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# TRENDS

## IN INTERNATIONAL BUSINESS

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Jean Moulin Lyon University  
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University of Economics Prague (VŠE)



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## **4th Franco-Czech Conference « Trends in International Business »**

**Magellan Research Center, IAE Lyon, Jean Moulin Lyon 3 University  
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The conference proceedings are coordinated by Catherine PIVOT, IAE Lyon, Jean Moulin Lyon 3 University.

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## **ABSTRACTS**

### **ATTRACTIVENESS OF THE CZECH REPUBLIC FOR FOREIGN DIRECT INVESTMENTS**

Magda Neuwirthová and Jan Kopecký (VŠE, Prague)

Foreign direct investors have to make decision relating to the location of their investment. In this paper some important factors influencing this decisive process is analysed. Corruption, taxation, telecommunication, education, purchasing power, labour cost and productivity are stressed.

### **THE DEVELOPMENT OF THE EFFECTIVE EXCHANGE RATES OF THE CZECH CROWN**

Daniela Baluchová and Ota Melcher (VŠE, Prague)

There have been important developments in effective exchange rates in the context of European economic integration. Effective exchange rates are of paramount importance, due to several reasons, especially for small and open economies which trade large part of both their input and output in foreign currencies. This paper looks at one such example and deals with the evolution of the effective exchange rates of CZK before and after the Czech Republic became a member of the EU. Several reasons for effective exchange rate fluctuations are depicted as well as general long term trends of recent history.



## **THE RECENT DEVELOPMENT OF SELECTED RUSSIAN INDUSTRIES AND PERSPECTIVES FOR FOREIGN INVESTORS**

Ilya Bolotov (VŠE, Prague)

The paper examines the recent development of the Russian retail trade and automobile industry as the two most dynamic industries of the Russian economy by stating main companies, sales trends and current problems that persist in both industries. Apart from this, it briefly evaluates the current investment climate in Russia and perspectives for foreign, especially Czech and French, companies in general and in the mentioned industries of the Russian economy.

## **ENTERING CENTRAL AND EASTERN EUROPEAN MARKETS THROUGH GATEWAY STRATEGIES: THE CASE OF THE FRENCH COMPANY SLAT**

Noémie Dominguez and Ulrike Mayrhofer (Magellan, IAE Lyon)

This paper focuses on the international development of SLAT, an independent SME which develops, produces and markets solutions of secured alimentations. Located in the Rhône-Alpes region, the company has 67 employees. The SME has mainly developed in international markets through export activities: it realizes 15% of its total sales abroad and its products are marketed in 37 countries. The company has recently decided to implement a sales subsidiary in Germany to strengthen its presence in international markets. In this process, the company was accompanied by ERAI (Entreprise Rhône-Alpes International), a French agency which helps companies from the Rhône-Alpes region to expand into foreign markets. The authors of this paper explain the role played by ERAI in the establishment of the foreign subsidiary and the influence of a successful accompaniment experience on the internationalization process.

## **MARKETING ANALYTICS FOR ASSESSING SME POTENTIAL IN CZ & RU**

Pramod Dasan (VŠE, Prague)

**Purpose** - This paper aims to focus on the determinants influencing the internationalization of small and medium-sized enterprises (SMEs) in Czech Republic and Russia. The objective is to investigate and evaluate the business environment and, then, examine the importance of developing and promoting entrepreneurship to allow SMEs in Czech & Russia to develop a competitive position in the international marketplace.

**Design/methodology/approach** - An overview is provided of the current economic situation facing SMEs in CZ & RU. Then factors necessary for the expansion of the business are discussed, along with the challenges of overcoming the resource gaps identified. We have conducted empirical surveys and used SPSS statistical tools to predict the potential of revenue growth in SME sector.

**Findings** - Information is provided concerning the current situation for SMEs in CZ & RU and the challenges encountered as they face a business environment that is becoming more competitive. We also found that SMEs are more and more integrated to global economy and not limited to regional/international activities. Quantitative analysis has shown there is significant potential for SME for next couple of year despite economic uncertainty.

**Originality/value** - This paper integrates entrepreneurship, resource-based internationalization of SMEs in India, specifically focusing on the use of technology.

