has placed to be delivered from 2010 to 2014.

Table 10: Fleet Composition by leased and owned for three low cost carriers

Aircrafts	*AirAsia*	*Ryanair*	*EasyJet*
Leased	81	41	74
Owned	3	140	107
Total	84	181	181

***Source:** Annual reports of AirAsia, Ryanair and EasyJet*

CONCLUSION

Almost all the airlines are faced with the same financial risks which are intrinsic to the industry and are beyond the control of airlines. Hedging is the most sought-after solution to mitigate these risks. Low cost carriers, in particular, depend on sound business and financial strategies to achieve cost leadership and therefore engage heavily in hedging against these macroeconomic risks. The recent volatility in fuel prices and foreign exchange rates have led the airlines to lock in prices to stabilize the otherwise fluctuating profitability and cash flows through cost containment. Though airlines offset a portion of their risk exposure, hedging does not provide complete immunity to the unfavorable economic developments. It may even prove contrary to the desired objectives of hedging when it is used as speculation rather than risk mitigation leading to

Table 11: Financing approach of Air Asia during various periods

Financing type	*Currency involved*	*2006 (RM'000)*	*2007 (RM'000)*	*2008 (RM'000)*	*2009 (RM'000)*
Term loans	RM/USD	1,052,636	3,303,254	4,947,068	5,937,371
Finance leases (Ijarah)	RM/USD	_	344,820	1,150,543	1,085,190
Commodity Murabaha	RM/USD	_	_	126,087	117,347

***Source:** Annual reports of AirAsia*

windfall gains or massive losses. AirAsia lost to a tune of RM 1,065 million in 2008 as hedging related losses.

Besides these financial risks, airlines face the challenge of financing aircraft acquisition which depends on the liquidity of the capital markets and to strike favorable terms of financing. Recently, the low cost airlines have been aggressive in expanding their routes and fleet with AirAsia ordering 175 Airbus A320-200 with an option of 50 to be delivered by 2014. The economic downturn makes it difficult for airlines to raise funds for aircraft financing given the tight global credit supply. This in turn, increases cost of borrowings especially those secured from commercial banks. Airasia uses a mix of term loans and Islamic finance leases (Ijarah and commodity Murabaha) to fund its new aircraft deliveries. AirAsia is yet to tap fully the benefits of Export Credit Agencies to secure better financing deals.

What has made the situation worse is the economic slowdown of 2007-09 which saw reduced global passenger traffic and revenue decline. According to IATA, loss estimate for the global airline industry in 2008 could be between $ 5 billion to $ 8.5 billion and revising its 2009 loss estimate from $ 2.5 billion to $ 4.7 billion. The industry performance depends on economic recovery provided fuel prices remain low and the airlines are optimistic about positive economic developments by the end of 2009 reversing loss-making trend.

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Perceptions of Corporate Boards about Standards of Corporate Governance in Thailand

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The aim in this study is to discover the nature and extent of corporate governance in listed companies in Thailand. This includes a consideration of theoretical underpinning for amendments made to the western models of corporate governance that have been implemented by Thai listed companies, and of the effect of corporate governance principles on financial information, including financial reports, used by stakeholders in Thai listed companies. The results in this study show that after the Asian financial crisis corporate governance in Thailand improved especially in enforcement and disclosure, and outside/independent directors and professional organisations are playing leading roles in that process. Better corporate governance has resulted from improved internal corporate governance mechanisms and enhanced accounting standards, information disclosure, and auditing standards. New and up-dated rules, new and revised laws, and increased regulation are in the forefront of improved corporate governance. Process-related activities like monitoring, supervising, enforcing, and higher awareness have increased. Moreover, corporate governance practices are now in the spotlight throughout the financial and investment markets.

INTRODUCTION

Globally, corporate governance has become a key focus in the international business agendas of not just corporations but also of governments and supranational authorities. Indeed, the World Bank sees the corporate governance agenda being anchored to our development agenda at a number of critical points: international financial stability; broadening access to capital; promoting efficiency; fighting corruption; and fastening the savings that will ultimately broaden welfare provision. The spectacular collapses of Enron, WorldCom, Tyco and Global Crossing in the United States of America (USA), HIH in Australia, Parmalat in Italy and APP in Asia were obviously key motivators for the heightened interest in corporate governance (Anandarajah, 2004).

In Asia, corporate governance has additionally gained greater distinction since the Asian financial crisis in 1997. Corporate governance is claimed, by a large number of authors who point to serious structural weaknesses in the financial markets and the lack of prudential controls, as having lead to the financial crisis (Alba, Clasessens a&nd Djankov, 1998; Keong, 2002; Claessens, Djankov & Lang, 2000). Many authors (Kaplan & Minton, 1994; Limpaphayom & Connelly, 2004; Iskander & Chamlou, 2000; Nam & Lum, 2005; Claessens, Djankov & Lang, 2000) also claim that better governance may result from improved internal corporate governance mechanisms and enhanced accounting, disclosure, and auditing standards. In addition, the results of several studies (Limpaphayom & Connelly, 2004; Nam & Lum, 2005) show that corporate governance benefits companies with respect to increased long-term investment and increased credibility.

The USA introduced the Sarbanes-Oxley Act in 2002 and made major changes to the New York

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Stock Exchange Listing Rules. In the United Kingdom (UK), the Combined Code underwent a review with the resultant Cadbury Report, Greenbury Report, Hampel Report, Higgs Reviews, and the Smith and Turnbull Report being introduced. Although, many of the initiatives in the USA and the UK were pushed for by the respective regulators, the initiatives in the Asian region were motivated by the combined efforts of the World Bank and the Organisation for Economic Co-operation and Development (OECD). In 1999, The OECD Principles, which have been accepted the world over, initially identified the following principles as the five key elements of a strong corporate governance framework: the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders in corporate governance, disclosure and transparency, and the responsibilities of the board of directors.

The OECD Principles have been a reference for corporate governance initiatives around the world. The new OECD Principles presented in April 2004 included a sixth key area of corporate governance. The Principles (OECD, 2004) now include: ensuring the basis for an effective corporate governance framework; the rights of shareholders; the equitable treatment of shareholders; the role of stakeholders in corporate governance; disclosure and transparency; and responsibilities of the board of directors.

Thailand has introduced codes of corporate governance which adopt the OECD Principles to varying degrees. Thailand, similar to many other Asian countries, had poor corporate governance systems which contributed to the financial crisis in 1997, as its banks, specialised financial institutions and corporations had previously been effectively protected from the operation of market discipline. Prior to the Asian financial crisis, Thai corporate governance practices were characterised by ineffective boards of directors, weak internal controls, unreliable financial reporting, inadequate protection of minority shareholder rights, lack of adequate disclosure, poor audits, and generally lacked enforcement to ensure regulatory compliance. Additionally, the dominance of family control over business operations was prevalent; Thai firms were generally held and managed by majority family interests.

The Thai Government has since introduced a reform strategy which focuses on streamlining institutional arrangements, enhancing the reliability of financial information and disclosure, improving corporate board oversight and effectiveness, and improving shareholder rights. It has also focused on improving the effectiveness of the legal and regulatory framework for the enforcement of laws and regulations related to public companies. In particular, the current Thai Government has given significant focus to good corporate governance – the 'Year 2002 Good Corporate Governance Campaign' being one example of this initiative. This focus came about not only as a result of international scandals but also following international investors' complaints that Thai publicly listed companies lacked transparency with respect to their business operations.

According to Hongcharu (2002) prior to 1997, the Stock Exchange of Thailand (SET) had realised the significance of corporate governance in developing its capital markets and commissioned Price Waterhouse Management Consultants Ltd to undertake the first survey of listed companies and others concerned with the capital market. The survey was undertaken in mid-1996. After the sudden flotation of the Thai currency, the baht, in July 1997, the lack of corporate governance was regarded as one of the most significant factors contributing to the collapse of banks and many finance companies in Thailand. Several laws were drafted and corporate governance practices were incorporated. The Thai Securities and Exchange Commission (SEC) and the SET cited four factors as their rationale to promote good corporate governance: fairness; transparency; accountability; responsibility. These four factors have been incorporated in most of the legal instruments supported by the government, the SEC and the SET.

A policy study on "Thailand's Corporate Financing and Governance Structures" was conducted by Alba, Clasessens and Djankov (1998) for the World Bank. Analysing financial statements of companies listed on the SET, they found five problems related to corporate governance: concentration of ownership, high level of diversification, weak market incentives, lack of protection for minority shareholders, and inadequate accounting standards and practices. These problems should decrease as a result of implementation of corporate governance by organisations in Thailand.

The current study investigates the relevance of corporate governance: to the Thai financial crisis in 1997; ownership structure; regulation; and disclosure requirements in listed companies in Thailand. This study also investigates the nature and extent of corporate governance principles, as applied in Thailand, adapted from western models of corporate governance. The overall aim in this study is to assess the impact of corporate governance on ownership structure, board structure and composition, directors' and officers' legal duties in listed companies in Thailand and to provide information that would be of use to listed companies in their attempts to improve corporate governance structures. This study also provides an analysis and understanding of the nature and extent of corporate governance principles as applied by listed companies in Thailand.

This study proceeds by an investigation of the following matters. Firstly, the nature and extent of corporate governance in Thai listed companies; the importance of alterations to western models of corporate governance mechanisms in Thailand; improvements in the financial reports of Thai companies resulting from the implementation of corporate governance; and the measures for strengthening corporate governance in Thailand.

LITERATURE REVIEW

Each of the matters to be investigated is briefly considered in this literature review. Expected research outcomes are developed in this section.

i) To discover the nature and extent of corporate governance in listed companies in Thailand

Thailand faced a financial crisis in 1997 and the crisis has been attributed to poor corporate governance. The criticisms of corporate governance in Thailand are mainly in respect of the high concentration of ownership, excessive government intervention, an under-developed capital market and a weak legal and regulatory framework for investor protection. Alba, Clasessens and Djankov (1998) indicate that bank, finance and securities companies were not sufficiently cautious about their lending. The Bank of Thailand (BOT) and the SET did not have corrective measures on financial performance; and furthermore, auditors did not announce real information about the financial performance of business. An objective in this study was to discover the nature and extent of corporate governance in Thailand. It was expected that corporate governance and regulation in Thailand would have improved since the financial crisis in 1997. It was also expected that despite some change, the ownership structure would still be in the hands of very few families.

ii) To examine the importance of alterations to western models of corporate governance mechanisms in Thailand

The SET and the Thai SEC have adopted several measures to improve the accountability of management to shareholders, to enhance transparency and disclosure, and to ensure fairness to all shareholders. They studied corporate governance practices in several developed markets and adopted the practices deemed suitable to the Thai culture. As a result, western models of corporate governance mechanisms may be applied in Thailand. Many researchers have suggested a mixture of corporate governance models is appropriate for developing countries such as Thailand (Alba, Clasessens & Djankov, 1998; Keong, 2002; Khan 2004). It was expected that alterations of western models of corporate governance mechanisms may be appropriate for Thailand.

iii) To investigate the improvements in financial reports of Thai companies resulting from the implementation of corporate governance

The results of several studies (Alba, Hernandez & Klingebiel, 1999; Limpaphayom & Connelly, 2004; Nam & Lum, 2005; Claessens, Djankov & Lang, 2000) indicate that corporate governance and disclosure systems were weak in Thailand prior to the financial crisis. In addition, the capital markets played a limited role in the governance of firms. It was expected that organisations such as the SET and SEC might drive Thai companies to accept the rules and implementation of corporate governance. It was also expected in this study that information disclosure and transparency in financial reports would have improved since the Thai financial crisis.

iv) To recommend a number of measures for strengthening corporate governance in Thailand

Alba, Clasessens and Djankov (1998) investigated issues on Thai corporate governance problems and concluded that the most important task in improving the structure of corporate financing and the framework for corporate governance was to change incentives by enhancing enterprise monitoring, improving disclosure and accounting practices, better enforcement of corporate governance rules, facilitating equity institutions, and strengthening institutions. Hence, in this study the appropriateness of these recommendations for strengthening corporate governance in Thailand are examined.

RESEARCH QUESTIONS

The purpose of this study is to investigate what occurs in the context of relatively little corporate governance regulation and a new demand for corporate governance stemming from the Asian financial crisis of 1997.

Proposition 1

According to Warr (1999), Thailand, like most economies based on private enterprise, has had serious company failures. Since 1997 many of these have been attributed to the financial crisis, but further investigation has shown that the underlying weaknesses of Thai corporate structures made them highly exposed to such crises. In this study, it was considered important to discover whether corporate governance has improved since the Asian financial crisis. Therefore, one of the objectives of this research is to discover the nature and extent of corporate governance in listed companies in Thailand. It was expected that corporate governance and regulation of rules in Thailand have improved since the Asian financial crisis. This objective generates Proposition 1.

There is a relationship between corporate governance and each of the Thai financial crisis, ownership structure, and regulation of listed companies in Thailand.

Proposition 2

On the grounds that Thailand is an Asian country with environmental characteristics such as culture and styles of business operation that differ from western countries, variables affecting the successful implementation of corporate governance in Thailand may not be the same as those in western countries. In addition, Letza et al., (2004) indicate that corporate governance is completely changeable and transformable and there is no permanent or universal principle which covers all societies, cultures and business situations. Although there are many corporate governance models, researchers have concluded that each governance system has its own weaknesses; no perfect system exists that can be applied to all countries.

Western style principles and models of corporate governance, developed by the World Bank, the International Monetary Fund (IMF) and the OECD have been proposed as preferred theoretical reporting models for Thailand. Therefore it is an objective in this study to extend the theory in this area to include information characteristics fundamental to the share ownership and familial control patterns that exist in the Thai context. This objective leads to Proposition 2.

There will be significant differences from western models of corporate governance mechanisms in listed companies in Thailand

Proposition 3

The Asian financial crisis has shown that the economy in Thailand was weak in the area of corporate governance. Alba, Clasessens and Djankov (1998) indicate that lack of transparency and the lack of solid information regarding financial transactions as a result of this structural feature may have been critical factors contributing to the Thai crisis. It was expected that the Thai Government, the SET, and the SEC might improve regulations related to information disclosure as part of its program to implement corporate governance. This expectation generates Proposition 3.

There will be significant improvement in information disclosure in financial reports of Thai companies resulting from the implementation of corporate governance.

Proposition 4

There were three different groups of individuals whose opinions and perceptions were considered important in this study, Chief Executive Officers (CEOs); executive directors; and outside/independent directors (audit committee). It was expected that each group would have different views about how to strengthen corporate governance in Thailand. This expectation leads to Proposition 4.

There will be significant differences in measures of responses from different groups for strengthening corporate governance in Thailand.

RESEARCH METHODS

This study will proceed in two distinct yet inter-linked stages. These are: (1) An extensive literature review; (2) Collection of data from a survey.

Stage 1: An extensive literature review

Numerous books and articles have explained corporate governance with respect to benefits, problems, implementation, success and satisfaction. This research commenced with a thorough international search of all pertinent literature for the reason that numerous international studies have investigated various aspects of the implementation of corporate governance whereas there are only a small number of studies of corporate governance in Thailand where corporate governance is a relatively new phenomenon. This stage of the research drew upon the knowledge base of materials from several disciplines to build the propositions of the research.

Stage 2: Collecting data from survey

In this study a survey of 453 listed companies in eight industries on various aspects of corporate governance in Thailand was conducted. The industries and the number of companies in each industry are as follows. Agro and Food industry (42); Consumer Products (37); Financial (66); Industrials (50); Property and Construction (80); Resources (18); Services (78); and Technology (43); Other (39).

As the population, comprising all companies listed on the SET that operate in the Bangkok region (453 companies), is very large, a mailed questionnaire survey (the 'questionnaire') was regarded as the appropriate method for gathering data and testing the research propositions (Ticehurst & Veal 1999; Sekaran 2000). Questionnaires, which were subjected to 'translate-retranslate', were sent to the CEO, the executive directors, and outside/independent directors (audit committee) responsible for the implementation of corporate governance within companies. Approval of the questionnaire was obtained from the Human Research Ethics Committee of Victoria University.

DATA ANALYSIS

The quantitative data analysis, together with the testing of propositions relating to cultural effects and performance such as family ownership, involved the use of the Statistical Package for the Social Sciences (SPSS) program for statistical analysis. Tests included descriptive and inferential statistical analysis: frequencies, means, standard deviations of attributes of good corporate governance, board of directors, audit committee, disclosure, and shareholder rights, with measures of performance.

Frequency distributions were suitable for analysis of data such as the personal information, the classification of industry groups, the company size, the ownership structure, decision making in the company, board size, board structure, independence of board members, board meetings, board qualification and independence of board members, audit committee size, audit committee structure, audit committee meetings, qualification, position and truly independent. In addition, information disclosure, language available, shareholder rules, shareholder meetings, function of the board of directors, background information, ethics and governance improvement, incentives for investment, initiation of corporate governance, tasks for better corporate governance, level of corporate governance, and benefits of corporate governance, are also tested using frequency distributions.

Other statistical measures, such as means and standard deviations, are used in analysing data such as the ownership structure, decision-making in the company, function of the board of directors, information and disclosure for shareholders and procedure for shareholder meetings, function of the board of directors, effectiveness of the board, rules to improve corporate governance, enhancing corporate governance in Thailand, better performance of independent directors, and the impact of the implementation of corporate governance in Thailand.

RESULTS AND DISCUSSION

The questionnaires in this study were addressed to the Chief Executive Officer (CEO), executive directors, and outside/independent directors of each company. This resulted in 1,359 questionnaires being sent and 160 usable questionnaires being returned. Not all questions on the 160 usable responses were completed by the respondents: the total number of respondents is indicated in each of tables 2, 4, 8 and 9 is 136, 135, 135 and 134 respectively. Of the 453 companies, 101 returned questionnaires; 62 companies each returned one questionnaire, 19 companies each returned two questionnaires and 20 companies each returned three complete questionnaires.

Table 1: Response rate

	Number of questionnaires	*Number of companies*
Questionnaires	1359	453
Unanswered	24	8
Net questionnaires	1335	445
Usable responses	160	101
Response rate	11.98%	22.69%

Table 2: Broad demographic characteristics of respondents

Charact-eristics	*Categories*	*Fre-quency*	*Percent-age*
Gender	Male	119	87.5
	Female	17	12.5
	Total	136	100
Age	20-30 years	2	1.4
	31-40	13	9.6
	41-50	56	41.2
	51-60	39	28.7
	Over 60 years	26	19.1
	Total	136	100
Education	Less than a degree	1	0.8
	Degree	35	25.7
	Master's degree	93	68.4
	Doctorate	7	5.1
	Total	136	100
Country of graduation	Thailand	72	52.9
	Overseas	64	47.1
	Total	136	100

Many (64%) of the respondents serve on more than one board of directors, and 36% of the respondents serve on only one board. The respondents that serve on only one board are all CEOs. 15 (13%) respondents serve on more than five boards. The maximum number of boards on which a respondent serves is thirteen. The majority of respondents serve on between 1-5 boards (87%). Nam (2004) predicted that if a corporate officer serves on more than one board conflict of interest may occur that could lead to poor corporate governance. Furthermore Nam and Lum (2005) show that in Thailand, bank directors are not permitted to serve in more than three business groups. The fact that some directors (13%) are still serving on a large number of boards has negative corporate governance implications. These results are shown in Table 3.

Table 3: Service on other boards of directors

Number of other Boards	*Frequency*	*Percentage*	*Ranging*
1	41	36	1
2	17	15	2
3	16	14	4=
4	9	8	5
5	16	14	4=
6	4	3	7
7	1	1	11=
8	5	4	6
10	3	3	8
11	1	1	11=
13	1	1	11=

In this study, the number of employees, net assets, market capitalisation and net profit were variables chosen to measure the size of companies. The broad ranges chosen for the number of employees were from less than 500 to more than 2,000 (SET, 2003; Chongruksut, 2002). Most respondent companies have less than 1,000 employees. These respondent companies are likely to be family controlled companies as these tend to be small rather than large. Claessens, Djankov and Lang (2000) also found that ownership of many Thai public companies is family dominated. Table 4 shows that 45% of the responding companies have less than 500 employees (small size), and 24% have between 501-1,000 employees (medium size).

Table 4: Number of employees

Number of employees	*Frequency*	*Percentage*
Less than 500 (small size)	60	45
501-1,000 (medium size)	33	24
1,001-1500 (medium size)	11	8
1,501-2,000 (large size)	11	8
More than 2,000 (large size)	20	15
Total	135	100

Table 5 shows the ownership structure of the companies. Multiple responses were received from some companies. 74 of 131 responding companies are partially owned, but not controlled by foreign investors. 63 of 129 responding companies are the family-based business groups and 38 of 130 of the respondent companies are single companies. As expected, companies in Thailand are characterised as having highly concentrated ownership structures. La Porta, Lopez de-Silanes and Shleifer

Table 5: Ownership structure

Ownership structure	*Yes*		*No*		*Total*	
	No.	*%*	*No.*	*%*	*No.*	*%*
Single company	38	29	92	71	130	100
Holding company family-based business group	44	34	85	66	129	100
Subsidiary of a family-based business group	19	15	110	85	129	100
Partially owned, and controlled by the government	2	2	127	98	129	100
Partially owned, but not controlled by the government	14	11	115	89	129	100
Partially owned, and controlled by foreigners	12	9	118	91	130	100
Partially owned, but not controlled by foreign investor	74	56	57	44	131	100

Table 6: Composition of the board

Directors on Board	*Yes*		*No*		*Total*	
	No.	*%*	*No.*	*%*	*No.*	*%*
Accountant/Lawyer	127	94	9	6	136	100
Representative of a financial institution	48	35	88	65	136	100
Representative of a customer company	9	7	126	93	135	100
Representative of a labor union	0	0	136	100	136	100
Representative or member of controlling shareholder's family	88	65	48	35	136	100
Representative of a supplier	8	6	128	94	136	100
Government appointee-member of parliament	0	0	135	100	135	100
Government appointee-public service	22	16	112	84	134	100
Government appointee-other	12	9	124	91	136	100

Table 7: Disclosure and transparency (%)

Information disclosed	*Web Site*		*Annual Report*		*No Disclosure*	
	Yes	*No*	*Yes*	*No*	*Yes*	*No*
Semi-annual financial statements	79.8	20.2	24.0	76.0	7.8	92.2
Quarterly financial statements	84.6	15.4	21.5	78.5	4.6	95.4
Consolidated financial statements	69.5	30.5	80.9	19.1	2.3	97.7
Major share ownership and voting rights	47.4	52.6	88.0	12.0	2.3	97.7
Self-dealing (related-party) transactions	43.5	56.5	90.1	9.9	4.6	95.4
Names of board members	63.7	36.3	94.1	5.9	0	100.0
Directors selling or buying of shares in the company	45.1	54.9	56.6	43.4	18.0	82.0
Resume/background of directors	40.7	59.3	91.9	8.1	2.2	97.8
Remuneration of directors	29.6	70.4	93.3	6.7	4.4	95.6
Fees paid to external auditors, advisors, and related parties	26.9	73.1	88.1	11.9	9.0	91.0
Major contingent liabilities such as cross-guarantees of debt	27.9	72.1	86.0	14.0	10.1	89.9
Policies on risk management and the company objectives	23.7	76.3	95.6	4.4	3.7	96.3
Significant changes in ownership	27.6	72.4	69.8	30.2	21.6	78.4
Material issues regarding employees and stakeholders	22.5	77.5	79.1	20.9	16.3	83.7
Governance structures and policies	33.1	66.9	91.7	8.3	6.0	94.0
Extent to which corporate governance practices conform to established standards	27.5	72.5	91.6	8.4	7.6	92.4

(1999) noted that in most East Asian countries corporate control is enhanced through pyramidal structures and cross-holdings among family-controlled firms. Family-based business groups are likely to be more reluctant to implement corporate governance structures and processes than companies that have sizeable foreign shareholdings.

The board often included members of controlling shareholder's families (88 of 136) (65%). Bertrand et al. (2004) believe that the pressure of family members is likely to have a negative impact on the implementation of corporate governance, and is likely to cause conflicts of interest. None of the boards of directors has members representing labour unions or government appointed members of parliament. These results are shown in Table 6.

The data in Table 7 show that most companies disclose all major corporate information in their annual report. They also provide semi-annual and quarterly financial statements. Financial statement information is disclosed on the main company web site. One of the six OECD Principles (OECD, 2004) is the requirement to provide adequate disclosure, and Thai companies appear to have embraced this Western-style guideline.

Table 8 shows the respondents' beliefs in relation to improvement in the standard of business ethics and corporate governance in Thailand over the last five years. Most respondents agreed that overall, corporate governance in Thailand had improved (97%). 72% of respondents believed it had improved considerably, and only 25% of respondents believed that, generally, little improvement had occurred. These results support the view of Limpaphayom and Connelly (2004) who said that corporate governance in Thailand has improved since the financial crisis.

Table 8: The standard of business ethics and corporate governance

	Frequency	*Percentage*
Improved considerably	98	72
Improved a little	34	25
Remained largely unchanged	1	1
Deteriorated slightly	1	1
Deteriorated a lot	0	0
Unsure	1	1
Total	135	100

The majority of respondents (87%) show that the state of the corporate governance regime in Thailand provides an incentive for foreign investment in Thailand. National Corporate Governance Committee (NCGC) (2005) stated that corporate governance ensures transparency and stakeholders are less likely to take risks with an organisation without a good corporate governance structure. Iskander and Chamlou (2000) argued that improved transparency and good corporate governance structures are likely to provide an inducement to foreign investors. These results, shown in Table 9, provide further general indicators that corporate governance in Thailand is both improving, and seen to be improving.

The findings drawn from the analysis of questionnaire data highlight the factors that determine corporate governance in Thailand. The key findings included that most respondents' backgrounds are banker/ financiers and accountants (97%) indicating their business and educational background is likely to have been a positive factor in the implementation of corporate governance by Thai companies. The ownership structures of respondent companies, indicates substantial levels of partial ownership, but not control, by foreigners (56%). If the respondent companies are a family-based business group most of the respondents believe that the owners' family negotiate fairly with top management and share a common vision about the company.

Table 9: Improved corporate governance is an incentive for investment

	Frequency	*Percentage*
Yes	117	87
No	1	1
Unsure	16	12
Total	134	100

Regarding the roles of CEOs and board, the results show that most important decisions are made by the board of directors (60%). The size of the board of directors is large (76% have between 8-12 members, and 18% more than 12 members, maximum is 18). Most boards have relatively few independent directors (56% have 3 independent), which may have adverse implications for the successful implementation of a good corporate governance structure. The main function of the board appears to be to review financial reports and ensure the integrity of the company financial report.

Most respondents agreed (97%) that corporate governance in Thailand had improved and also indicated that the SET (81%) and the SEC (86%) are the most important organisations for the promotion and improvement of corporate governance in Thailand. Finally, the greatest impact of the implementation of corporate governance in Thailand was seen in improved transparency and disclosure, followed by support from top management and truly independent directors, as well as the introduction of appropriate checks and balances.

CONCLUSIONS AND SUMMARY

In 1997, the Asian financial crisis occurred. This crisis led to the collapse of many companies and to the introduction of corporate governance structures in countries like Thailand. As a result, interest in corporate governance increased in Thailand. Government, business, institutional investors, professional advisers, consultants and academics have all taken a closer interest in issues like corporate ownership structure, board structure and composition, directors' and officers' legal duties and chief executive officer's remuneration. Good corporate governance in listed companies is likely to increase confidence and trust in the Thai capital market.

One of the most important characteristics of the corporate sector in Thailand is the feature of family control over business operations. At the time of the 1997 financial crisis, Thai public companies were characterised by their large family ownership with family members and related-party shareholders as the controlling shareholders. Lack of transparency and the lack of solid information regarding financial transactions as a result of this structural feature may have been critical factors contributing to the Thai financial crisis (Alba, Claessens & Djankov, 1998).

It was expected that when a company was in a reactionary economy, it would learn to improve corporate governance. Proposition 1 examined the relationship between corporate governance and each of the following variables: the Thai financial crisis; ownership structure; and, regulation in listed companies in Thailand. The results confirmed that after the Thai financial crisis corporate governance in Thailand improved. The regulation and rules governing listed companies in Thailand were improved by the Stock Exchange of Thailand (SET) and the Thai Securities and Exchange Commission (SEC). The major changes and reform efforts have been in the area of process especially in enforcement and disclosure. New and updated rules, new and revised laws, and increased regulatory oversight have been the outcome of the push for increased corporate governance.

Corporate governance in Thailand is currently at a crossroads. Much of the relevant literature claims huge benefits from the implementation of corporate governance. Thus, corporate governance has received substantial interest from Thai companies and regulators and is of concern to both the public sector and the private sector.

The international corporate governance system assumes a separation of ownership and control, a questionable assumption in the Thai context. Since the Asian financial crisis, all listed companies, especially family-owned businesses, have made generally poor information disclosure about related-parties transactions. This could be improved as part of the move to promote and enhance corporate governance. Family owners should be more interested in working with outside shareholders to maximise firm value.

Consideration should be given to the use of outside directors, a tool normally used in western cultures. The purpose is that outside directors can help monitor management and family owners. However, Thai people are non-confrontational and group-orientated. Many boards become so-called "rubber stamp" boards, not because directors are unaware or uninterested in their roles and duties but because they are being considerate and respectful of the owner's decisions (Limpaphayom et al. 2004). Further, there is a limited number of individuals qualified to serve as outside directors and fewer still that can be considered truly independent. The use of outside board members can be a very powerful tool under a corporate governance system that recognises institutional and cultural differences.

Cultural attitude is important to identify the root cause for legal tardiness in Asian countries where legal practices are considered a foreign element that is not part of Asian culture. Actual implementation of legal processes is mostly avoided and settlement outside the court is more popular. Corruption is another factor that does not ensure justice for those who need or warrant it. However, corruption has a long history in Thai culture, stretching over many centuries. The Thai aversion to confrontation inherent in any adversarial legal system means that parties prefer amicable settlement rather than litigation.

After the Asian financial crisis, the influence of institutional investors and of investor activists has grown steadily. Institutional investors are taking a more active role and exercising their voting rights more frequently. The results show that all respondent companies provided adequate and timely information.

The roles and effectiveness of the board of directors of Thai listed companies have responded to the drive by regulators to develop more independent boards. The results in this study show that all companies have independent directors on their boards, with a large majority of respondent companies having three or more independent directors on the board. This is partly a result of the SET requirement that all listed firms must have an audit committee consisting of at least three independent directors. The results also show that Thai boards are active, engaged, and take their responsibilities very seriously.

After the financial crisis the Thai Constitution was amended to include provisions to prevent conflicts of interest between elected officials and big business, including an unprecedented bar on politicians holding shares in companies. Such provisions were seen as necessary to avoid repetition of the corruption in previous governments that greatly contributed to Thailand's 1997 financial collapse. However, in a significant oversight the Thai Constitution does not bar family members of politicians from owning shares in companies that do business with the government (Shawn, 2003).

Stakeholder theory is that companies are so large and their impact on society so pervasive that they should discharge accountability to many more sectors than solely their shareholders (Solomon & Solomon, 2004). If corporate governance in Thailand is to improve, outside directors and professional societies will be expected to play the leading roles, supplemented by efforts of financial supervisory agencies and the judiciary. Better governance would also result from improved internal corporate governance mechanisms and enhanced accounting, disclosure, and auditing standards (Limpaphayom & Connelly 2004).

As a summary, in this study corporate governance in Thailand is regarded as improving, and outside directors and professional organisations are identified as playing leading roles. Better governance has resulted from improved internal corporate governance mechanisms and enhanced accounting, disclosure, and auditing standards.

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A Study of Human Resource Issues in Dubai

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The study examines the human resource issues of concern for managers in Dubai. The data collected from 146 managers working in Dubai at different levels in different organisations form the basis of the study. The study concludes that motivating employees, cost control, ethics in work place, recruitment, performance management, employee selection, training and development, human resource planning, employee benefits and services, and managing change are the top ten HR issues for managers in Dubai. Though t-test results show some interesting differences among the managers working in different types of organisations at different levels, in HR and non-HR departments, it seems that there are some common issues of concern such as motivating employees, cost control, and ethics in workplace for all managers

INTRODUCTION

Human resource Management (HRM) is a strategic approach to managing employment relations which emphasizes that leveraging people's capabilities is critical to achieve sustainable competitive advantage, this being achieved through a distinctive set of integrated employment policies, programmes and practices (Bratton, 2003). The business challenges such as competing through sustainability, competing through globalization and competing through technology increase the importance of HRM practices (Noe, Hollenbeck, Gerhart and Wright; 2007). As HRM operates in a wider economic, technological, political, and social context, this creates so many issues and challenges for managing people in an organisational setting. Therefore on a day-to-day basis, managers focus on specific challenges and issues that pertain to human resource (Snell &, Bohlander 2007). This paper makes an attempt to find out the issues and challenges faced by human resource management in Dubai.

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REVIEW OF LITERATURE AND RESEARCH

According to a survey conducted by Bureau of National Affairs in 1991, the five most frequently cited HR issues (chosen by at least 20 % of the respondents) are, in order: training and development; employee benefits; recruiting, selection, and placement; compensation administration; and employee/ labor relations. Kermske (1998) identifies workplace flexibility, global business, work and society, workforce development, the definition of jobs, and the strategic role of HR are the six major HR issues. As per the study conducted by Schoonover (1998) development of business partnership, improved integration across functional, business and global boundaries, accomplishment of business objectives in a challenging operating environment, development of competent HR professionals, and management of on-going and rapidly evolving change as the key HR challenges. Using a qualitative methodology Khatri and Budhwar (2002) identify five strategic HRM issues. Two of these are related to the central organisational-level constructs of structure and culture. The other three pertain to HR strategy, HR competencies and HR outsourcing

Torrington, Hall and Taylor (2002) point out that current issues in HRM include becoming more flexible and place employment relationship in a different psychological setting; striking a balance between human resources strategies which operate globally and human resource policies which vary from country to country; thinking about change processes and management of people in technologically specialized roles; conforming with the law that reduced flexibility and increased costs; and bringing equity and justice

The study conducted by Giannantonio and Hurley (2002) has rated 41 issues in the order of importance. The study reveals that managing change, job satisfaction, loyalty and commitment, performance/ productivity, skill shortages, raising health care costs, turnover, encouraging innovation and Strategic HRM are the main nine HR issues of concern for HR managers. The ten HR issues that are of least concern for HR managers are: age discrimination, outsourcing HR services, telecommuting, internet abuse, global competition, downsizing, elder care, reverse discrimination, immigrant patterns and international assignments.

Bennington and Habir (2003) indicate that equal opportunity policy and practice (e.g. forced labour and child labour, gender, ethnicity, and religion, employment of the disabled and older workers), recruitment, selection and retention, training, compensation, performance management, and retirement are the issues in core HR functions in Indonesia. Given the diversity that exists among the countries of Asia and Southeast Asia, Burton, Butler and Mowday (2003) believe that there are several macro HRM challenges and opportunities such as economic recession and political stability, the changing role of women, and the impact of religion in this region.

Gomez-Mejia, Balkin, and Cardy (2004) classify the key challenges of HRM into three categories such as environmental challenges, organisational challenges and individual challenges. Rapid change, rise in the internet, workforce diversity, legal framework, evolving work and family roles, skill shortage and the rise of service sector are the challenges that emerge from environment in which HRM operates. Competitive position of the organisation, cost and quality concerns or distinctive capabilities of the organisation, decentralisation, downsizing, organisational restructuring, self-managed work teams, growth of small business, organisational culture, technology and outsourcing are the challenges of HRM within the context of the organisation. Matching people and organisations, ethics and social responsibility, productivity, empowerment, brain drain and job insecurity are the individual challenges to be addressed by HR. According to Fisher, Schoenfeldt, and Shaw (2006) the current and future challenge of HRM is to integrate programmes involving human resources with strategic organisational objectives. As reported by Snell and Bohlander (2007) the competitive challenges HR is facing for the past decade include going global, embracing new technology, managing change, managing talent or human capital, responding to market and containing costs. Banfield and Kay (2008) mention that the most common challenges of HRM are motivating employees; understanding employee wants and identifying the best way to reward them; recruiting and retaining them; getting workers to be more flexible and delivering higher levels of discretionary effort; balancing between treating workers fairly and ensuring organisational interests; and reducing or eliminating the causes of conflict and building loyal workforce.