## **NON-FINANCIAL EXPORT PROMOTION FRAMEWORK FROM SME'S POINT OF VIEW: EXAMPLE OF THE CZECH REPUBLIC**

Stanislav Richter (VŠE, Prague)

This article elaborates specific non-financial export promotion framework in the Czech Republic. It reviews the current literature and introduces the basic approaches and objectives that should be followed by properly established export promotion system and describes the historical as well as contemporary development of the non-financial export support scheme in the Czech Republic. Subsequent research is then conducted in order to obtain unbiased view on actual situation. For this purpose SMEs are approached to review the export promotion framework and share their opinion.

## **DELIVERING SUSTAINABILITY THROUGH SUPPLY CHAIN DISTRIBUTION NETWORK REDESIGN**

Denise Ravet (Magellan, IAE Lyon)

**Purpose** - Companies could gain competitive advantage (cost, service, green/sustainable) through the supply chain network. The goal of this article is to study how to deliver sustainability through the supply chain distribution network redesign.

**Design/methodology/approach** - A literature review is conducted to examine research relating to sustainable supply chain strategies and supply chain distribution network redesign.

**Findings** - A study of the supply chain literature reveals the importance to rethink the supply chain distribution network design and to treat sustainability as integral to operations.

## **FOOD MARKETING TO CHILDREN- INTRODUCTION TO ETHICAL ISSUES**

Květa Olšanová (VŠE, Prague)

The working paper provides an overview of key stakeholders involved in the food marketing to children in Europe and in the Czech Republic. It analyzes the role of the legislation as well as of voluntary codes of conduct in the food industry. The industry part of the issue is also covered by explanation of their role and position in the obesity issue. The form of food industry cooperation at the Food Chamber through a working group of involved companies is analyzed and an example of the corporate responsibility program is shown. The paper is going to serve as a review of the issue for further exploration needs.

## **WOMEN IN MANAGEMENT RESEARCH: THEORETICAL PERSPECTIVES**

Cansu Akpınar-Sposito (Magellan, IAE Lyon)

The purpose of this literature review is to analyze the different theoretical approaches in female leadership in the global arena. The literature review comprises peer-reviewed journal articles, white papers, conference proceedings and institutional reports by multilateral organizations on the topic of women in management and career barriers for women. Firstly, we examine the theory of Fagenson, and afterward biological models, socialization models, and structural/cultural models in an organization will be discussed.

## **MANAGING CHANGE AND INCORPORATING THE LEARNING ORGANIZATION CULTURE IN ACADEME**

Syed G. Abbas (Magellan, IAE Lyon), Muhammad Imran Qureshi (Comsats University, Pakistan), Muhammad Tariq Yousafzai (FAST-NUCES Peshawar, Pakistan)

This survey is based on few months of participant observation, informal exchanges, and formal interviews and explores higher education sector of Pakistan in the context of change management and Learning Organization (LO). Literature on change and learning shows that organizational learning takes place when employees and employers act as learning agents for the organization by timely responding to changes in the external and internal environments (Argyris and Schön, 1997). In other words, organizations with proactive approach towards change make “change management” an important ingredient of their culture and incorporate the learning organization principles in true spirit. Inspired with the phenomenon of “learning organization” presented by Senge (1990), James (2003), and Garvin et al., (2008), this preliminary exploratory study focuses particularly on the organizational learning and change, witnessed by higher education sector of Pakistan and sheds light on how the public sector, semi government and private sector universities have addressed this challenge. For this study primary data was collected using semi structured interviews supported by a questionnaire. However some data from secondary sources has also been used as additional sources of information. Results revealed that semi government and private sector faculty were on same page, as they have been found proactively addressing the issues of change and learning as compared to the public sector.

## **A COMPARISON OF THE CONDITIONS OF THE 1980'S AND AT PRESENT, CULTURAL DIFFERENCES, THE IMPACT ON CURRENT BUSINESS ACTIVITIES IN IRAQ**

Miloslav Hostaša (VŠE, Prague)

Brief characteristic of business of Czechoslovak companies in Iraq in 1980's during the period of rule of S. Hussein, evaluation of Iraqi businessmen, way of doing business. Roles of the personnel of the commercial department of the Czechoslovak Embassy. Current situation and the way of doing business in private and in state sector under the new conditions in Iraq. Comparison of both periods, conclusions and recommendations.



**PART 1 –  
DOING BUSINESS IN CENTRAL AND  
EASTERN EUROPE**



# ATTRACTIVENESS OF THE CZECH REPUBLIC FOR FOREIGN DIRECT INVESTMENTS

**Magda Neuwirthová, Jan Kopecký<sup>1</sup>**

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## **Abstract**

*Foreign direct investors have to make decision relating to the location of their investment. In this paper some important factors influencing this decisive process is analysed. Corruption, taxation, telecommunication, education, purchasing power, labour cost and productivity are stressed.*

## **Keywords**

*foreign direct investments, corruption, human resources.*

**JEL classification: D73, F21, F66, J01, J24, J30.**

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## **Introduction**

An internationally recognized consulting company PricewaterhouseCoopers performed research among transnational corporations, which had invested in the Czech Republic. This research was carried out at the end of previous millennium.

Twelve criteria were chosen, specifically: labour and total costs (I), stability of the national economy (II), investment incentives (III), advantageous tax system (IV), stability of political system (V), local availability of skilled management (VI), appropriate infrastructure (VII), availability of building site (VIII), telecommunication (IX), bureaucracy (X), corruption (XI), size of the domestic market (XII). Each criterion was appreciated by point according to the scale starting from 1 point to 10 points. The more points assigned, the more importance of this criterion for investing in the Czech Republic.

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Tab. 1: The importance of factors influencing direct investing to the Czech Republic

Criterion	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
Score	8,4	8,1	8,1	7,8	7,6	7,6	7,6	7,2	6,8	6,3	5,8	4,4

Source: Plchová, Lukáš, Hradová (2002, pp. 129).

Following text is based on analysis some of problems mentioned above.

### **Corruption**

Large scope of corruption in an economy is serious problem for doing business there. Transparency is very important for effectiveness of economic transactions. Paying a bribe to a public clerk increases total costs of the business activity. Additionally, the corruption creates bad conditions for bringing up young people. The youth becomes less solid in the environment of widespread corruption, because young people get used seek for immoral means of accomplishing their goals. Apart from the system of education, the level of corruption in an country influences the quality of labour force and consumers very much.

Measuring the rate of corruption in an society is very difficult task. Transparency International non-governmental and non-profit organization, which has subsidiaries all over the world. The objectives of this organization are observing and analyzing the corruption in countries and putting pressure on governments in order to reduce bribery. For purpose of measuring the scope of corruption in particular countries Transparency International issues annually the list of countries, in which each country receives points. It is called Corruption Perception Index (CPI), which reflects the size of corruption in public sector by perception of respondents. It should be stressed the perception concerning corruption is not the real size of corruption. The scale for each national economy is from zero to one hundred. The less points a country is granted, the larger size of corruption there.

Tab. 2: CPI for 2012.

Rank	Country	CPI score	Rank	Country	CPI score	Rank	Country	CPI Score
1	Denmark	90	46	Hungary	55	133	Kazakhstan	28
1	Finland	90	<b>54</b>	<b>Czech Republic</b>	<b>49</b>	133	Russia	28
1	New Zealand	90	62	Croatia	46	139	Azerbaijan	27
9	Canada	84	62	Slovakia	46	144	Ukraine	26
13	Germany	79	66	Romania	44	154	Kyrgyzstan	24
17	Japan	74	69	Macedonia	43	170	Turkmenistan	17
19	United States	73	75	Bulgaria	41	170	Uzbekistan	17
25	Austria	69	80	China	39	174	Afganistan	8
37	Slovenia	61	94	Moldova	36	174	North Korea	8
41	Poland	58	113	Albania	33	174	Somalia	8

Source: Transparency International (2012), own processing.

In 2012, the Czech Republic occupied 54<sup>th</sup> place among almost 180 countries and was granted 49 points. It is interesting, that Denmark and Finland are the best in anti-corruption conditions at the same time they are societies with huge share of public sector on the whole economy. On the other hand, the positions of Somalia, North Korea and Afganistan are not surprising.

Tab. 3: Development of CPI from 2009 to 2012.

country\year	2009	2010	2011	2012
Germany	14	15	14	13
Austria	16	15	16	25
Poland	49	41	41	41
Hungary	46	50	54	46
<b>Czech Republic</b>	<b>52</b>	<b>53</b>	<b>57</b>	<b>54</b>
Slovakia	56	59	66	62

Source: Transparency International (2012), own processing.