THE PRESENT STUDY

The Objective and the Setting

The objective of the study is to find out the managers' perceptions on HRM issues and challenges. The setting of the study is Dubai. This country has long been recognized as the leading regional trading hub of the Middle East (Sheikh Mohammed Bin Rashid Al Maktoum, 2001). Enjoying a political culture that allows for openness and embracing market solutions as a way to thinking beyond an oil-based economy, Dubai, despite not being a democratic city-state, has been able to establish itself as a steadily growing economic powerhouse - one that is both modern and relatively stable (Eric Lee 2005). Trading, manufacturing, tourism, banking, insurance, transport, storage, communication, real estate, government service, construction, food, tourism etc. are non-oil business activities in Dubai. One can find diverse workforce in business organizations in Dubai because in addition to its native population, Dubai is inhabited by a mixture of Arab nationals as well as Asians, Europeans, etc.

The Instrument Design

The review of literature and research earlier conducted on HR issues and challenges generated a list of HR issues and challenges. Face to face discussions were conducted with some of the managers working in Dubai on the items of HR issues. Considering the outcome of the discussions, the list of items to be incorporated in the questionnaire was finalized. The questionnaire constructed with two sections. Section one consisted of 41 items relating to HR issues and challenges. (e.g., absenteeism, balancing and work and family career plateauing, changing attitudes toward work life, downsizing, employee quitting). The second section of the questionnaire contained the questions relating to the respondent's details such as nature of business of the organisation in which the respondent works, functional background of the respondent, level of management of the respondent and number of employees working in the organisation.

Sample

The questionnaire was distributed among managers working in different organisations at different levels in Dubai. 146 usable filled in questionnaires were received. Table 1 shows the background information of the respondents. 48.6% of the respondents represent service sector such as banking, insurance, hospitality, retail, real estate, airlines, travel and tourism, and trading. 30.1% of them represent manufacturing sector, which includes fast moving consumer goods companies, power, processing, and engineering and construction companies. The remaining 21.2% of the respondents represent information technology companies. With regard to functional areas, an overwhelming majority (80.8%) of the respondents are non-HR mangers. Though the respondents are at different levels of management in their respective organisations, a majority (61.6%) of them are at middle level management cadre. With respect to headcount in their organisations, a majority (59.6%) represent large organisations which employ more than 500 employees whereas the remaining respondents represent small organisations which employ less than 500 personnel.

Table 1: Background Information of the Respondents

Sl. No	*Items*	*Number of Respondents (%)*
1	***Nature of Business***	
	Manufacturing	44 (30.1)
	Service	71 (48.6)
	IT	31 (21.2)
2	***Category***	
	Non-HR Managers	118 (80.8)
	HR Managers	28 (19.2)
3	***Level of Management***	
	Lower Management	9 (6.2)
	Middle Management	90 (61.6)
	Senior Management	47 (32.2)
4	***Company Size (Headcount)***	
	Less than 500 Employees	59 (40.4)
	More than 500 Employees	87 (59.6)
	N	**146**

Source: Primary Data

Methods of Data Analysis

The methods of analysis included calculating mean scores, and standard deviation (S.D) for each item in the list of HR issues and challenges. Calculation of grand mean is also carried out. Then items were divided into two categories, that is, items more than one S.D. above the grand mean were considered as the most important for the respondents and those items which were more than one S.D. below the grand mean were considered as least important. Nature of business, headcount of the organisations, level of management, and functional area (non-HR and HR) were considered as control variables. The data were divided and t-tests were conducted. At nature of business level, the data was compared for manufacturing, service and IT organisations. At functional level, data of non-HR managers and HR managers were compared. At management level, comparison was between junior, middle and upper management cadre of respective respondents. At organisational level, data of small organisations and large organisations were compared.

RESULTS AND ANALYSIS

The respondents were requested to indicate their level of concern for the HR issues based on their experience in their respective organisations on a four point scale from one to four, with one being no concern and four being major concern. Table 2 shows the mean scores and standard deviations for all HR issues dividing them into one S. D. above and below the grand mean. Though there are more than 15 issues that are above the grand mean the first 15 items were found to be more significant based on the t-test results.

Motivating employees, cost control, ethics in work place, recruitment, performance management, employee selection, training and development, human resource planning, employee benefits and services, managing change, employee relations, managing highly talented personnel, handling employee grievances, discipline management, and changing attitudes of the employees are the most important issues of concern for managers working in Dubai. It is interesting to note that these findings are similar to observations made by Banfield and Kay (2008) on HR issues. The reasons for these findings in Dubai would be that most of the employees who work in Dubai are basically expatriates. They might prefer to make money and go back to their parent countries. They might not expect a great career in Dubai. Subsequently their motivation to work and effective performance with cost consciousness might not be that great. Recruitment and selection could be the issues of concerns because of a combination of reasons. The expatriates who prefer to work in Dubai are mostly from Asian region. Now-a-days countries like India are growing economically and offer decent salaries for qualified workers in the country. Subsequently, getting expatriates to fill the vacancies available might be a challenge in Dubai. Another reason could be skill shortage in the region.

The study finds low scores for the issues such as international assignments, and women in workforce, outsourcing HR services, contingent/temporary workforce, mergers and acquisitions, sexual harassment, internet abuse, flexible working hours/workdays, and employee privacy. International assignment is also not an issue of concern because the executives who are deployed for these types of assignments have enough exposure internationally. Interestingly this finding of the study is similar to the study conducted by Giannantonio and Hurley (2002). The respondent managers of their study also have rated the international assignments as the lowest level of issue of concern for them. Women in workforce might not be an issue because of the native culture of Dubai. Contingent/temporary workforce might not be a major issue because getting people to fill unskilled/ semi skilled type of jobs is relatively easy. The law of Dubai is stringent that deal with internet abuse, and sexual harassment.

Comparative Analysis

Some interesting similarities and differences have emerged from the data based on the means scores and t-test results of control variables such as nature of business, level of management, functional areas - HR and non-HR, and size of the organisations on HR issues (Appendix one shows the t-test results for control variable on HR issues).

Nature of Business

A comparative analysis of HR issues in manufacturing, service and IT organisations reflects some interesting similarities and differences in the organisation based on the nature of business they carry out. Table 3 indicates that

Table 2: HR Issues

1 S D above and below the grand mean (grand mean = 2.60 S D = 0.98)			
	1 S D above mean	*Mean*	*SD*
1	Motivating employees	3.25	0.76
2	Cost control	3.01	0.86
3	Ethics in workplace	3.01	0.95
4	Recruitment	2.99	0.85
5	Performance management	2.96	0.88
6	Selection of employees	2.94	0.89
7	Training and development	2.91	0.80
8	Human resource planning	2.90	0.92
9	Employee benefits and services	2.88	0.85
10	Managing change	2.88	0.86
11	Employee relations	2.88	0.90
12	Managing high talented personnel	2.88	0.92
13	Handling employee grievance	2.82	0.88
14	Discipline management	2.80	0.94
15	Changing attitudes toward work	2.78	0.91
16	Career plateauing	2.75	0.88
17	Measuring HR contribution	2.71	0.87
18	Balancing work and family programmes	2.71	0.91
19	Pay-for-performance schemes	2.70	0.96
20	Strategic HRM	2.69	0.88
21	Deployment/redeployment of employees	2.68	0.90
22	Downsizing	2.66	0.98
23	Salary fixation	2.66	0.87
24	Managing diversity	2.63	0.92
25	Employee quits	2.62	0.93
26	Legal Compliances	2.62	1.10
	1 S D below mean		
1	Changes in information technology	2.57	0.97
2	Global markets and competition	2.54	0.92
3	Absenteeism	2.49	1.13
4	Cost and benefit comparisons of HR programmes	2.49	0.91
5	Changing profile of workforce	2.41	0.79
6	Health care programmes for employees	2.33	0.98
7	Employee privacy	2.29	0.92
8	Flexible working hours/workdays	2.26	0.95
9	Internet abuse	2.24	0.93
10	Sexual harassment	2.21	1.24
11	Mergers and acquisitions	2.18	1.04
12	Contingent/temporary workforce	2.15	0.88
13	Outsourcing HR services	2.08	0.97
14	Women in workforce	2.08	0.90
15	International Assignments	2.06	0.91

Source: *Primary data-Computed value*

motivating employees is the top issue of concern for manufacturing and service organisations whereas ethics in workplace is the top issue for IT sector. With respect to second top issue, these three type organisations have three different issues. Motivating employees is the second top concern for managers in IT sector whereas cost control is the second top issue in manufacturing organisations. But performance management has received this position in service sector. Managing highly talented personnel is the top third issue of concern for managers in manufacturing sector whereas it is sixteenth issue of concern for managers in service sector and twelfth issue of

Table 3: HR Issues in different nature of organisations

Sl. No	*Manufacturing Sector*	*Service Sector*	*IT Sector*
1	Motivating employees	Motivating employees	Ethics in workplace
2	Cost control	Performance management	Motivating employees
3	Managing high talented personnel	Cost control	Selection of employees
4	Recruitment	Managing change	Training and development
5	Measuring HR contribution	Employee benefits and service	Employee relations
6	Performance management	Recruitment	Recruitment
7	Balancing work and family programme	Ethics in workplace	Handling of employee grievance
8	Strategic HRM	Discipline management	Human respu4ece planning
9	Ethics in workplace	Employee relations	Performance management
10	Selection of employees	Deployment and redeployment of employees	Employee benefits and service
11	Training and development	Human resource planning	Discipline management
12	Career plateauing	Selection of employees	Managing high talented personnel
13	Human resource planning	Handling employee grievance	Downsizing
14	Changing attitudes toward work	Changing attitudes toward work	Pay-for-performance schemes
15	Legal compliances	Training and development	Managing change

Source: Primary data

concern for IT sector managers. Recruitment is the fourth issue of concern for managers in manufacturing sector whereas it is the sixth issue of concern for managers in service sector and managers in IT sector. Another significant observation is that measuring HR contribution is the fifth issue of concern for managers in manufacturing organisations whereas it is in top thirty issues out of total forty one issues for managers in service sector and managers in IT sector. Balancing work and family programmes, and strategic HRM are among the top ten issues of concern for managers in manufacturing sector. But these two are among the first thirty issues of concern for managers in service and IT sectors.

Size of Organisation

The organisations which employ less than 500 personnel are considered as small organisations and the organisations with more than 500 people are considered as large organisations for the purpose of the study. Based on the size of the organisation, some interesting similarities and differences have emerged in this study. The top 15 issues of concern for the managers working in large and small companies are presented in Table 4. Interestingly, motivating employees is the top one issue of concern in both small and large organisations. Recruitment is the top second issue for managers in small companies whereas cost control is the top two issues for mangers in large organisations. With regard to top third issue, it is significant to note that ethics in workplace is the issue of concern for managers in both types of organisations. Performance management is the top fourth issue of concern for managers in small companies whereas managers in large organisations consider recruitment in this place. The fifth top issue of concern for managers in

Table 4: HR Issues in size-wise organization

Sl No	Small Organisations	Large Organisations
1	Motivating employees	Motivating employees
2	Recruitment	Cost control
3	Ethics in workplace	Ethics in workplace
4	Performance management	Recruitment
5	Employee relations	Managing high talented personnel
6	Selection of employees	Performance management
7	Cost control	Human resource planning
8	Training and development	Selection of employees
9	Managing change	Training and development
10	Changing attitudes toward work	Employee benefits and services
11	Employee benefits and services	Managing change
12	Human resource planning	Discipline management
13	Pay-for-performance schemes	Handling employee grievance
14	Handling employee grievance	Employee relations
15	Managing high talented personnel	Strategic HRM

Source: *Primary data*

small organisations is employee relations, whereas it is in fourteenth place as per the managers in large organisations. The fifth top issue of concern for managers in large organisations is managing highly talented personnel. However it is the fifteenth issue of concern for managers in small organisations.

Level of Management

It is assumed that the HR issues of concern may vary from one level of managers to another. Based on the experience and responsibilities managers handle, they are divided into three categories such as junior, middle and senior managers. The top 15 issues of concern for the managers based on their level of management are presented in Table 5. There are some significant differences in the perception of HR issues based on the level of management of the respondent managers. Motivating employees is the top one concern for middle and senior managers whereas it is in sixth position as per the perception of junior managers. Recruitment is the second top concern for junior managers and senior managers whereas it is eleventh issue of concern for middle managers. Employee selection is third top issue of concern for junior managers and fourth top issue for middle managers. But it is in the thirteenth position as an issue of concern for senior managers. Ethics in workplace is the third top concern of the middle and senior managers whereas it is the thirteenth concern for junior managers. Managing change has secured fourth place as an issue of concern for junior managers. But it is in seventh position as per the perception of the senior managers and it is in fourteenth position as a HR issue for middle managers.

Perception of HR and Non HR personal

The respondent managers represent various functional areas of management (e.g. Marketing, Finance, Operations, HR, and Projects). All managers other than HR managers are considered non-HR managers for the purpose of the study. The top 15 issues of concern for the non-HR managers and HR managers are presented in Table 6. Some interesting similarities and differences in the issues for HR and non-HR managers have emerged in this study. Motivating employees, ethics in workplace, cost control and performance

Table 5: HR Issues as Perceived by Different Levels of Managers

Sl No	*Junior managers*	*Middle managers*	*Senior Managers*
1	Performance management	Motivating employees	Motivating employees
2	Recruitment	Cost control	Recruitment
3	Selection of employees	Ethics in workplace	Ethics in workplace
4	Managing change	Selection of employees	Performance management
5	Managing high talented personnel	Performance management	Cost control
6	Motivating employees	Managing high talented personnel	Employee benefits and services
7	Pay-for-performance schemes	Training and development	Managing change
8	Employee relations	Employee relations	Training and development
9	Human resource planning	Handling employee grievance	Changing attitudes toward work
10	Managing diversity	Human resource planning	Human resource planning
11	Cost control	Recruitment	Career plateauing
12	Deployment/redeployment of employees	Employee benefits and services	Employee relations
13	Ethics in workplace	Discipline management	Selection of employees
14	Absenteeism	Managing change	Managing high talented personnel
15	Discipline management	Measuring HR contribution	Handling employee grievance

Source: Primary data

Table 6: HR and Non-HR managers Perception

Sl No	*Non-HR*	*HR*
1	Motivating employees	Ethics in workplace
2	Recruitment	Managing change
3	Cost control	Motivating employees
4	Ethics in workplace	Performance management
5	Selection of employees	Cost control
6	Performance management	Strategic HRM
7	Employee benefits and services	Training and development
8	Human resource planning	Employee relations
9	Training and development	Human resource planning
10	Employee relations	Managing high talented personnel
11	Managing high talented personnel	Discipline management
12	Handling employee grievance	Employee benefits and services
13	Changing attitudes toward work	Measuring HR contribution
14	Managing change	Recruitment
15	Discipline management	Employee quits

Source: Primary data

management are amongst first top six issues of concern for non-HR and HR managers. However recruitment is the second most important concern for non-HR managers whereas it is the fourteenth issue of concern for HR managers. Managing change is the second most important concern for HR managers whereas it is the fourteenth important issue of concern for non-managers.

CONCLUSION

The study leads to the conclusion that motivating employees, cost control, ethics in work place, recruitment, performance management, employee selection, training and development, human resource planning, employee benefits and services, and managing change are the top ten HR issues for managers in Dubai. However international assignments, women workforce and outsourcing HR services are not important issues of concerns for mangers in Dubai. Comparative analysis indicates that motivating employees is the top issue of concern for managers in manufacturing and service organisations whereas ethics in workplace is the top issue for managers in IT sector. A further comparison based on the size of organisations leads to the conclusion that motivating employees is the topmost concern for managers in both small and large companies. When the data is divided based on the level of management of managers, it is observed that junior managers have the topmost concern for performance management whereas middle and senior managers have concern for motivating employees. When compared between HR and non-HR managers motivating employees, ethics in workplace, cost control and performance management are amongst the first top six issues of concern for non-HR and HR managers. In the ultimate analysis, it can be stated that managers in Dubai need to equip themselves with the required knowledge, skills and abilities to address the pressing issues and challenges.