From the dynamic point of view, position of the Czech Republic was worsening between 2009 and 2011, the previous year is exception to this tendency. Among the former centrally planned economies included in Central Europe, Poland and Hungary are more successful in comparison with the Czech Republic and the Slovak Republic.

## Taxation

A tax burden is something, which seriously influences an economic activity in an economy. Taxes reduces incentives to work, do business, consume. High taxes stimulate illegal tax evasion apart from legal optimization of paying taxes called tax avoidance.

Measuring the tax burden in an economy, statistics use index called tax quota. This indicator is calculated as the share of taxes paid on gross domestic product. In the Czech Republic the relative amount of taxes levied on economic agents there is lower than in Austria, Germany and Hungary. Poland and Slovakia are more attractive from the tax burden point of view.

Tab. 4: Development of tax quota from 2001 to 2011 (in %).

territory\ year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
EU-27	40,7	40,1	40,1	39,9	40,2	40,7	40,6	40,4	39,7	39,6	40,0
Austria	46,8	45,3	45,2	44,6	43,6	43,0	43,2	44,2	44,1	43,6	43,7
Germany	40,9	40,4	40,6	39,7	39,7	40,0	40,0	40,2	40,8	39,3	40,0
Hungary	38,8	38,1	38,1	37,8	37,5	37,4	40,5	40,4	40,2	38,0	37,1
<b>Czech Republic</b>	<b>33,8</b>	<b>34,6</b>	<b>35,5</b>	<b>35,9</b>	<b>35,7</b>	<b>35,4</b>	<b>35,9</b>	<b>34,5</b>	<b>33,4</b>	<b>33,5</b>	<b>34,5</b>
Poland	32,2	32,7	32,2	31,5	32,8	33,8	34,8	34,3	31,8	31,8	32,4
Slovakia	33,2	33,1	33,0	31,7	31,5	29,4	29,5	29,4	29,1	28,3	28,8

Source: Eurostat (2013c), own processing.

Not only the aggregate look at the tax burden is possible and appropriate. We should distinguish between indirect and direct taxes (and special kind of direct taxes called social contributions). Direct taxes are negative for economic activity, indirect taxes are relatively transparent and easily collectible. On the other hand, imposition tax on

consumption is risky from the business cycle point of view. Reduction of disposable income and consequent decrease in consumption is a serious problem for aggregate demand and achieving full employment.

In 2011, the share of direct taxes on total tax revenue in the Czech Republic was the second lowest among the Central European economies. In the indirect taxes (especially corporation taxes and personal income tax) the Czech Republic is its position comparatively higher. Specific feature of the Czech public finance is extremely high share of social contributions on tax revenue (it is the highest position among all members of EU-27 (Eurostat, 2013b). Problem of the Czech pension scheme and health care services has to be solved immediately in order to avoid weakening competitiveness.

Tab. 5: The structure of tax revenues in 2011 (in % of total tax revenues).

	indirect		direct		social
Hungary	45,8	EU-27	33,2	<b>Czech Republic</b>	<b>44,7</b>
Poland	43,3	Austria	30,9	Slovakia	43,0
Slovakia	37,9	Germany	30,0	Germany	40,1
Austria	34,7	Poland	21,7	Hungary	35,5
EU-27	34,5	<b>Czech Republic</b>	<b>21,1</b>	Poland	35,3
<b>Czech Republic</b>	<b>34,2</b>	Slovakia	19,1	Austria	34,6
Germany	29,8	Hungary	18,7	EU-27	33,5

Source: Eurostat (2013b), own processing.

## Costs and productivity of labour

Labour source is internationally less mobile than capital. So the transnational company has to take into account price of locally available workers. The economic growth is inherently connected with increasing capital/labour ratio and the cost of labour force loses its huge importance.

Tab. 6: Labour costs per hour in EUR (according to the purchasing power parity).

Territory/ Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Germany	23,3	23,6	24,0	25,0	25,6	26,2	26,8	26,9	27,2	27,7
EU-25	16,9	17,2	18,0	19,2	19,6	20,3	20,6	21,1	21,2	
<b>Czech Republic</b>	<b>3,0</b>	<b>3,2</b>	<b>3,4</b>	<b>3,9</b>	<b>4,6</b>	<b>5,4</b>	<b>5,5</b>	<b>5,9</b>	<b>6,6</b>	<b>7,1</b>
Hungary	3,2	3,0	3,1	3,6	4,0	4,9	5,1	5,5	6,1	6,3
Poland	3,4	3,7	4,1	4,5	5,3	5,3	4,7	4,7	5,6	6,0
Slovakia	2,6	2,9	2,8	3,1	3,3	3,6	4,0	4,4	4,8	5,3
Germany /EU-25	1,38	1,37	1,33	1,30	1,31	1,29	1,30	1,27	1,28	
<b>CR/EU-25</b>	<b>0,18</b>	<b>0,19</b>	<b>0,19</b>	<b>0,20</b>	<b>0,23</b>	<b>0,27</b>	<b>0,27</b>	<b>0,28</b>	<b>0,31</b>	
Hungary /EU-25	0,19	0,17	0,17	0,19	0,20	0,24	0,25	0,26	0,29	
Poland/ EU-25	0,20	0,22	0,23	0,23	0,27	0,26	0,23	0,22	0,26	
Slovakia/ EU-25	0,15	0,17	0,16	0,16	0,17	0,18	0,19	0,21	0,23	

Source: Machková, Taušer et al. (2007, pp. 156), Plchová, Abrahám, Helísek (2010, pp 112), own calculations.

During studied 10 years Czech labour costs were increased more than twice and became the most expensive among post-communist countries in the Central Europe. However, an average German employee is four times more expensive than Czech one and an average employee of EU-25 is three times more expensive than average Czech worker.

Tab. 7: Comparative productivity of labour per one worker (in %, according to the purchasing parity power)

	1997	1998	1999	2000	2001	2002	2003	2004	2005
EU-25	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
Austria	113,7	113,4	114,2	115,5	112,9	112,0	115,7	116,4	115,8
Germany	106,3	104,8	103,3	101,4	100,3	99,7	104,2	102,8	102,3
Hungary	59,2	60,1	59,4	61,9	65,4	67,7	68,6	69,7	71,2
<b>Czech Republic</b>	<b>57,1</b>	<b>56,7</b>	<b>58,4</b>	<b>58,2</b>	<b>59,1</b>	<b>60,2</b>	<b>63,7</b>	<b>65,9</b>	<b>66,7</b>
Slovakia	49,9	51,2	52,3	54,6	56,0	59,0	62,1	64,7	67,8
Poland	46,9	48,0	51,1	53,2	54,0	56,0	57,2	58,8	59,0

Source: Machková, Taušer et al. (2007, pp. 160,161), own calculations

Costs of labour force should be compared to its productivity. Level of the Czech Republic is in this indicator at 66,7 % of the EU-25 level. In the context of previous labour costs relations we can see competitive advantage of Czech labour force.

## Education

Modern economies are tightly linked with education, there is strong dependency between high level of gross domestic product per capita and qualification of labour force. Economy based on knowledge, knowledge society are notions typical for modern world. Each national system of education has its own characteristic features, which has background in national culture. It makes international comparison difficult. On the other hand, financial data are available (collected by Organisation for Economic Co-operation and Development, OECD). It enables us to compare many economies and their systems of education.

Tab. 8: Share of education expenditures on gross domestic product (in %)

Year\ Territory	Austria	OECD total	Poland	Germany	<b>Czech Republic</b>	Hungary	Slovakia
1995	6,1	5,8	5,2	5,1	<b>4,8</b>	4,8	4,6
2000	5,5	5,9	5,6	4,9	<b>4,0</b>	4,4	4,1
2005	5,5	6,0	5,9	5,0	<b>4,5</b>	5,1	4,4
2009	5,9	6,4	5,8	5,3	<b>4,8</b>	4,8	4,7

Source: OECD (2012), own processing.

Ordinary measure of importance dedicated to education is ratio, in which nominator represents amount of money spent on education (both public and private) and in denominator is gross domestic product. Among post-communist economies in the Central Europe Poland is leader, the Czech Republic and Hungary have relatively the same position, the Slovak Republic has the weakest position. Globally (OECD, 2012), Iceland is at the highest position (8,1), Indonesia (3,6) and India (3,5) are the worst all over the world.

Tab. 9: Change in studied indicator (in %, comparison 2009 and 1995).