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APPENDIX

HR Issues t-test Results of control variables				***Nature of Business***			***Organisational Size***		***Level of Management***			***Functional Area***	
	HR Issues	***Mean***	***S D***	***Mfg***[1]	***Service***	***IT***[2]	***<500***	***>500***	***JM***[3]	***MM***[4]	***SM***[5]	***NHR***[6]	***HR***[7]
1	Absenteeism	2.49	1.13	2.34	2.55	2.58	2.73	2.33	2.89	2.57	2.28	2.43	2.75
2	Balancing work and family programmes	2.71	0.91	2.93	2.61	2.61	2.75	2.68	2.78	2.67	2.77	2.67	2.86
3	Career plateauing	2.75	0.88	2.91	2.63	2.81	2.80	2.72	2.33	2.70	2.94	2.74	2.82
4	Changing attitudes toward work	2.78	0.91	2.89	2.77	2.65	2.88	2.71	2.33	2.71	3.00	2.81	2.68
5	Changes in information technology	2.57	0.97	2.64	2.48	2.68	2.61	2.54	2.22	2.52	2.72	2.58	2.54
6	Changing profile of workforce	2.41	0.79	2.52	2.41	2.26	2.32	2.47	2.33	2.36	2.53	2.36	2.64
7	Contingent/temporary workforce	2.15	0.88	2.20	2.10	2.19	2.19	2.13	2.33	2.11	2.19	2.17	2.07
8	Cost and benefit comparisons of HR programmes	2.49	0.91	2.61	2.42	2.45	2.49	2.48	2.67	2.40	2.62	2.44	2.68
9	Cost control	3.01	0.86	3.27 *	2.93 *	2.84 **	2.93 **	3.07 *	3.00	3.00	3.04 *	2.97	3.18 *
10	Deployment/redeployment of employees	2.68	0.90	2.64	2.83	2.39	2.78	2.61	3.00	2.74	2.49	2.64	2.82
11	Discipline management	2.80	0.94	2.61	2.86	2.94 *	2.78	2.82	2.89	2.79	2.81	2.76	2.96 *
12	Downsizing	2.66	0.98	2.39	2.73	2.90 *	2.64	2.68	2.44	2.70	2.64	2.69	2.54
13	Employee benefits and services	2.88	0.85	2.77	2.90 *	3.00	2.88	2.89	2.78	2.81	3.04	2.86	2.96
14	Employee privacy	2.29	0.92	2.16	2.30	2.48	2.31	2.29	2.11	2.31	2.30	2.25	2.46
15	Employee quits	2.62	0.93	2.52	2.62	2.77	2.75	2.54	2.56	2.66	2.57	2.56	2.89
16	Employee relations	2.88	0.90	2.70	2.86	3.16	3.00 **	2.79	3.11 **	2.83	2.91 **	2.84	3.04 **

HR Issues t-test Results of control variables				***Nature of Business***			***Organi-sational Size***		***Level of Management***			***Func-tional Area***	
	HR Issues	***Mean***	***S D***	***Mfg[1]***	***Service***	***IT[2]***	***<500***	***>500***	***JM[3]***	***MM[4]***	***SM[5]***	***NHR[6]***	***HR[7]***
17	Ethics in workplace	3.01	0.95	2.91 *	2.89 *	3.45 *	3.03 *	3.00	3.00	2.98 **	3.09 *	2.96 **	3.25 *
18	Flexible working hours/workdays	2.26	0.95	2.18	2.27	2.35	2.32	2.22	2.11	2.31	2.19	2.17	2.64
19	Global markets and competition	2.54	0.92	2.52	2.52	2.61	2.44	2.61	2.33	2.52	2.62	2.53	2.61
20	Handling employee grievance	2.82	0.88	2.66	2.80	3.10 **	2.83	2.82	2.78	2.82	2.83	2.82	2.82
21	Health care programmes for employees	2.33	0.98	2.39 **	2.15	2.65	2.27	2.37	2.22	2.29	2.43	2.37	2.14
22	Human resource planning	2.90	0.92	2.91	2.82	3.06 *	2.88	2.91 *	3.11	2.82	3.00	2.86	3.04
23	Internet abuse	2.24	0.93	2.27	2.14	2.42	2.31	2.20	2.67	2.23	2.17	2.24	2.25
24	International Assignments	2.06	0.91	2.25	2.03	1.87	2.20	1.97	2.33	2.08	1.98	2.00	2.32
25	Legal Compliances	2.62	1.10	2.84	2.52	2.52	2.58	2.64	2.67	2.52	2.79	2.56	2.86
26	Managing change	2.88	0.86	2.84	2.92 *	2.87	2.90	2.87	3.22	2.77	3.04	2.81	3.21
27	Managing diversity	2.63	0.92	2.70	2.54	2.74	2.61	2.64	3.11	2.53	2.72	2.60	2.75
28	Managing high talented personnel	2.88	0.92	3.05 **	2.75	2.94 **	2.81	2.92 **	3.22 **	2.86	2.85	2.84	3.04 **
29	Measuring HR contribution	2.71	0.87	2.98 *	2.58	2.65	2.68	2.74	2.89	2.76	2.60	2.66	2.93
30	Mergers and acquisitions	2.18	1.04	2.23	2.13	2.23	2.20	2.16	2.56	2.06	2.34	2.17	2.21
31	Motivating employees	3.25	0.76	3.27 **	3.20 **	3.35 *	3.36	3.18	3.22	3.22	3.32	3.26	3.21
32	Outsourcing HR services	2.08	0.97	2.23	2.01	2.03	2.24	1.98	1.78	2.13	2.04	2.08	2.11
33	Pay-for-performance schemes	2.70	0.96	2.77	2.56	2.90	2.85	2.60	3.22	2.64	2.70	2.67	2.82
34	Performance management	2.96	0.88	2.93	2.94 *	3.03 *	3.02	2.92	3.33	2.87	3.06	2.90	3.21
35	Recruitment	2.99	0.85	3.02	2.90	3.16 **	3.08 **	2.93	3.33 **	2.82	3.26 **	3.01	2.93
36	Salary fixation	2.66	0.87	2.61	2.66	2.71	2.80	2.56	2.89	2.67	2.60	2.68	2.57
37	Selection of employees	2.94	0.89	2.91 *	2.80 *	3.29 *	3.00	2.90	3.33	2.91	2.91	2.95	2.89
38	Sexual harassment	2.21	1.24	2.25	2.10	2.39	2.34	2.11	2.67	2.20	2.13	2.16	2.39

HR Issues t-test Results of control variables				***Nature of Business***			***Organi-sational Size***		***Level of Management***			***Func-tional Area***	
	HR Issues	***Mean***	***S D***	***Mfg***[1]	***Service***	***IT***[2]	***<500***	***>500***	***JM***[3]	***MM***[4]	***SM***[5]	***NHR***[6]	***HR***[7]
39	Strategic HRM	2.69	0.88	2.93	2.56	2.65	2.58	2.77	2.44	2.72	2.68	2.58	3.18
40	Training and development	2.91	0.80	2.91 *	2.75	3.29 **	2.93 **	2.90 *	2.89	2.84	3.04 **	2.85	3.18 **
41	Women in workforce	2.08	0.90	2.00	2.06	2.26	2.03	2.11	2.44	1.96	2.26	2.04	2.25
	* p < .01,												
	** p < .05												

[1]. Manufacturing Sector; [2]. Information Technology; [3]. Junior Management; [4]. Middle Management; [5]. Senior Management; [6]. Non-HR Managers; [7]. HR Managers

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Innovative use of Technologies for Business Education: A Case Study

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This paper demonstrates how virtual technology can be creatively used to foster meaningful industry institute interactions and to tear down physical barriers to global learning opportunities. iPASS™ (Industry Professionals Assistance in Students' Success), the e-learning model developed by the first author of this paper, facilitates virtual engagement of industry professionals and enhances online learning, networking, and career opportunities for the students. It presents a way to optimize the constrained faculty resources available with most universities, too. It is shown how innovative instruction can be the best recruitment, marketing, and public relations tool for an institution. Preliminary feedback implies that implementation of the i-Pass™ at the University of Southern Mississippi's tourism management program resulted in a significant positive impact in terms of industry regulators' and leaders' confidence in the program. The paper also provides various tips on best online practices for virtual technology.

Keywords— *Tourism education, ICT, e-learning, industry-institute-interaction, 4Ps of learning, iPASS™, case study, and USM.*

INTRODUCTION

We live in a time wherein our interactions with the outside world are wholly or partly being mediated by a variety of technologies. Technologies, in particular information and communication technologies (ICT), have played a key role in constituting the fabric of our present day socio-cultural landscape. In the context of higher education, ICTs have opened up altogether novel approaches of learning, collectively called Technology Enabled Learning (TEL) or, more popularly, e-learning. E-learning originated as the confluence of different streams such as education, information and communication technologies, management, marketing, social psychology, and library science, among others. Khan (2005) identifies eight dimensions of e-learning, which are: pedagogical, technological, institutional, ethical, interface design, resource support, management, and evaluation.

Technologies that support e-learning offers the learner a lot of flexibility over content, pace, and media. E-learning provides almost everyone access to resources that are otherwise unreachable for most individuals. In addition, use of e-learning can help reduce a significant portion of instructional cost upon the educational institution, compared with face to face instruction or even asynchronized distance learning (Gibbons and Fairweather, 2000). A more compelling argument for the adoption of TEL comes from Bates (2009): it embeds in learning the essential ICT skills required to succeed in the information economy.

Online learning is becoming more and more popular (an increase at the rate of 12.9% vis-à-vis a negligible 1.2% for overall higher education enrolment) and that students generally appear to be at least as satisfied with their on-line classes as

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they are with traditional ones (Allen and Seaman, 2008). Students enrolled in e-learning courses fare better than their counterparts undergoing traditional learning courses, notes a US Department of Education report (Means, et al. 2009).

Some studies show that there exists a mismatch between the level of technology use expected out of educators and the actual use of technology (Kanaya, Light, and Culp, 2005). As expected, this is in part triggered by the lack of technology fluency and techno-phobia among the educators (Bennett and Kottasz, 2001). However, a more important issue is the philosophy with which educators approach e-learning. Zhang (2005) concludes that instructors should not be perceived as information or media controllers, the same will reduce the benefits of e-learning. On the other hand, the same study found that enabling the learner to manipulate the learning media under the overall supervision of the loosely held social network of learners would enhance the value of e-learning. Inspired by the emergence of Web 2.0, the term Learning 2.0 is often used to heighten the awareness that e-learning is no longer about the linear replication of traditional learning philosophies and methodologies to the electronic format (Brown and Adler, 2009). Learning 2.0 assumes that knowledge is socially constructed and emphasizes the use of social media as against expert controlled media.

E-learning learning applications can be characterized in terms of (a) the kind of learning experience they provide, (b) whether computer-mediated instruction is primarily synchronous or asynchronous and (c) whether they are intended as an alternative or a supplement to face-to-face instruction (Means, et al., 2009). Institutions of higher learning employ a variety of online-offline mixes. Figure 1 tries to capture how the Sloan Foundation report on e-learning classifies these combinations.

By the beginning of the 21st century, e-learning has become an acceptable instructional format for tourism education in the undergraduate and graduate levels (Blum, Dodd, and Goh, 2000). There is a growing demand for online courses in tourism and hospitality area, observed Rosenberg (2001). Hubbard (1997) rightly anticipated that technology enabled distance education could prove to be a significant growth area for tourism and hospitality higher education. A study conducted in 1996 found that hospitality students were most interested in pursuing computer-mediated instruction, followed by satellite courses, and tele-course study (Iverson, 1996). While many tourism instructors are satisfied with a web facilitated or hybrid format, a few experiment with 3D virtual environments such as "Second Life" (Singh and Lee, 2008). E-learning is slowly but steadily increasing in popularity as a format to provide continuous training to the existing tourism industry workforce as well (Garber, 2004; Kooser, 2007).

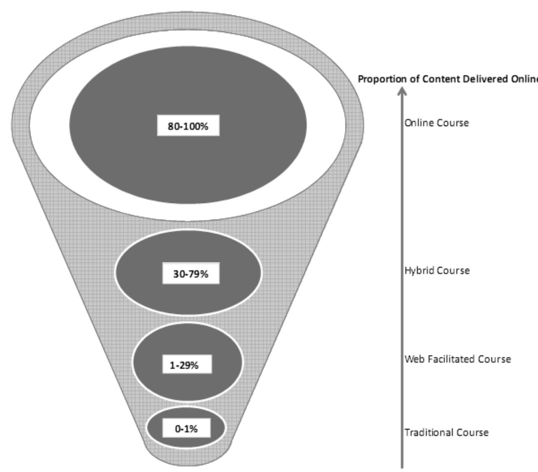

Fig. 1: Prototypical Online – Offline Course Classifications (Adapted from the Sloan Foundation Report on E-learning)

Some hospitality firms and industry associations have used e-learning format aimed at consumer education: for instance, the educational web sites launched by many beverage companies, distributors, and associations often provide quick and easy answers to the many questions raised by consumers and retailers alike. At times, universities have collaborated with tourism industry to provide training for the industrial work force: a good example of this is the collaborative partnership between the Hotel and Catering

International Management Association and Surrey University to develop an e-learning approach for the Association in Great Britain (HCIMA, 2004). Many tourism firms respond to the need for innovation and adjustment to the new economy by adopting e-learning based solutions (Baruchelli et al., 2002).

Even as universities and other tourism teaching institutes absorbed a variety of ICT tools to augment instruction, all these solutions were focused on only two types of actors: the instructor and the students. For a job-oriented, professional program like tourism, the sheer absence of the industry in the e-learning system was quite conspicuous. One such pioneering attempt was at the University of Otago, New Zealand, which developed a number of loosely connected computer-mediated tourism distance learning resources that enabled the online provision of study information and course materials for students (Higham, 2002). Until recently, even tourism students did not seem to be well aware of the importance of industry contribution in their education. In a survey conducted by Collins and Van Hoof (2001), students rated communication, course management, and student support as important issues on their minds when it comes to e-learning.

iPASS™: THE BACKGROUND

Following the devastation of the Mississippi gulf coast by Hurricane Katrina in August 1995, The University of Southern Mississippi (Southern Miss) began to look at alternative delivery systems for offering classes to the students enrolled at the Gulf Park campus destroyed by this catastrophic event. The need was twofold: to reach out to displaced students and to resolve the problem of faculty displacement/vacancies. Wimba was identified as a preferred software package for creating a virtual classroom for displaced students. For those unfamiliar, Wimba Classroom is a live, virtual classroom environment that simulates a face-to-face meeting between the instructor and students. Its features include audio, video, application sharing and content display (Wimba, 2009).

The College of Business of Southern Miss participated by selecting two courses to pilot this effort, one of which was a course titled Casino Resort Operations Management. At a faculty meeting, everyone was unanimous in their opinions that the mere offering of an online course was not going to generate significant increases in student enrollment, capture the industry's confidence in the program, or provide a competitive advantage. It is in this context that we thought about developing a new model of online instruction from the scratch. Finally, employing an action research methodology and with the support of established theories of learning, the first author of this manuscript developed the iPASS™ (Industry Professionals Assistance in Students' Success) model.

This paper presents the theoretical framework of observational, experiential, and situational learning on which the iPASS™ instructional model was developed. It explains how the first author used a virtual technology Wimba to make iPASS™ a success. The results of iPASS™ implementation reveals how virtual technology provides value to all stakeholders beyond its primary role as an instructional tool.

CONCEPTUAL FRAMEWORK

The iPASS™ instructional model is deeply rooted in the marketing paradigm. According to Kotler (1984), beneficial exchanges and relations with target markets must be maintained for achieving organizational objectives. Given this, the first criterion for iPASS™ is to ensure a win-win outcome for all stakeholders, i.e., the students, the industry, and the institution. The academic-practitioner collaboration and town-and-gown relationship must ultimately benefit student learning and career placement success. The improved learning environment must be a reservoir of knowledge, skill, and attitude (SKA) desired by potential employers. The students' career placement preparedness must represent quality human capital for industry employers. The industry must be recognized for its corporate citizenship in promoting education. The institution must enjoy increased student enrollment, improved town-and-gown relationship, and renewed regulators' and industry's confidence in its tourism management program.

Learner isolation is a common concern and occurrence among online students. The feeling of disconnect and isolation affects students' levels of participation, satisfaction, and learning (Young-Ju Joo et al., 2000). Learner isolation and feelings of exclusion can be minimized if the course adopts an open and inclusive format and encourages social networking (Riel and Polin, 2004). To minimize learner isolation, iPASS™ must use online communication tools to give students "face-to-face" social inclusion.

According to Vygotsky's (1978) social learning theory, observational learning occurs when the observer's behavior changes after observing the behavior of the model. The curriculum must provide the opportunity for students to observe positive role models. Collaborative learning within the social and environmental context must be encouraged because it is where learning occurs. Educators must also provide incentives and a supportive environment for the learned behavior to be assessed. Industry professionals could serve as positive role models for the students if iPASS™ could facilitate student access to these professionals.

The situated learning theory (Lave and Wenger, 1990) posits that learning is embedded and occurs unintentionally within the authentic activity, context, and culture. Lave and Wenger (1990) calls this a process of "legitimate peripheral participation." Social interaction and collaboration are essential for students to become involved in a "community of practice." Students become more of an expert as they move from the peripheral to the center of the community. The purpose of iPASS™ is not only to expose students to subject matter experts from the industry, but for unintentional learning to take place as the students interact with industry professionals. Examples of such learning could be ethical behaviors critical to operating in the highly regulated casino industry. Situated learning bridges the learning gap between the classroom and the boardroom.

Meaningful learning occurs when students exhibit active interest in learning, when what they do in and outside the classroom in association with a course of study is informed by real life situations, and (3) and, when they reflect upon the real life situations with the instruments of critical thinking (Driscoll and Carliner, 2005). Kolb's experiential theory (1984) is a four-stage learning cycle where "knowledge is created through the transformation of experience." The stages involve "do" (concrete experience), "observe" (observation and

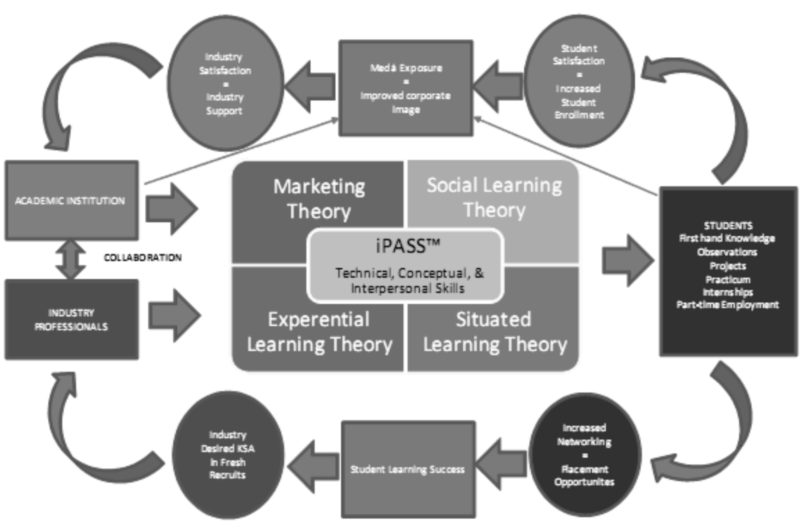

Fig. 2: The iPASS™ instructional model

reflection), "think" (forming abstract concepts), and "plan" (testing in new situations). For learning and placement success, iPASS™ must put students through this learning cycle.

The iPASS™ instructional model is summarized below in figure 2.

Once the basic premises of the conceptual model of i-Pass™ is laid out as described above, the next significant question to address is whether the iPASS™ concept can be applied to an online environment. How does the instructor bring industry professionals into the online environment and interact with the students? Additionally, would virtual interaction have the same quality effect as face-to-face interaction? The following section reveals the best practice steps taken by the instructor to guarantee the success of the iPASS™.

APPLICATION OF I-PASS™ MODEL TO THE VIRTUAL ENVIRONMENT

The initial step to iPASS™ success is to solicit participation from industry professionals. The instructor identified key executives in the industry and shared the potential benefits of their involvement in students' learning success. Public relations efforts to promote positive corporate image for their involvement in promoting education is highlighted. In anticipation of their busy schedule, and to alleviate any anxieties the professionals may have in presenting in an unfamiliar environment, the instructor assured them of technical, visual aid development, and classroom management support.

Once the industry professionals were committed to serving as iPASS™ presenters for the online casino management course, the instructor must ensure a quality virtual interaction. In Spring 2007, the instructor developed 5-10 minutes video segments of interviews with industry professionals. The videos were well-received by the students and achieved the goal of providing students with up-to-date and firsthand information from industry professionals. However, the videos did not allow one-on-one interaction and networking to occur between the industry professionals and students. The application of Wimba Classroom proved to be the ideal solution for iPASS™ success. The video conferencing capabilities of Wimba simulate that of a face-to-face interaction.