Territory	Brazil	Poland	OECD total	Germany	Slovakia
Change	50	12	10	4	2
Territory	Hungary	Czech Republic	Austria	Canada	Israel
Change	1	-1	-4	-9	-9

Source: OECD (2012), own calculations.

From dynamic point of view we can look at the change in the ratio, which was mentioned above. It depicts movement from 1995 to 2009. From the Tab. 9 we can see that Brazil is the best country all over the world (the increase in studied indicator by 50 %), the worst is Israel (decrease by 9 %). The Czech Republic is the worst from the post-communist Central European societies, Poland achieved excellent result.

### Telecommunication

Developed telecommunication infrastructure is one of the assumption for realization specific activities. It facilitates communication with suppliers and costumers, makes more effective propagation and the whole range of marketing activities.

Tab. 10: Participants in mobile phone net per 100 citizens.

Country	Czech Republic	Germany	Austria	Hungary	Poland	Slovakia
2008	135	130	129	122	109	102
Country	Austria	Germany	Czech Republic	Hungary	Slovakia	Poland
2000	76	59	42	30	23	17

Source: Český statistický úřad (2009), own processing.

Number of participant in a mobile phone net related to one hundred inhabitants. As we can see from TAB DOPLNIT, the Czech Republic has being leader in this indicator among the Central European post-communist economies. Additionally, it became the best country among all six important Central European economies, because it had outpaced Austria and Germany.

Tab. 11: High-speed accesses per 100 inhabitants.

Country	Germany	Austria	Czech Republic	Hungary	Slovakia	Poland
2008	27	21	19	15	11	9
Country	Austria	Germany	Czech Republic	Hungary	Slovakia	Poland
2005	14	13	7	6	3	2

Source: Český statistický úřad (2009), own processing.

In the second half of the last decade the Czech Republic was at the top among former centrally planned economies in the Central Europe in high-speed Internet access (measured as relation of number of Internet accesses and one hundred persons), Germany and Austria were more successful. We should note, that the distance of the Czech Republic from Austria and Germany decreased.

### Size of domestic market

The size of an average purchasing parity in an economy is measurable by gross domestic product per capita. High level of this indicator tell us that demand for luxurious goods exists there. The indicator is usually adjusted according to the purchasing power parity, which takes into consideration the influence of different level of prices among economies.

Tab. 12: Comparative gross domestic products (in %, according to the purchasing power parity)

Year\territory	EU-27	Austria	Germany	Czech Republic	Slovakia	Hungary	Poland
2007	100	124	115	83	68	61	54
2008	100	124	116	81	73	64	56
2009	100	125	115	83	73	65	61
2010	100	127	119	80	73	65	63
2011	100	129	121	80	73	66	64

Source: Český statistický úřad (2013a), own processing.

Austria exceeds the level of EU-27 by almost one third, analogously it is 20 % in case of Germany. The Czech Republic is the most developed among former centrally planned, but its position (in comparison with EU-27) was weakening in the last studied years. Slovakia, Hungary and Poland were strengthening in mentioned years.



Tab. 13: Share of particular countries on total population of EU-27 (in %).

Territory	EU-27	Germany	Poland	Czech Republic	Hungary	Austria	Slovakia
1.1.2012	100	16,25	7,65	2,09	1,98	1,68	1,07

Source: Eurostat (2013a), own calculations.

We should take into account the whole size of domestic market measured by number of inhabitants. Weak position of Poland in gross domestic product per capita is compensated by population (it creates almost 8 % of population of 27 member states of EU). The Czech Republic has (in connection with gross domestic product per capita) relatively strong position compared to Hungary, Austria and Slovakia.

Tab. 14: Share of gross national savings on disposable income (in %).

Territory	Germany	Austria	EU-27	Hungary	Slovakia	Czech Republic	Poland
2011	16,48	12,60	11,11	10,38	9,85	9,58	2,11

Source: Český statistický úřad (2013b), own processing.

The share of savings on disposable income give us information concerning propensity to consume. In 2011, the positions of Hungary, Slovakia and the Czech Republic are approximately the same (i.e. near below the EU-27), but Poland is characterised by strong inclination to consumption.

### **Stability of economic and political system, bureaucracy**

All post-communist countries underwent an operation of tranformation, i.e. systemic change from centrally planned economy to market economy based on private ownership, change from totalitarian political regime to plural and democratic society.