Since Wimba is a new instructional tool, the instructor developed classroom protocol and written instructions on Wimba for the students. Wimba Helpline contact information was included for 24/7 access to technical support. The instructor conducted separate trial runs with the students and the guest presenters to troubleshoot hardware/ software compatibility issues. The trial run also served as an orientation and "Getting to Know You" social networking session for the class to be acquainted with each other and the instructor. By the end of the trial session, students found the Wimba Classroom less intimidating than anticipated and looked forward to the actual sessions. The instructor was able to address learner isolation concerns, and apply observational and situated learning concepts via Wimba presentations by industry professionals.

To apply the experiential learning cycle, the instructor required students to perform the following: (1) read from published sources about a specific issue (PREPARE); (2) participate in Wimba for industry professionals' expertise and viewpoint on this issue (PARTICIPATE); (3) plan to write a research paper based the previous two steps (PLAN); and (4) write and submit the research paper (PUT DOWN). The research content of the papers must be supported with material obtained through the interactions with the industry professional mentors. The industry professional mentor is selected by each student for his or her subject matter expertise and willingness to help the student with the research project. The interview could be conducted via email, online chat, phone, or in-person. The research/interview project gives the students additional opportunity to interact and learn from industry professionals. These opportunities also increase students' knowledge of job openings at the respective properties. This process is summarized in figure 3.

Another success criterion for iPASS™ is ensuring a mutually beneficial exchange between the industry and the institution. The instructor used the novelty of virtual technology and industry professionals' engagement in student learning to promote the benefits of the town-and-gown relationship. The instructor collaborated with the university and the industry professionals' public relations staff to create a news release for distribution to the local media, trade magazines, and corporate employee newsletters. Coverage on positive town-and-gown relationship is a desired win-win outcome of iPASS™. In addition to news release, the instructor also promoted the corporation within the course by including the industry professionals' name, title, and corporation name and logo in the title slide and branding window in Wimba.

Finally, the instructor recognized the importance of providing learning alternatives for those unable to attend the live Wimba sessions as the synchronicity of Wimba Classroom may prove inconvenient to those who may not be able to fit a live classroom in their schedule. As a solution, the instructor provided students an opportunity to listen to the archives and write a one-page summary. The ease of simply clicking a button to archive the Wimba sessions gave students a "do-over" opportunity—one that would not have been possible if the presentation was a traditional face-to-face guest presentation. Students were also given post-Wimba opportunity to communicate with the industry professionals through Wimba Voice Recorder. The Wimba Voice Recorder is a voicemail tool in which the students could record their question to the industry professionals, who in turn, could record their response to the students.

Flexibility is a key to online success. Heavy use of live virtual technology could ruin the attractiveness of online learning for students who chose online to meet their demanding lifestyle needs. Therefore, the instructor scheduled Wimba sessions around traditional class schedules, industry professionals' work hours, and international time zones. The instructor also limits mandatory attendance to three live sessions (one per month). Students earn bonus points for additional sessions. Grades are given to ensure good attendance. A poorly attended session may be discouraging for the industry professionals and may discourage them from future participation.

OUTCOMES OF iPASS™ IMPLEMENTATION

The iPASS™ model using Wimba Classroom collaboration technologies have been well-received by all stakeholders and has enabled the instructor to meet the University's strategic focus areas: image development, connection with the community, top-flight educational experiences, and a culture of healthy minds and bodies (ID Group Consulting & Creative, 2007). The quantitative results reflect data collected from the University's course roster and course evaluations completed by the students via the University's 'Southern's Online Accessible Records' (S.O.A.R.) system. The qualitative results are quotes gathered from students' written course reflection paper submitted at the end of the semester.

Outcomes for Students

The instructional value of iPASS™ was evaluated over seven semesters. On a five-point Likert scale

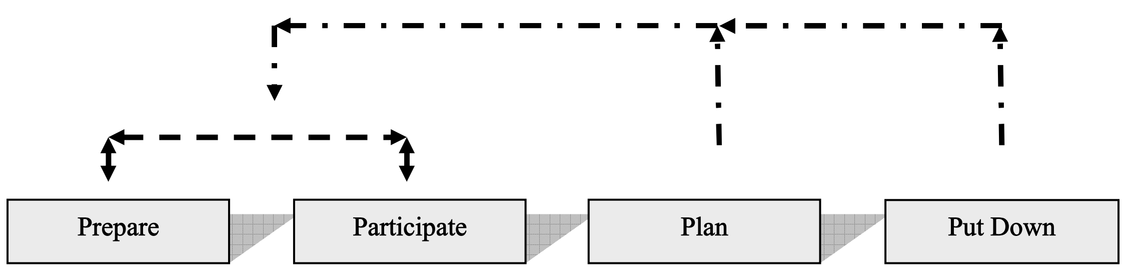

Fig. 3: The 4P Framework of Learning in iPASS™

with five being excellent, the average overall course rating was 4.50. When asked to estimate how much they learned from the course, the students gave an evaluation score of 4.50. The students rated the effectiveness of the course in challenging them as 4.40 (Source: The University of Southern Mississippi, TM 378 student course evaluations, 2007-2009).

Many students were skeptical at first about Wimba but were surprised that they actually enjoyed their online class more than a traditional classroom course. A student stated that Wimba is "an excellent use of technology to hear from industry executives" (student personal communication, July 16, 2007). One student commented, "I never thought an online course could be as engaging as this one proved to be." (student personal communication, July 17, 2007). Another student had anticipated an impersonal list of readings and work, but found the course very interactive and connected him to not only his classmates and the instructor, but also to important members of the industry. "My expectations were far exceeded by this course. It was the best online course I have ever taken." he concluded (student personal communication, December 8, 2008).

The iPASS™' theoretical framework of observational, experiential, and situational learning proved successful in student learning success. When asked, "Which aspect of the course did you find most beneficial?" ninety-eight percent of the 137students enrolled in the course over a period of seven semesters, rated the exposure to industry professionals to be the most beneficial aspect of the course (student course reflection papers, 2007-2009). Sample reflection statements include "The Wimba presentations were an exceptional way of presenting and asking questions" and "I was able to learn things that I did not learn from working in the casino." Through the Wimba sessions, students were able to get a feel of what industry professionals do, how they do it, and get a response back to many of their questions that they had wanted to ask of the professionals (student personal communication, April 27, 2008). A student commented that learning from the textbook could be repetitive and boring. "Listening to someone with experience and such hands-on knowledge of what is in the textbook is so awesome. You really get a better understanding of what you are learning," he said (student personal communication, April 18, 2007).

The course reflection reports also suggested that students find their interactive experience with industry professionals, motivating and inspirational. The interaction opened up the career paradigm for students who were not sure if they have what it takes to succeed in the casino industry. Many stated that they have not considered working in the industry because of family religious beliefs and the myths surrounding the bad reputation of the industry's history. Observing the philosophical outlooks of these industry professionals seem to evoke a stronger passion and drive within the students. A student found Rick Carter, owner of the Island View Casino Resort, Gulfport, Mississippi, very inspirational to him. "Mr. Carter talked about having goals and striving to meet those goals. I have many goals and plan on meeting those goals, and after listening to his words of wisdom, my drive has been strengthened," he wrote in his course reflection (student personal communication, December 4, 2008). Another student stated, "Mr. Carter seems to truly love what he does and throughout his success, remain genuine. Everyone could take a page from his book while they ascend the corporate ladder" (student personal communication, December 8, 2008).

The course reflections also indicated that a few of the female students find the women executives inspirational. One of them finds Anne Mockler's story inspirational. She said that Anne Mockler, director of surveillance, Beau Rivage Resort and Casino, Biloxi, Mississippi, gave her hope because Ms. Mockler started her career at an entry level at the same age as she is now. Ms. Mockler's career biography showed the student that she could "have a family and maintain it while taking on a challenging position in a male-dominated position" (student personal communication, April 28, 2008).

The industry professionals' involvement in iPASS™ and Wimba sessions also inspired their staff to return to school. Mike Cray, director of casino operations, The Isle, Biloxi, Mississippi, inspired his administrative assistant to complete her college career that she had abandoned in 2002 to raise her family. She wrote in her course reflection, "Seeing Mike get more involved in promoting the industry encouraged me to go back to school" (student personal communication, December 8, 2007).

The improved town-and-gown relationship created by iPASS™ also increased placement opportunities for the students. Beau Rivage Resort and Casino hired two recent graduates who participated in the iPASS™ experimentation, and a third student was offered a job opportunity with the IP Casino-Resort-Spa, until he was admitted to law school later.

Outcomes for the Industry

The instructor wanted to ensure the industry professionals and their corporations benefitted from engaging in student learning success. By giving back to the community via engaging in student learning success, the casino industry gains a positive corporate citizenship image. Positive corporate citizenship is especially important to the casino industry that continues to fight the myths and bad reputation of the industry's past. Media coverage provides greater credibility than advertisement. Based on the feedback from industry professionals and media coverage, the iPASS™ model and Wimba Classroom achieved this goal.

"They keep me on my toes," commented Anne Mockler (Mockler A., personal communication, July 29, 2009). She said that knowing what they learn and what they know helps her prepare for what she can expect when she recruit new hires. The one-on-one interaction also gave her a first look at potential recruits. Mockler along with other industry professionals, have announced job placement opportunities during their Wimba session, offered placement or mentoring assistance to the students, and given their direct contact information to the class. Such accessibility gives the students a networking and placement competitive edge.

The local media was invited to attend the first Wimba session to observe the state-of-the-art technology and academic-practitioner collaboration at work. The result was an article in the Mississippi Gaming News (July, 2007). The initial coverage also led to other coverage of department activities involving industry professionals-students' interaction, e.g. field trips.

Finally, students appreciate the industry support of their education. "What I found most beneficial were the contacts I made, and the people I now know are supportive of the program here at Southern Miss," a student commented in his course reflection (student personal communication, April 24 2008). The positive corporate image also creates a favorable impression of the industry professionals as potential employers. A student in the Spring 2009 class said that the course had a very positive impact on his outlook on the casino industry (student personal communication, April 28, 2009). Another student wrote that the IP Casino Resort & Spa, Biloxi, Mississippi, "stood out like spotlight in the night sky to me" when the corporation's president, Jon Lucas and Brad Rhines, VP of marketing and casino operations took time out of their schedule to speak to the class. The generosity of their time investment in the students' education impressed the student (student personal communication, April 28, 2009).

The exercise seemed to have quite an unexpected outcome as well: in the aftermath of this exercise, many industry executives who had significant fear for technology became evangelists of e-learning. While writing this manuscript, some of them have been consulting with us about possibilities like incorporating e-learning in their own training and development programs. This change might be implicative of the reduced fear and resistance of technology in the workplace, too.

Outcomes for the Institution

The original intent of putting the casino management course online was to reach out to displaced students and to increase enrollment. An unexpected outcome was the quality of the online education attracted non-majors. Since the course's inception in Spring 2007, student rosters indicated that fifty-eight percent of the course enrollment is comprised of students from 15 different majors (The University of Southern Mississippi, TM 378 rosters, 2007-2009).The success of iPASS™ also represented significant savings for the program and the University. Through Wimba Classroom, the University is able to provide students worldwide access to industry professionals from as far as Las Vegas and Kuala Lumpur, Malaysia, without incurring any travel expenses. For example, a student commented on a presentation from Kathi Meci, former Vice President of Casino Operations, Wynn Macau, "I had never wanted to go into the gaming industry but after Kathi spoke of her experience in Macau, it made me want to investigate more. She had such a passion for what she does and that's what impacts students like me!" (student personal communication, April 28, 2008).

Virtual technology also helps the University resolve its dual-campus challenges in terms of faculty assignment and student travel. The cost savings align with the University's sustainability initiatives. Students from both cities are able to take an online course from the same instructor, a cost savings for the department and University. By offering TM 378 online, students from both campuses could take the class without having to commute to class or travel to meet industry professionals. The Wimba sessions also help connect students from both campuses with each other.

The town-and-gown relationship building implications of virtual technology gave the institution value beyond instruction. The institution formalized its town-and-gown relationship with the department's *Partnering with Professionals* program (Sun Herald, April 28, 2007). To date, 36 industry professionals, many of whom are senior executives have participated in iPASS™ activities such as Wimba sessions, video interviews, field trips, etc. These professionals also serve as mentors with whom students consult for academic research and career placement needs. Another fifteen or more professionals will be named in the *Partnering with Professionals* program in 2009.

With the improved town-and-gown relationship, the Mississippi Casino Operators Association (MCOA) recognized the recipient of its endowed scholarship for the first time, at its Southern Gaming Summit 2009 general session. The recipient, a Southern Miss casino management student received his award from Mississippi Governor, Haley Barbour. The media coverage of this event gave the University recognition among industry leaders.

The success of iPASS™ has also restored regulators' confidence in the casino management program. Mr. Larry Gregory, executive director, Mississippi Gaming Commission now serves as a member of the department's advisory board. Mr. Gregory and his senior executives have participated in iPASS™ and hosted the students at a Mississippi Gaming Board meeting on September 18, 2008. Deputy director, Allen Godfrey made a campus visit on April 21, 2009 that was covered by WDAM, the NBC-affiliate in Hattiesburg, Mississippi.

A potentially negative outcome for an educational institution while implementing a technology mediated learning platform like iPASS™ is the failure in successfully transmitting the core values of the institution to the learners. Despite the fact the web 2.0 technologies permit rich interchange of ideas, they are yet to develop to the level of being able to transmit implicit norms and cultural ideals. If we hold that universities have an objective beyond the generation and dissemination of knowledge, a cultural logic, courses delivered using ICTs might fall short of expectations. If we employ synchronous learning technologies rather than asynchronous ones, cultural transmission can probably be made relatively smoother. More research needs to be conducted on how to tweak technologies to transmit implicit cultural norms and values more effectively (Edmundson, 2007).

iPASS™ IMPLEMENTATION CHALLENGES

The implementation of the new instructional technology solution was not without challenges. Vonderwell and Zachariah (2005) notes that technology and interface characteristics, content area experience, student roles and instructional tasks, and information overload are some of the factors that can influence the success of e-learning. The bottlenecks we encountered while implementing iPASS™ were numerous: unreliable technology (software bugs, intermittent internet outages, incompatible hardware interfaces, to name a few), technology illiteracy of stakeholders (industry professionals, students, and teaching assistants), cynicism about the claimed benefits of technology, technophobia, perceived lack of control, the capital investment required for technology deployment, to name a few.

In many instances, we have found users adopting iPASS™ model with the traditional mindset: the mindset that believes that learning always originates from the expert (Barajas and Owen, 2000). This makes some experts to feel offended when students go beyond merely answering the questions asked and some students to feel neglected when experts do not provide 'to the point', deterministic solutions. It is important for the students to understand that reality is chaotic and for the experts to understand that students live in a world which provides them many alternate channels of information other than what they get from the classroom. Successful e-learning requires students to be competent self-regulated and self-controlled learners and studies show that such learners outperform the rest (Singla, 2001).

Quality monitoring and control of iPASS™ centric instruction poses yet another challenge. This concern is often overstated since the idea of an external expert overseeing instructional quality does not go well with our present idea about the nature of knowledge (Salmon, 2001). As discussed elsewhere, truth at any point of time is an emergent reality and the only meaningful adjudicators of truth are the actors within the truth generating system. This would mean that the negotiated exchanges in the community of students, industry executives, and the instructor constituting the iPASS™ learning ecosystem will ensure its quality. Again, quality as a post-measure is not very relevant if we can ensure the input and process quality.

Finally, a few words on motivation: faculty motivation is a vital link in the iPASS™ conception, development, and implementation. While many faculty colleagues are capable of innovating, the lack of proper extrinsic motivations prevents this from happening. It is important that E-learning innovations like iPASS™ be rewarded as evidences of scholarly achievement for career advancement. Again, for its widespread adoption, institutions should be willing to commit a critical sum of financial resources towards new faculty training in the system (Christou and Sigala, 2000).

CONCLUDING REMARKS

Without virtual technology, the concept of iPASS™ would not have benefitted online students. The unmatched value of firsthand, up-to-date knowledge, and on-the-job experiences of industry professionals has given iPASS™ the desired student learning success outcomes and stakeholder benefits. Encouraged by iPASS™ and Wimba successes, the CHTM faculty and administration are currently working on launching an online graduate and an undergraduate casino management certificate program targeting an international student market. The institution is confident that iPASS™ and Wimba would give its online certificate programs the necessary competitive edge.

It should be stressed that the preliminary findings of iPASS™ need to undergo a more rigorous re-examination. Such a re-examination will, inter alia, help us refine the model, too. Additional quantitative data from the students on their perception of the benefit of industry professionals' engagement in student learning should be gathered and analyzed. The students' course reflection statements that we used heavily during the present discussion do not provide the instructor with quantitative data on the types of perceived benefits and the value ranking of each benefit. Future course reflections should include a Likert-scale evaluation and ranking of perceived benefits. For example, students can be asked to rate the value of industry professionals engagement in terms of first-hand information, networking opportunities, placement opportunities, motivation, etc.

It is not essential that every school that use the iPASS™ model should have Wimba. There are many alternate technologies; some of them open source freeware. Again, instead of employing a comprehensive suite like Wimba, instructors can use independent technological solutions for various types of productivity functions. For instance, an internet protocol based communication utility like Skype could be used for chats and voice conferencing; a wiki such as Wetpaint could be used for collaborative writing; a search engine such as Google Scholar could be used for information search; and, finally, a dedicated social network for the course may be created using service such a Ning. Moodle is a great free open source platform around which many iPASS™ related tasks can be performed. Google Pack is another productivity suit, available free of cost, that might help the implementation of iPASS™. Internet centric technology has been evolving at a very rapid pace and the good news is that many of these technologies can be used without much tweaking to enhance the value of teaching and learning.

As with many other enabling technologies, e-learning technologies do raise the probability of elimination of instructors, the middlemen of knowledge. In order to avoid disintermediation, instructors have to raise to the occasion and transform themselves as coordinating actors in the provision of e-learning experience. In some studies, the presence of a course instructor did not significantly enhance the quality of e-learning outcomes (Bernard and Lundgren-Cayrol, 2001). Moderation of learning by the community of learners was found to be creating a more liberating set of conditions for learners (De Wever, Van Winckel, and Valcke, 2008).

The successful online implementation of iPASS™ underscores the value of virtual technology beyond the 'web-ification' of traditional instruction. Through the application of marketing philosophy in course development, the instructor turned an ordinary course into an extraordinary recruitment, marketing, and public relations tool for the university. By thinking beyond the traditional course development paradigm, the present instructor turned a potentially boring online course into a dynamic, interactive, and popular course with students throughout campus. So far, this has by and large remained as an individual initiative. We look forward for our faculty colleagues to adopt the iPASS™ framework and enjoy its varied benefits.

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Measuring Service Quality in Apparel Retailing – A Study in the State of Andhra Pradesh

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Liberalization of the Indian economy in the nineties and the entry of big business houses in the retail business have brought the retail industry into focus. The Indian retail industry is valued at about $ 396 billion and is expected to grow to $ 785 billion by 2015 and is the second largest employment provider after agriculture. The fast pace of the Indian retail industry presents many companies with a host of daily challenges. In today's competitive environment and with the growing importance of services, delivering superior quality services has become the basic retailing strategy especially in Apparel Retailing. In order to deliver high quality of services it is important on the part of marketer to measure them, the present paper identifies the critical dimensions of service quality in apparel retailing and also measures the impact of service quality on Customer Satisfaction and Attitude. A structured questionnaire was administered for data collection. Primary data collected from 550 respondents from four major retail trading areas in the state of Andhra Pradesh. Secondary data was collected from research databases, reports, journal articles etc. SPSS 17.0 was used for statistical analysis. The results will help the Retail service managers to plan and design their service strategies.

Keywords— *Service Quality, Apparel Retailing, Customer Satisfaction*

INTRODUCTION

Liberalization of the Indian economy in the nineties and the entry of big business houses in the retail business have brought the retail industry into focus. Indian Retailing industry is the second largest employer after agriculture and is witnessing an exponential growth in the space occupied by organized retailers. India has a very favorable demographics like a large young working population, nuclear families in urban areas, along with increasing numbers of working women and emerging opportunities in the service sector which are the key growth drivers of the organized retail sector. The Indian retail industry is valued at about $ 396 billion and is expected to grow to $ 785 billion by 2015 (Business Monitor International (BMI) India Retail Report, 2011) contributing over 10 percent of the country's GDP. Indian retailing has emerged as one of the most dynamic and fast-moving industries with several Multi National players entering the market. Indian cities are witnessing a significant growth in organized retail space with the entry of new malls, the major places where these malls setting up are Mumbai, Delhi, Bangalore, Hyderabad and Pune.

The apparel industry is one of the India's largest foreign exchange earners, accounting for nearly 16% of the country's total exports. A recent estimation of the domestic clothing market by Images Fashion puts it at Rs. 493 billion of which the share of ready-made is Rs. 300 billion. Most of the growth has come from the branded segment, which is growing exponentially at about 21.8 per cent every year. In the domestic apparel market, men's segment dominates with 46% market share

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whereas women and children's wear have 17% and 37% market share respectively.

NEED FOR THE STUDY

With the growing competition, customer attraction and customer retention have become the basic retailing strategies. Several researches proved that service quality is the antecedent of customer satisfaction and customer retention (Finn and Lamb, 1991; Kaul, 2005; Dabholkar et al, 1996; Zeithaml, 2000). Deficiencies in service delivery certainly cause customer dissatisfaction and also affect profitability in the long run. To outperform the competition it becomes essential to all service managers to measure their service quality. Customers perceived service quality is the difference between customer expectations of the service and how they perceived. The present study is aimed to measure service quality in apparel retailing and to know the impact of service quality on customer satisfaction and customer attitude.

LITERATURE REVIEW

Measuring service quality has become difficult due to its unique characteristics like intangibility, heterogeneity, inseparability, and perishability. Seth et al. (2005) found that the service quality outcome and measurement is dependent on the type of service setting, situation, time and need factors. Service quality is linked to the concepts of perception and expectation (Parasuraman et al., 1985, 1988; Lewis and Mitchell, 1990). The SERVQUAL scale has been tested and/or adapted in a great number of studies conducted in various service settings, cultural contexts, and geographic locations. These include the quality of service offered by a hospital (Babakus and Mangold, 1992), websites (Iwaarden et al., 2003), a major mobile communications company in mainland China (Lai et al., 2007), a dental school patient clinic, business school placement centre, tire store, and acute care hospital (Carman, 1990), pest control, dry cleaning, and fast food (Cronin and Taylor, 1992), banking (Cronin and Taylor, 1992; Spreng and Singh, 1993; Sharma and Mehta, 2004), and discount and departmental stores (Finn and Lamb, 1991; Teas, 1993; Dabholkar et al., 1996; Mehta et al., 2000; Va´zquez et al., 2001; Kim and Jin, 2002). Riadh Ladhari (2009) reviewed 20 years (1988-2008) of research on the SERVQUAL scale for measuring service quality. Studies that have applied the SERVQUAL scale in this 20-year period were examined in a non-exhaustive review of the literature. Despite these criticisms, the paper concluded that SERVQUAL still remains a useful instrument for service-quality research.

The popular Service Quality measurement scales such as SERVQUAL and SERVPERF, essentially measure non-retail services in terms of customer perception. The scales are not suitable for retail services because of their composite nature with quality of goods. Retail service activities such as negotiating, locating merchandise, and interacting with different store personnel for returning merchandise are all associated with quality of service as well as quality of goods (Finn and Lamb, 1991). Gagliano and Hathcote, 1994 identified that Service Quality in Retailing is different from any other product or service environment; in continuation to this study a new performance-based measurement scale called Retail Service Quality Scale (RSQS) was developed by Dabholkar et al. (1996) to measure the quality of retail services. The scale has been widely tested in many developed and developing countries, and it has produced mixed results in application. Boshoff and Terblanche (1997) found the scale to be very useful in the context of department stores, specialty stores, and hypermarkets in South Africa. Mehta et al. (2000) found RSQS appropriate among supermarket consumers in Singapore. Kim and Jin (2002) reported that four of the five RSQS dimensions were useful for the USA and Korea. Subhashini Kaul, (2005) applied the RSQS in the Indian Retail setting with a sample of 144 apparel retail customers selected in one of India's fastest growing cities i.e. Bangalore and observed that the scale may be used for assessing the overall services provided by the store and to track the changes in service over a period of time. So it is evident from the earlier studies that there was no generic scale to measure service quality in Indian Retailing. There is a need to extend the study to other cities with large sample having varied demographics to explore new dimensions of retail service quality scale.

OBJECTIVES OF THE STUDY

1. To Identify the Dimensions of Service Quality in Apparel Retailing
2. To Study the impact of Service Quality on Customer Satisfaction
3. To Study the impact of Service Quality on Customer Retention
4. To Examine the impact of Customer Satisfaction on Customer Retention

METHODOLOGY

The data was collected by using a structured questionnaire in the State of Andhra Pradesh, which is being ranked among the top ten States in India, in terms of Potential Retail Growth. For the study "Area Sampling" was adopted and selected four major Retail trading Areas such as, Hyderabad, Vijayawada, Vishakhapatnam and Tirupati. The total sample constitute of 550 respondents from all the four Areas, 250 respondents from Hyderabad city, 100 respondents from Vishakhapatnam city, 100 respondents from Vijayawada city and 100 respondents from Tirupati city who were drawn systematically (every fifth customer) after their purchase at the shopping malls. Modified Retail Service Quality Scale (RSQS) was administered to collect the primary data and secondary data was collected from research reports, data bases and journal articles. SPSS 17.0 was used for data analysis, Factor Analysis, Multiple Regression and ANOVA techniques were used to interpret the data.

RESULTS AND DISCUSSION

Identifying the Dimensions of Service Quality in Apparel Retailing

A total of 26 items (Annexure I) were used to identify the dimensions of Service Quality. By using factor analysis the items were extracted to five important dimensions namely Personal Interaction, Physical Facilities, Courtesy, Reliability and Policies of the store. Kaiser-Meyer-Olkin Measure of Sampling Adequacy was 0.913 and Bartlett's Test of Sphericity value was (sig.000) proves the efficiency and validity of the test. It is inferred from the results that Personal Interaction and Physical facilities are the key dimensions effecting Service Quality.

Impact of Service Quality on Customer Satisfaction

Multiple Regression test was conducted to know the Impact of Service Quality on Customer Satisfaction, with Customer Satisfaction as dependent variable and Service Quality dimensions as Independent Variables. Customer Satisfaction was measured using 13 items (Annexure III). The following hypotheses were made.

H1: Service Quality dimensions effects Customer Satisfaction

The results indicated (Table 1) that at Vijayawada city, out of five dimensions only Courtesy (.000) Reliability (.001) and Policy (.024) have significant effect on Customer Satisfaction, at Vishakhapatnam city only Courtesy (.004) and Policy (.005) dimensions were significant, at Tirupati city Personal Interaction (.001), Physical facilities (.005) and Policy (.000) dimensions were significant, whereas at Hyderabad all the five dimensions have significant effect on customer satisfaction. It is inferred that customers in Hyderabad city expect service quality in all the respects whereas in other cities the importance of service quality dimensions will vary according to geographic location. It is evident that Service Quality dimensions have significant effect on Customer Satisfaction. Hence the hypothesis H2 is accepted.

Impact of Service Quality on Customer Retention

To identify the important Service dimensions affecting Customer Retention, Multiple Regression was conducted, considering Customer Retention as dependent variable and Service Quality

Table 1: Regression Coefficients[a]

City Name	*Model*		*Unstandardized Coefficients*		*Standardized Coefficients*	*t*	*Sig.*
			B	*Std. Error*	*Beta*		
Vijayawada	1	(Constant)	42.691	.824		51.795	.000
		Personal Interaction	.000	.769	.000	-.001	.999
		Physical Facilities	-.737	.658	-.098	-1.119	.266
		Courtesy	2.799	.847	.329	3.306	**.001**
		Reliability	3.380	.831	.366	4.066	**.000**
		Policy	1.764	.771	.204	2.288	**.024**
Vishakapattanam	1	(Constant)	46.369	.417		111.317	.000
		Personal Interaction	1.101	.616	.173	1.787	.077
		Physical Facilities	.835	.486	.159	1.716	.089
		Courtesy	1.267	.432	.273	2.935	**.004**
		Reliability	.851	.412	.204	2.064	.042
		Policy	1.150	.403	.275	2.851	**.005**
Tirupati	1	(Constant)	46.823	.354		132.139	.000
		Personal Interaction	2.270	.674	.330	3.370	**.001**
		Physical Facilities	2.091	.729	.259	2.869	**.005**
		Courtesy	.899	.561	.145	1.603	.112
		Reliability	.628	.488	.125	1.286	.202
		Policy	2.732	.555	.447	4.923	**.000**
Hyderabad	1	(Constant)	46.007	.355		129.502	.000
		Personal Interaction	2.019	.316	.299	6.397	**.000**
		Physical Facilities	.845	.319	.121	2.645	**.009**
		Courtesy	1.940	.324	.281	5.986	**.000**
		Reliability	3.644	.317	.522	11.483	**.000**
		Policy	2.386	.316	.345	7.545	**.000**

a. Dependent Variable: Overall Customer Satisfaction

Table 2: Coefficients

City Name	*Model*		*Unstandardized Coefficients*		*Standardized Coefficients*	*t*	*Sig.*
			B	*Std. Error*	*Beta*		
Vijayawada	1	(Constant)	23.389	.505		46.358	.000
		Personal Interaction	-.153	.471	-.037	-.324	.747
		Physical Facilities	.109	.403	.026	.270	.788
		Courtesy	1.456	.518	.304	2.809	**.006**
		Reliability	1.509	.509	.291	2.966	**.004**
		Policy	.260	.472	.053	.550	.584
Vishakhapatnam	1	(Constant)	25.937	.362		71.641	.000
		Personal Interaction	1.219	.536	.217	2.276	**.025**
		Physical Facilities	1.607	.423	.345	3.801	**.000**
		Courtesy	.853	.375	.208	2.273	**.025**
		Reliability	.885	.358	.240	2.469	**.015**
		Policy	.295	.350	.080	.842	.402
Tirupati	1	(Constant)	25.314	.182		139.325	.000
		Personal Interaction	.525	.345	.159	1.520	.132
		Physical Facilities	.401	.374	.103	1.072	.286
		Courtesy	.606	.288	.204	2.109	**.038**
		Reliability	.550	.250	.228	2.198	**.030**
		Policy	.932	.285	.317	3.276	**.001**
Hyderabad	1	(Constant)	25.901	.279		92.762	.000
		Personal Interaction	1.283	.248	.291	5.174	**.000**
		Physical Facilities	.901	.251	.198	3.589	**.000**
		Courtesy	.288	.255	.064	1.132	.259
		Reliability	1.613	.249	.355	6.469	**.000**
		Policy	.938	.249	.208	3.775	**.000**

a. Dependent Variable: Customer Retention

dimensions as independent variables. Customer Retention was measured using 7 items (Annexure IV).

H3: Service Quality factors affect Customer Retention

The results (table 2) indicated that at Vijayawada city, Courtesy (.006) and Reliability (.004) dimensions are showing significant effect on Customer Retention, at Vishakhapatnam city Personal Interaction (.025), Physical Facilities (.0000, Courtesy (.025) and Reliability(.015) are significant, at Tirupati city Courtesy (.038) and Reliability(.030) and Policy(.001) are significant, whereas at Hyderabad city Personal Interaction (.000), Physical facilities(.000), Reliability(.000) and Policy(.000) have significant effect on

Table 3: ANOVA[b]

City Name	*Model*		*Sum of Squares*	*df*	*Mean Square*	*F*	*Sig.*
Vijyawada	1	Regression	5189.256	1	5189.256	169.998	**.000[a]**
		Residual	2991.494	98	30.525		
		Total	8180.750	99			
Vishakapattanam	1	Regression	517.577	1	517.577	46.508	**.000[a]**
		Residual	1090.613	98	11.129		
		Total	1608.190	99			
Tirupati	1	Regression	475.684	1	475.684	50.176	**.000[a]**
		Residual	929.066	98	9.480		
		Total	1404.750	99			
Hyderabad	1	Regression	7778.749	1	7778.749	276.575	**.000[a]**
		Residual	6975.075	248	28.125		
		Total	14753.824	249			

a. Predictors: (Constant), Customer Retention

b. Dependent Variable: Overall Customer Satisfaction

retaining customers. It is understood that Service Quality factors significantly affects Customer Retention, hence hypothesis H3 is accepted. These results help the retailers to customize their CRM strategies according to city specific and customer specific. This also helps to understand which dimensions are critical in retaining Apparel Retail customers.

Effect of Customer Satisfaction on Customer Retention

Several researchers proved that Customer Satisfaction is precedent to Customer Retention, but the impact may vary according to geographic location. To study the effect of Customer Satisfaction on Customer Retention one way ANOVA test was administered.

H4: Customer Satisfaction affects Customer Retention

The significant values for Vijayawada (.000), Vishakhapatnam (.000), Tirupati (.000) and Hyderabad (.000) are less than .05. This indicates that in all the cities Customer Satisfaction is significantly affecting Customer Retention. It is understood that Customer Satisfaction affects Customer Retention irrespective of the geographic location.

CONCLUSION

The purpose of this study is to identify the critical dimensions of Service Quality, and also to examine how the Service Quality Dimensions affect Customer Satisfaction and Customer Retention in Apparel Retailing. The study results indicated that Personal Interaction, Physical Facilities, Courtesy, Reliability and Policies of the store are the important dimensions of Service Quality. It also revealed that Personal interaction in the store and Physical aspects of the store are more critical dimensions that affect Service Quality more. It is also proved from the study that Service Quality factors significantly affect Retail Customer Satisfaction and also Customer Retention. The importance of service quality dimensions will vary from one city to other city as there exists Cultural and Demographical differences. It is understood that in the Hyderabad City all the dimensions of Service Quality are significantly affecting Customer Satisfaction, whereas in the cities Vijayawada, Vishakhapatnam and Tirupati only some of the Service Quality dimensions are significant. This enables the service managers in taking decisions where service improvement is needed and where service can be maintained.

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ANNEXURE I: Items used for measuring Service Quality (modified RSQS scale)

Q1 : The store has modern-looking equipment and fixtures (Lighting, Furniture, Displays)

Q2 : Materials associated with this store's service (such as shopping bags, loyalty cards and Catalogs) are visually appealing

Q3 : The store has clean, attractive and convenient physical facilities (restrooms, fitting rooms)

Q4 : The store layout at this store makes it easier for customers to find what they need

Q5 : The store layout at this store makes it easier for customers to move around in the store

Q6 : When this store promises to do something (such as repairs, alterations) by a certain time, it will do So

Q7 : This store provides its services at the time it promises to do so

Q8 : This store performs the service right the first time

Q9 : This store has merchandise available when the customers want it

Q10 : This store insists on error-free sales transactions and records

Q11 : Employees in the store have the knowledge to answer customers' questions

Q12 : The behavior of employees in this store instills confidence in customers

Q13 : Customers feel safe in their transactions with this store

Q14 : The employees in this store give prompt service to customers

Q15 : Employees in this store tell customers exactly when services will be performed

Q16 : Employees in this store are never too busy to respond to customer's requests

Q17 : This store gives customers individual attention

Q18 : Employees in this store are consistently courteous with customers

Q19 : Employees in this store treat customers courteously on the telephone

Q20 : This store willingly handles returns and exchanges.

Q21 : When a customer has a problem, this store shows a sincere interest in solving it

Q22 : Employees of this store are able to handle customer complaints directly and immediately

Q23 : This store offers high quality merchandise

Q24 : This store provides plenty of convenient parking for customers

Q25 : This store has operating hours convenient to all their customers

Q26 : This store accepts all major credit cards

ANNEXURE II: Table Rotated Component Matrix[a]

	Component				
	1	2	3	4	5
Q1	.149	.818	.112	.087	.053
Q2	.693	.356	.035	-.028	.081
Q3	.306	.673	.126	.103	.252
Q4	.495	.535	-.070	.014	.106
Q5	.281	.629	.027	.096	.211
Q6	.534	.250	-.053	.137	.326
Q7	.486	.562	.222	.202	-.185
Q8	.471	.386	.273	.134	-.087
Q9	.649	.178	.145	-.026	.034
Q10	.742	.207	.198	.118	-.062
Q11	.655	.186	.246	.113	.272
Q12	.605	.227	.090	.146	.258
Q13	.695	-.016	.182	.166	.135
Q14	.662	.116	.122	.187	.251
Q15	.255	.336	.255	-.105	.609
Q16	.606	.218	-.001	.208	.215
Q17	.322	.219	.289	.474	.293
Q18	.233	.131	.723	.191	.039
Q19	.134	.014	.755	.106	.278
Q20	.080	.198	.723	.278	.017
Q21	.165	.285	.176	.395	.504
Q22	.123	.141	.209	.714	.071
Q23	.159	.048	.053	.710	.305
Q24	.203	.035	.117	.295	.656
Q25	.060	.026	.248	.681	-.022
Q26	.111	-.068	.411	.214	.343

Extraction Method: Principal Component Analysis.
Rotation Method: Varimax with Kaiser Normalization.
a. Rotation converged in 8 iterations.

ANNEXURE III: Items used for measuring Customer Satisfaction

Q1 : How satisfied were you with the price paid relative to the value of the service

Q2 : This shopping trip at this store was truly a joy and highly satisfied

Q3 : Compared to other things that I could have done, the time spent at this store was truly enjoyable.

Q4 : I enjoyed the shopping at this store for its own sake, not just for the items I have purchased.

Q5 : Shopping at this store was a complete waste of time.

Q6 : Overall, I am satisfied with the decision to choose this store

Q7 : While shopping at this store, I found just the item(s) I was looking for.

Q8 : I spent more time in this store than I originally planned

Q9 : This is my choice of store in which I regularly come to shop

Q10 : The amount of time that I spent on looking around was fairly high

Q11 : I bought more things than I expected at this store.

Q12 : I paid most of my attention on items I plan to buy on this trip

Q13 : It is very likely that I will purchase a product from this store in the future

ANNEXURE IV: Items used for measuring Customer Retention

Q1 : I used to say positive things about this store to other people

Q2 : I will recommend this store if someone asks my advice

Q3 : I encourage my friends and relatives to buy from this store

Q4 : I will consider this store as my first choice to buy

Q5 : I will visit the store again in the coming days

Q6 : I will search and buy at lowest prices from other stores

Q7 : I will switch to a competitor when I experience a problem with this store

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Performance Measurement using Balanced Scorecard: Indian Experience

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In order to more effectively cope with the significant competitive issues of increasingly sophisticated customers and management practices, accelerating globalization and matching international requirements in terms of product design, advanced process technology, quality standards and on time delivery, an innovative multi-dimensional corporate performance measurement system -Balanced Scorecard (BSC) – was developed by Kaplan and Norton. BSC today has become one of the most talked about performance managements systems and is seen as an important tool having the potential to improve organizational performance. It does not only includes financial measures which highlight the results of actions already taken but it balances these with non-financial measures concerning customer satisfaction, internal processes and the organization's innovation and improvement activities. The article starts by giving a short theoretical introduction to the concept of performance measurement, followed by Balanced Scorecard and its perspective, then selected case studies to examine the ways in which the BSC is currently being used in Indian scenario. It concludes by addressing the benefits, implications and challenges associated with BSC in Indian perspective and key issues to address in further research.

Keywords— *Performance measurement, balanced scorecard.*

INTRODUCTION

Businesses are facing tough challenges to succeed in a global competitive market. Customer demand is changing rapidly in terms of sophistication of the products and services. As a result, companies need to become more responsive to customers and market needs, with a greater number of customer specific products and/or services, more flexible processes, suppliers and resources. In the emergence of the information and competitive era, manufacturing and services organizations are required to acquire new capabilities for competitive success. The essence of the competitive advantages has shifted from tangible assets to intangible ones. Therefore, the ability of an organization to mobilize and exploit its intangibles or invisible assets has become more decisive than investing in and managing physical and tangible assets. Today's business environment requires a better understanding of customers and their needs, streamlined internal business processes and highly skilled staff who are expert in problem solving. Congruently, several management theories have evolved. Total Quality Management (TQM), Just in Time (JIT), Benchmarking, Lean Management, Balanced Scorecard and Six Sigma are some of the more well known. Each movement with its own life span, its share of popularity and level of acceptance has the same basic goal – improvement in quality by measuring performance.

The liberalization and globalization of the Indian economy compelled Indian companies to adopt

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contemporary performance measurement techniques in order to ensure survival and maintain competitive advantage. While financial measures continue to dominate in the corporate performance scorecard, there has been growing use of non-financial, forward-looking measures for performance evaluation by corporate India in today's information age (Anderson and Lanen, 1999; Joshi, 2001). The financial measures alone are inadequate tools for strategic decision-making as they are unable to ensure goal congruence between management decisions and actions. There has been growing criticism of financial measures as they are historic in nature and lack futuristic outlook (Kaplan and Norton, 1996). The other criticism of financial measures is that they strive to quantify too many things and that too in a wrong way. Their relevance in the information age is questioned. The financial measures of performance only tell about a company's past performance while non-financial measures reflect the health and wealth-creating potential of the company (Kalafut & Low, 2001). Thus, the performance measurement systems should have strategic focus and should include both financial and non-financial measures.

OBJECTIVES OF THE STUDY

The present paper is an attempt to examine the adoption of Balanced Scorecard (BSC) practices as a performance measurement system by Indian Companies and is envisaged with the following objectives:

i) To examine the conceptual framework of Performance Measurement with special reference to Balanced Scorecard;

ii) To examine the extent of usage of the Balanced Scorecard by Indian corporate sector;

iii) To evaluate the effectiveness of the Balanced Scorecard as a performance management tool.

METHODOLOGY

The purpose of this paper is to examine the adoption of Balanced Scorecard (BSC) practices by Indian companies and to evaluate the effectiveness of BSC as a performance measurement tool. By referencing relevant literature, the paper first examines the conceptual framework of performance measurement, Balanced Scorecard and its utility for business organizations. In its second part, the experiences, problems and benefits associated with designing and implementing BSC performance measures are discussed with the help of selected and reviewed case studies. The third part emphasizes the suitability of BSC as a corporate performance measurement tool and the need for further research to develop the effective and comprehensive performance measurement system for global organization.

CONCEPTUAL FRAMEWORK

Performance Measurement

Performance is how well a company does, and a measure or measurement is a quantitative value that can be scaled and used for purpose of comparison. Performance measurement can be defined as a process of assessing progress towards achieving pre-determined goals, including information on the efficiency by which resources are transformed into goods and services, the quality of those outputs and outcomes, and the effectiveness of organizational operations in terms of their specific contributions to organizational objectives (Amaratunga & Baldry, 2003). The purpose of measuring performance is not only to know how a business is performing but also to enable it to perform better. Performance measurement in business serves the purposes of monitoring performance, identifying the areas that need attention, enhancing motivation, improving communications and strengthening accountability. Performance measurement has become increasingly important due to the changing nature of work; increasing competition; specific improvement initiatives; national and international quality awards; changing organizational roles; the power of technology and changing external demands (Neely, 1999).

Development of an effective measurement system is a crucial task for any organization exposed to tough competition. Measurement is difficult in organizations because it is not an exact science with hard rules and predictable interrelationships between variables (Brown, 2000). One of the critical reasons for this is the impact of so many variables on organization's performance and hence difficulty in understanding interactions exists between those different variables.

Balanced Scorecard

In order to more effectively cope with the significant competitive issues of increasingly sophisticated customers and management practices, accelerating globalization and product or service differentiation, a number of proposals have been put forward with regard to developing more appropriate performance measurement systems. Of all the frameworks for performance measurement, it is the balanced scorecard (BSC) approach that has gained wide acceptance, particularly in the developed countries. Kaplan and Norton developed an innovative multi-dimensional corporate performance scorecard known as the Balanced Scorecard in 1992 as part of a KPMG funded research program. The Balanced Scorecard approach provides a multifaceted view of an organization's performance. More specifically, the scorecard not only includes financial measures which highlight the results of actions already taken by an organization but it balances these with operational measures concerning customer satisfaction, internal processes and the organization's innovation and improvement activities. They originally designed BSC as an evaluation and control system by incorporating financial indicators with non-financial indicators. Financial goals tell the managers what has happened. Rather they are 'lagging indicators'. The managers need to know if the business will succeed in future and the future success depends upon the non-financial goals - the 'leading indicators'.

"Balanced Scorecard is a strategic planning and management system to align business activities to the vision and strategy of the organization, improve internal and external communications, and monitor organization performance against strategic goals."

BSC compels the firm to align its performance measurement and controls with the customers' internal business processes and learning and growth perspectives and investigate their impact on the financial indicators. The name reflects the balance between short-term operational controls and long-term vision, strategy and objectives, between financial and non-financial measures, between lagging and leading indicators, and between external and internal performance perspectives (Kaplan and Norton, 1996). The Balanced Scorecard is used to guide current as well as target future performance by looking at measures in four categories:

Customer Perspective

This perspective requires an organization to know how it should create value for its customers if it is to succeed. A large, satisfied customer base means more revenues, which lead to improved financial outcome.

Learning and Growth Perspective

This focuses on innovation, creativity, competence, and capability. It also focuses on people—their attitude, culture, knowledge, development, etc., and their ability to learn and grow for managing and sustaining change and improvement.

Internal Business Process Perspective

The measures within this perspective are related to the critical internal processes and competencies where organization must excel to create customer delight and implement strategy. The managers should ensure that their businesses, based on internal processes, are running well and that the firm's products and services are meeting the customers' requirements and creating value for them.

Financial Perspective

BSC gives equal importance to the financial perspective because it provides a common language for analyzing and comparing companies. The financial measures alone are not sufficient to guide performance in creating value; they depend on non-financial measures. Moreover, this provides feedback as to whether improved performance in the non-financial perspectives is translated into monetary terms in the financial perspective box.

BALANCED SCORECARD PRACTICES: REVIEW OF LITERATURE

The implementation of the Balanced Scorecard is an innovative way to create strategic awareness in the organization. In his survey of 5,157 senior executives during the period 1993 to 1999 in 15 countries in North America, Europe, and South America, Rigby (2001) found that the corporate world has five dimensions in its performance scorecard. These are delivering financial results, building customer equity, strengthening core competencies, improving competitive positioning, and increasing the level of organizational integration. The four tools—strategic planning, mission and vision statement, benchmarking, and customer satisfaction measurement—are used globally. Nearly 44 per cent of the respondent firms reported that they are using the Balanced Scorecard. Giannetti et al. (2002) conducted a survey to investigate the integration process of both financial and non-financial performance measures in a sample of 39 Italian-based organizations. The analysis showed that the non-financial performance measures were generally used in an integrated way with financial performance measures.

Guenther & Gruening (2002) conducted a study to investigate the usage and type of performance measurement systems utilized by 181 companies in Germany. The findings showed that BSC was the dominating framework used by the sample, and most of the companies used a self-developed performance measurement system based on the original BSC approach. Oliveras and Amat (2002) conducted a survey on 254 companies in Spain, and showed that there was a possible cause-effect relationship between the drivers of profitable company growth. The improvement in the internal business process perspective might have an impact on customer satisfaction, which would improve

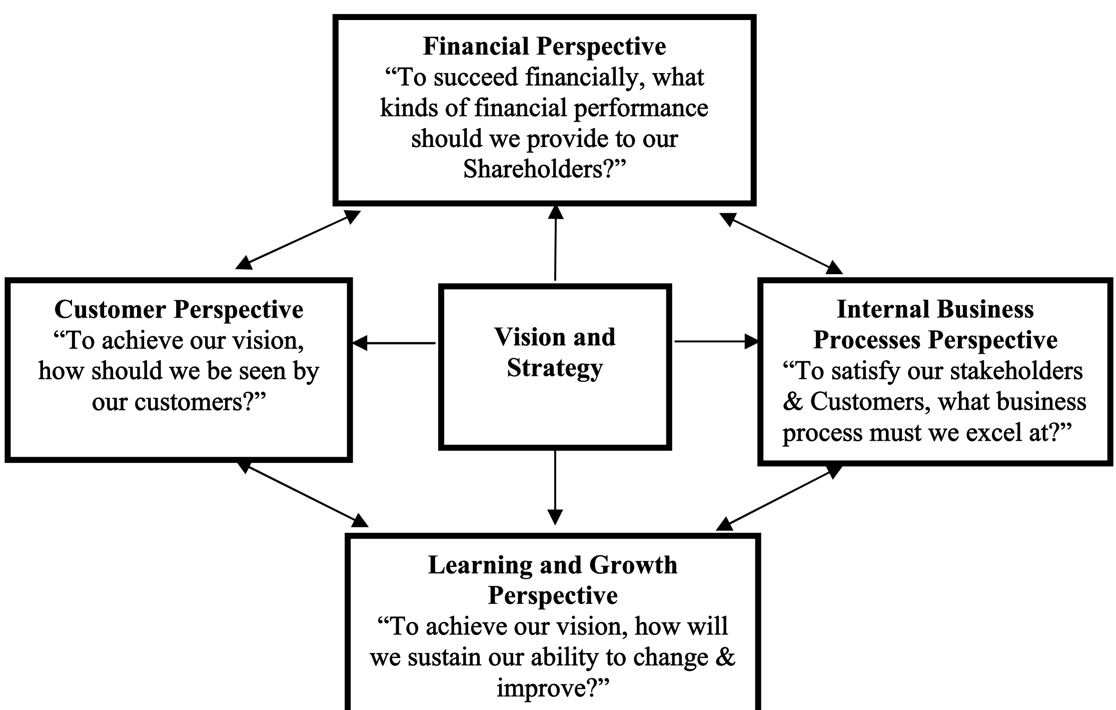

Fig. 1: The four Perspective of the Balanced Scorecard (Kaplan & Norton)

customer's loyalty leading to a growth in sales. Thus, more committed employees can stimulate a constant improvement in the business's internal processes.

Atkinson (2006) researched the role of the balanced scorecard in strategy implementation and concluded that the balanced scorecard could address the key problems associated with strategy implementation including communication, the role of middle managers and integration with existing control systems. Phillips (2006) studied the implementation of the balanced scorecard in a major UK hotel company over a three year period. The company successfully implemented the balanced scorecard using employee satisfaction, customer satisfaction, financial attainment against budget and strategic financial performance as its perspectives. Evans (2005) surveyed hotels in England in order to assess the usefulness of the balanced scorecard and concluded that a wide variety of measures were being used and that many hoteliers were using measures from all four of the category groupings identified in the balanced scorecard framework.

Frigo (2002) also highlighted that the use of balanced scorecard has enabled Hilton Hotels to achieve 5% increase in customer loyalty, and 1.1% increase in hotel annual revenues. Denton and White (2000) have investigated the application of BSC in a parent company known as White Lodging Services. They have also found that BSC helps the hotel to achieve a greater alignment of hotel's objectives between managers and owners, a higher level of understanding of property manager regarding owner's long term expectation, and valuable feedback regarding resources and processes needed to achieve hotel objectives.

Anand et al. (2003) conducted a survey of 53 Indian companies and found that 24 firms (45.28%) have adopted a BSC as a strategic tool. Balancing profit, growth, and control, balancing short-term results against long-term capabilities and growth opportunities and balancing performance expectations of different stakeholders were the key objectives for BSC scorecard adoption. Initiating the change in the organization, broadening of the performance measures, and facilitating the integration of business plans with the financial plans were the major motivations for the implementation of the BSC amongst the different sectors in corporate India. The financial perspective emerged as the most important, followed by customers' perspective, internal business perspective, and learning and growth perspective.

A survey of 60 large and medium-sized Indian manufacturing firms by Joshi (2001) found an extensive use of financial measures such as 'return on investment,' 'variance analysis,' and 'budgetary control' in performance evaluation. He also found a minimal use of non-financial measures in performance evaluation. In their study of 14 Indian firms, Anderson and Lanen (1999) found that information on customer expectations and satisfaction, competitors' performance, and internal information on process variations (e.g., quality measures, on-time delivery, and unit product cost) has assumed greater significance for strategy formulation in post-reform India. The organizational performance models of the Indian firms not only have external perspectives but are also equally important as traditional measures for increasing productivity.

BALANCED SCORECARD PRACTICES IN INDIAN COMPANIES

In India many organizations (both manufacturing and service) have implemented the balanced scorecard as a new performance measurement and management system. The implementation of the BSC is an innovative way to create strategic awareness in the organizations. The following are the experiences of some Indian companies with the balanced scorecard framework.

Tata Motors

The commercial vehicle business unit (CVBU) of Tata Motors has been inducted in the thirty-member elite club of organizations and corporate houses recognized by the prestigious Balanced Scorecard Collaborative for achieving excellence in overall company performance. Tata Motors-

Table 1: Balanced Scorecard in India Companies

Industry	*Company*
Hotels	Indian Hotels Company, ITC Hotels, The Leela Group.
Banks/Financial Institutions	ICICI Bank, State Bank of India, IDFC, Anand Rathi, NCDEX, India Infoline.
Retail	Pantaloon Retail India, Trent – Westside Retail.
Telecom	BSNL, Bharti Airtel, Orange India.
IT	Tata Consultancy Services, Infosys.
Automobile	Tata Motors.
Pharmaceuticals	Dr Reddy's Labs.
Airlines	Jet Airways.
Petroleum	HPCL, ONGC, Castrol India Ltd.
Electronics	Godrej-GE Appliances Limited, Bajaj Electricals Ltd., Usha Martin.
Others	Goodlass Nerolac Paints Limited, Kaya Skin Clinic.
Business Groups	Reliance Industries, Aditya Birla Group, Tata Group, RPG Group, Trident Group, Mahindra Group.

CVBU has been recognized for having achieved a significant turnaround in its overall performance. The implementation of the BSC has enabled greater focus on different elements of operational performance. Defining, cascading and communicating strategies across the organization have brought about transparency and alignment. The scorecard incorporates SQDCM (safety, quality, delivery, cost and morale) and VMCDR (volume, market share, customer satisfaction, dealer satisfaction and receivables). Ravi Kant, Executive Director, CVBU, Tata Motors, said, "While we were conscious of the benefits of the BSC when we began implementing it, we are extremely pleased that it has helped us achieve significant improvements in our overall performance. I believe that BSC will play an important part in our objective to become a world-class organization."

Infosys Technologies

One of the world's top IT Company, Infosys Technologies implemented the concept of BSC to track the progress of its various initiatives and to measure the impact on the organization's growth and profitability. Explaining the rationale for implementing BSC initiative at Infosys, Girish Vaidya, Head, Banking Business Unit, Infosys, "It is extremely important to migrate towards a culture of measurement where all decisions are data-driven. Only then can one manage what one can measure and at the same time ensure that every individual in the organization is aligned in the same direction and is in sync with what we are trying to achieve….a holistic approach towards implementing strategy be adopted since in an organization every function is important and no role is less significant than other." The benefits of implementing a balanced scorecard were improved communication across the entire organization and enhanced understanding of vision and strategy among individuals and departments concerned, helped in identifying deviations and allocating resource with focus on both managing current performance as well as long term value.

Godrej GE Appliances

The Mumbai-based consumer appliance manufacturing company has linked up a host of its on-going management initiatives-such as Six Sigma, Cost Take Out, and Target Ten-under one umbrella with the help of the BSC framework of strategic planning. Renaissance Worldwide is the implementing partner for BSC at Godrej GE Appliances Limited. BSC has reaped mixed results for the company so far. On the positives side:

(a) All the supply chain initiatives tied to the BSC on supplier management have added to the bottom line, with a gross impact of over Rs 9 crore in savings, (b) The process has resulted in a strong upstream supply chain and an improved vendor base backbone, (c) Cost Takeout and value engineering process has contributed to over Rs. 5crore, and (d) Profit Rs. 21 crore in the year of adoption against Rs. 3 crore in previous year. Overall, the process has yielded certain 'powerful' lessons, says Sunder Raman, VP Quality, Godrej GE Appliances. For one, all internal management initiatives have to be aligned to key statistical objectives. Two, companies have to hit upon the right strategy, and all actions have to be measurement driven and Third, the Balanced Scorecard works on a foundation of robust processes and practices.

Goodlass Nerolac Paints Limited

A leading paint company in India adopted the concept of BSC for deploying its business strategy, improving business profitability and managing organization performance. The very purpose of implementing the BSC in the Company's its endeavour to grow its business profitability over the next few years. Cedar Consulting (a global management consulting and enterprise solutions Company) assisted the Goodlass Nerolac in building and implementing the BSC framework. Highlighting the rationale for implementing BSC initiative, H.M. Bharuka, MD Goodlass Nerolac said, "As we accelerate our business growth, we need a performance management system which aligns the entire organization and allows us to measure the delivery of our strategy. The BSC helps us in reviewing our performance against targets appropriately. We have adopted the BSC to operationalize our long-term strategy and also allow us to measure our business performance clearly and give us a way to review business regularly."

Mr. Sanjiv Anand, Regional Director, Asia/Middle East and Global Head for Strategy, Cedar Consulting, said, "Cedar Balanced Scorecard enables Goodlass Nerolac to define market and customer segment priorities, short-term and long-term revenue drivers, cost management issues, key processes to be monitored and the alignment of enterprise performance with individual performance. Overall, the scorecard framework will create a strategy deployment system which will monitor month-on-month achievement against defined strategic objectives."

Pantaloon Retail India

The objective of Kishore Biyani, MD, Pantaloon Retail India behind BSC implementation was to drive the corporate strategy which comprised of the financial perspective of achieving Rs 1000 crore, reducing costs and operating efficiencies and improving return on current and new assets. The road to developing the BSC at Pantaloon began with keeping in mind the vision of the company. In order to achieve the vision, the four parameters - financials, customer service, internal processes and learning and growth - were incorporated, which would be applicable to the people in the corporate boardroom to employees at the headquarters and the stores.

The initiative increases the strategic feedback and learning for the organization as even employee non performance drives the department to understand and initiate the steps needed for correction. At the end of it, the bottom-line, said Mr. Prashant Desai, Senior Manager-Knowledge Management, was to drive the entire organization to achieve the Rs 1000 crore sales by the year 2005. Increasingly companies are realizing the importance of linking employee performance to the overall objective and vision of the company. And employee performance is not merely achieving the financial objective, but also matching up to the internal processes, knowledge gathering and also customer satisfaction.

Trent – Westside Retail Stores

The successful BSC implementation helped the Trent, the parent company of the Westside chain of retail stores, to improved turnover, profitability and continued expansion and consequently enhanced customer satisfaction delivered by the organization. "We felt a strong need to align the entire organization around a single vision; a commonly articulated strategy. There were several areas in which we needed to develop a consensus," says KVS Seshasai, Head of IT and corporate quality, and coordinator of the balanced scorecard initiative at Trent. "To gauge performance we were looking mostly at financial measures and we realized that wasn't good enough. What we needed was a more broad-based performance management system that also measured and monitored other important parameters such as what our customers feel about us, how our internal processes are performing and so on," he adds. "BSC, with its collaboratively created strategy map and four-pronged approach to performance, was a perfect fit."

"The benefits that have come out of the scorecard's implementation have been enormous. Today we are a highly profitable, rapidly growing retail organization. There have been vast improvements across the board, no matter which metric you look at," says Mr. Seshasai. Customer satisfaction levels are so high that Trent is now considered the best in class in the industry in terms of customer service.

Castrol India Limited

Castrol India Limited (CIL) started its business operations in India and established itself as a dominant brand in the premium automotive lubricants segment over a period of time. In order to respond to the current realities and to prepare itself for the emerging challenges, CIL designed and implemented a new performance management system called the balanced scorecard. Experimentation with balanced scorecard, CIL has grouped KPIs in six perspectives, viz., increased customer emphasis, financial, people, HSSE (health, safety, security, environment), ethics, and supply chain. The major advantage of the balanced scorecard is that it clearly communicates the strategy to all the constituents of the organization so that people become sensitive to the realities. BSC also helped CIL in terms of translating the vision, communicating and linking with customer and supply chain partners, sound business planning, and feedback on critical activities and their performance and creating learning culture within the organization.

Taj Group of Hotels

The Taj Group has been driving and monitoring its strategies using the BSC. This approach was adopted at the Taj group with the help of Cedar Balanced Scorecard Enterprise System. Clear initiatives identified to drive the strategies are being monitored by the top management on a monthly basis. The Group revisited its strategies and revised the metrics and initiatives to drive its vision of growth and efficiency under the current business scenario. These steps ensure that the corporate strategy gets translated into actions that are aligned across all hotels in the Taj. BSC implementation helped Taj group of hotels in terms of improved communication with employees and throughout the organization, made performance appraisals more objective, encouraged managers to focus on both long-term and short-term measures of success, ease of implementation of strategies and decisions, transparency and control over the resources, peoples and critical activities, better customer satisfaction and reduction of customers complaints.

Lakshmi Machine Works Ltd. (LMW)

LMW Ltd. was ranked by Standard & Poor's as one of the top ten emerging Indian Blue Chip Companies, and by Business Week as one of Asia's Top Growth Companies, with sales of $504 million and 3,500 employees. LMW implemented BSC to focus the company on its strategic performance drivers and to mitigate risk of cyclical nature of industry growth. Within the four years of BSC adoption revenues have soared from $120M to $504M, profits from $8.8M to $84.8M, and market capitalization from $33.8M to $1,158B. "Despite the recession in India's textile industry, we've achieved record results by becoming a Strategy-Focused Organization" says Director Sanjay Jayavarthanavelu. "The BSC has helped us to clarify our strategy, align resources to that strategy, set targets, and achieve greater transparency. More than 1,100 of our staff have their own scorecards, and the BSC has become a way of life at LMW."

North Delhi Power Ltd. (NDPL)

NDPL, a power distribution company that is a joint venture of TATA Power and the Delhi government, used BSC as a tool to transform itself from an ailing, government-owned utility to a consumer centric entity with a performance-driven culture. In the last five years revenues grew from \$275M to \$600M, operating margins went up from 8% to 20%, and customer complaints were reduced by nearly 50% in the last two years. The reliability and quality of electrical supply was improved, and customer and employee satisfaction went up 8 basis points (12%) and 5 basis points (8%) respectively. "The BSC is the strongest tool I've ever seen and used to align people in the organization to strategic objectives," according to Sunil Wadhwa, CEO. "The BSC makes everyone know what he does and why he does what he does, what to measure and why we do measure what we measure. It also clearly links the progress on measures (lead measures) to the outcomes (lag measures), and help us optimize data to improve our decision making."

DISCUSSION

This paper has assessed the performance measurement using balanced scorecard approach through a review of the available literature and through the BSC experience of Indian companies. Authors have researched that in India, many organizations have implemented BSC as a new performance measurement system which enables the managers to capture both financial and non-financial indicators. More specifically, the BSC has reaped positive results for corporate India. BSC implementation helped Indian companies in terms of reconciling the vision and strategy to the goals and objectives of the individuals and departments concerned, nurturing a learning culture among employees and inculcating competencies among them, encouraging managers to focus on both long-term and short-term measures of success, communicating and linking with customer and strategic partners, providing timely and accurate feedback on resources, people and critical activities, better customer satisfaction, reduction of customers complaints and consequently, improved financial performance.

However, the BSC has not only meant benefits. One difficulty that organizations have faced with the BSC is how to find links between the four different perspectives, and to establish a balance. Improving one perspective often means a negative effect on any of the other perspectives, thus it is difficult to balance all four perspectives. Managers find that the BSC is lacking in clarity, since it is difficult to decide and know what should be included in which perspective. Moreover, BSC adoption can be a lengthy and complex process, requiring commitment of time and resources.

IMPLICATIONS AND FUTURE RESEARCH

It is believed that the discussion and findings of the study will be of use to the industry in designing their effective, comprehensive and result oriented performance measurement system using balanced scorecard and to the academia for developing new theories and insights in the direction of establishing cause and effect relationship regarding performance measurement, balance scorecard and long term success of the organization.

Further it can be said the there is a greater acceptance of the Balanced Scorecard as a strategic management and performance measurement tool. The scope of present study is limited to review of available literature and Indian experience with BSC, therefore a large number of research issues have not been attempted and discussed. The role of corporate Indian/ corporate association in the successful implementation of the Balanced Scorecard and the relationship between the Balanced Scorecard adoption and financial performance of a firm and cause-effect relationship among different perspectives are some such potential issues for future research.

CONCLUSION

In an era of globalization, customer knowledge, and rapid change, the successful implementation of strategy plays a crucial role. A performance measurement system is needed to link the strategy with the action and it must include a balanced set of measures linked to the organization's strategy. Literature suggests that Balanced Scorecard prevails as the most influential and widely accepted performance measurement system. It translates the organization's mission and strategy into a comprehensive set of performance measures. The BSC complements financial measures of past performance with the measures of drivers of future performance. In this study, author has analyzed the current practice of the organizational performance management system with a focus on the Balanced Scorecard in India. The Indian experience shows that BSC bring many benefits to organization and help manager in terms of providing an insight on the key performance indicators of the organizational success.

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High Level Approach for Testing Banking Applications

Srinivasan Desikan

INTRODUCTION

The banking applications are becoming more complex and testing of these applications are becoming more and more challenging. Developing domain skills in banking got necessitated due to growing volume of transactions and complexity arising out of parameters such us mobile and cloud. As per reports coming out of banks the online transactions grew more than 10 times in the last one year and conventional banking systems which involves manual verifications and delays are getting phased away. Banks have lost more than 10 billion dollars in the last few years due to fraud transactions and half of them are attributed to the vulnerabilities of online applications. Few years back all industry analysts classified banking under the market segment BFSI (Banking, Finance, Securities and Insurance), however what reality has seen is that the banking corporations expanded the services to include add-on services of Finance, Securities (stock market) and Insurance. So Banks are not anymore standalone banks and nowadays they represent the entire market segment addressed by BFSI. Companies are moving away from deploying the generalists for testing these applications, to appointing domain specialists who are well aware of how the banking industry works (both good and bad) and how the applications can be used to take care of those challenges and to successfully serve their customers. Testing of banking applications needs clear understanding of the basic characteristics, special domain understanding and skills.

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BASIC CHARACTERISTICS OF BANKING APPLICATIONS

The following are the few characteristics of banking applications:

1. Multi-layer applications to serve different types of customers (deposit, loan, trading, financial services, bonds …etc)
2. Complex work flows that integrate some of the basic services such as deposits and withdrawal and integrate them into end-to-end services (Portfolio, credit rating management, wealth management …etc)
3. Compliance in doing business and implementing country specific variables by keeping the focus on global customers
4. Secure transactions and protecting the customers and banks from crime-ware/malware for online transactions
5. High rate of transactions and complying to high degree accuracy in those transactions
6. Integration with applications of other banks and governing agencies
7. Strong auditing with storage capabilities to store terabytes of customer data
8. Distributed database with business intelligence to track money-flow between parties and banks
9. Hosted from multiple places and enabled for disaster management
10. Developed using multiple technologies (mainframe, non-Web and Web based applications) but expected to work together to satisfy end-to-end customer scenarios

Table 1

Platform	*Banks that use the platform*
FlexCube	CitiBank, Barclays, Canara Bank, GE Money
Temenos	First Gulf Bank, Saudi Hollandi Bank, Bank Muscat, Union National Bank
Finnacle	SBI, ICICI Bank, BOB, IDBI Bank

11. Accessed and transacted by various mechanisms – manual, thick client, networked ATMs, PDAs, mobile …etc

The above list clearly indicate that most part of the complexities that are seen in the IT industry also hit the banking applications and these requirements make testing of banking application unique, complex but at the same time mission-critical, not to leave any scope for errors. Flaws in banking applications hit large majority of people and such flaws normally challenge the existence of a bank because of the huge losses/law-suits involved.

BANKING PLATFORMS AND APPLICATIONS

Fortunately, the complexity and strict compliance of banking requirements doesn't allow too many variants in the platforms on which the applications are written, as it will be too expensive for any bank to have their own platform. Since these platforms are also expected to send/receive data from different platforms belonging to other banks the world has seen consolidation/usage of these platforms. Here are few example platforms and the banks that use these platforms.

Even though the various platforms used are converging, to provide unique features to the customers and to show the differentiation towards excellence in service, banks have developed their own applications on top of these platforms using various technologies which throws up a challenge for test engineers.

FUNCTIONALITY TESTING

The functionality testing of banking applications involve use case scenarios and customer scenarios. So it is expected that the test engineers know the banking domain and simulate the environment and test cases that reflect the day-to-day activities of the customers. To accomplish this, applications are integrated together and test cases that span across applications are used in testing. The real challenge here is in automating those test cases. As specified earlier the application belong to several generations and technologies (legacy, non-web, web-based apps) and the testing tool that is used in automation should support these variety of applications and their integration. SOA (Service Oriented Architecture) enabled tools are preferred in this case.

NON-FUNCTIONAL TESTING

Testing the basic functionality alone is not enough, as "throughput" and "response-time" of applications are expected to be high to face the competition among the banks in winning their customers. A good performance testing that execute typical customer transactions concurrently under several load conditions of the applications, business logic and the databases, is expected to be part of the testing strategy. A global bank normally goes through millions of transactions per day and integrity and accuracy of those transactions are important for the success of the banks. Hence the transactions are also repeated in testing for prolonged time period (aka. Reliability testing) under different load conditions.

SECURITY TESTING

Banking applications are highly vulnerable to attacks with malware and intrusion/hacking techniques. Hence it is important to perform security testing that spans across various phases of development. An application is secured only if it's source code is secure and written well. So the source code that is generated for applications, is scanned for vulnerabilities in the earlier phase of development (Code scanning). Once those areas

Table 2

Testing tool	*Major Areas addressed*
HP QC/ALM	▪ Managing application life cycle management ▪ Test cases/Requirements/defects repository and traceability
HP QTP	▪ Automation of functional test cases
HP BPT	▪ Automation of business scenarios
HP Service Testing	▪ SLA testing and SOA testing for integrations
TDM	▪ Automates creation, management and masking of test data
HP Fortify	▪ Code scanning and dynamic analysis for security vulnerabilities
HP Web Inspect/QA Inspect	▪ Code scanning for web-applications
HP LoadRunner	▪ Performance/Load testing of applications

are addressed, the applications is instrumented with set of libraries and testing is performed (Dynamic analysis). This exercise brings out the security issues and those issues are addressed with seriousness. The report from security testing is often important as governance and compliance requires these testing aspects to be monitored.

SLA (SERVICE LEVEL AGREEMENT) TESTING

Banks have high degree of government regulations and reports from banks to their customers as well as to governing authorities can't miss the deadlines and intervals. If applications are taking time to run reports or taking more time to complete activities, then there is a chance that the bank can miss the contractual SLAs and end up paying interest/penalty. Not just the time the accuracy, effectiveness of the service also need to be monitored to meet those SLAs. So the functionality and scenarios mentioned in the functionality testing and non-functional testing have to undergo SLA testing to ensure they are well under the contractual, legal and compliance obligations.

TEST DATA MANAGEMENT

The volume of work involved in testing banking application is not small and that necessitated many banks to have partnership with many of the IT outsourcing companies. The majority of the testing is performed by these organizations. The success factor of any bank is in testing the real applications with real customer data. But when outsourcing is involved the details about the customer, the access details, transactions details, balance …etc, can't be passed on to people who are testing, and if done, can result in fraud. One of the features of test data management is masking the sensitive portion of the data that are supplied to testing. This feature enables this real time testing without revealing all details about customers. At the same time this approach helps in ensuring the testing effectiveness as it uses the real customer data/transactions.

TOOLS AND REPOSITORIES

As it was mentioned earlier, the banking software is not only complex but also voluminous. If testing remains manual then it impacts the timeline of service extended to the customers and the new offerings from the bank. This is often is the reason for missed business opportunity for the banks. Use of tools is important aspect of banking applications testing for this reason. Here is the list of tools that can be used in the testing for the points discussed in this paper..

SUMMARY

This paper discusses the high level approach to testing banking applications with intent to educate the students and entry level professionals. This is only the starting point in testing banking applications and other emerging technologies such as mobile and cloud make it further complex and various other aspects such as identity management testing, cloud infrastructure testing/automation, data integrity are not covered to make this paper simple. It is easily said than done as testing banking applications are far more critical and there are always multi dimensional (customers, banks, government, payer, receiver, governing body, agencies …etc) issues involved, in the topic of “Money” – and that is what many of the banks deal with on daily basis. Security in banking is another hot topic - It comes down to trusting the all parties to be free of malware and not just on the application side alone. And even with the big volume of testing and investments in testing that banks are doing today, we are not anywhere close to believe that all transactions are secure, safe, accurate and meeting expectations of all multi-dimensional stakeholders. Hence testing the banking applications is definitely a niche and interesting area that students and professionals worth considering.

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