The economic changes costed very much. High rates of inflation and drop in gross domestic product. In the Czech Republic the economic performance fell by approximately 15 % in the beginning. Czechoslovak general price level jumped by 56,7 % (according to the consumer price index) in 1991. In Poland these changes were more radical, in Hungary underwent gradual changes (Holman, 2000, pp. 32-38)

All former centrally planned economies belong to converging economies. Their economic growth is connected with real currency appreciation. This is one of the reasons for economic instability.

The political conditions in the Central Europe is comparatively stable, but there are problems concerning corruption, frequent changes of legislation. Corruption was discussed. Often repeated changes of laws are logical consequence of need of change institutional background in order to approximate these countries to modern societies. Adoption of *acquis communautaire* is institutional anchor (Klvačová, 2003, pp.141) in the sense of improvement of institutional framework. On the other hand, frequent changes complicate decision entrepreneurial decision making, make forecasting harder (Sojka et al., 2009, pp.15).

### **Appropriate transport infrastructure, available building site, investment incentives**

The Czech infrastructure is considered as a country with dense railway network in international comparison (Plchová, Abrahám, Helísek, 2010, pp. 126). Construction of new highways and reconstruction of existing road infrastructure is important problem of today's situation. It is caused by problems of fiscal policy resulting from growing public debt and inefficient spending public money (this problem is tightly linked to the high level of corruption).

The Investment and Business Development Agency (CzechInvest) is state-owned organization, which promotes the Czech Republic as the advantageous destination for foreign direct investments. It was established in 1992. Seriously increased governmental support for foreign direct investments has been in 1998, when the system of investment stimuli was legally founded (tax concessions, subsidies granted for hiring employees, providing industrial estate equipped with underground facilities) by the governmental decision.

### **Conclusions**

Corruption is serious problem for transitive societies. In the previous years situation in the Czech Republic was worsening. Among the Central European countries only Slovakia was worse than the Czech Republic.

In past three or four years the tax quota was decreasing. Lower tax quota is shown only by Poland and Slovakia. Share of direct taxes on total tax revenue is very low in the Czech Republic, but there is problem of huge percentage of social contributions.

The Czech labour force is the most expensive among the post-communist Central European countries, it is compensated by comparatively excessive level of productivity.

The share of education expenditures on gross domestic product lower than OECD total, Hungary and Slovakia are worse than the Czech Republic. Additionally, this share in the case of the Czech Republic decreased in comparison 2009 and 1995 (in Austria there was higher decrease, but the Czech Republic should more invest into education because of its less development).

Czech users of mobile phone and high-speed Internet are comparatively numerous. Telecommunication is very developed there. Modernization of transport infrastructure is slowed down by problems of fiscal policy.

The Czech economy is the most affluent among former centrally planned economies in the Central Europe. The weakness is size of population, which makes this market less attractive. Rate of savings is at the similar level with Slovakia, Hungary. This level is lower than Austrian and German rates.

The former centrally planned societies underwent many significant changes in past two decades, but basic institutions of market economy and democratic society were created. People living in these countries are more flexible.

### **Acknowledgement**

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# THE DEVELOPMENT OF THE EFFECTIVE EXCHANGE RATES OF THE CZECH CROWN<sup>2</sup>

Daniela Baluchová and Ota Melcher<sup>3</sup>

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## Abstract

*There have been important developments in effective exchange rates in the context of European economic integration. Effective exchange rates are of paramount importance, due to several reasons, especially for small and open economies which trade large part of both their input and output in foreign currencies. This paper looks at one such example and deals with the evolution of the effective exchange rates of CZK before and after the Czech Republic became a member of the EU. Several reasons for effective exchange rate fluctuations are depicted as well as general long term trends of recent history.*

## Keywords

*real and nominal exchange rate, effective exchange rate, appreciation, depreciation*

**JEL classification: E31, E42, F31, F36.**

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## Introduction

There have been important developments in effective exchange rates in the context of European economic integration. Effective exchange rates are of paramount importance, due to several reasons, especially for small and open economies which trade large part of both their input and output in foreign currencies. This paper looks at one such example and deals with the evolution of the effective exchange rate of the Czech crown (CZK) before and after the Czech Republic became a member of the EU.

Firstly, the paper deals with the methodology behind the effective exchange rates calculations of CZK. While taking economic theory and data availability into account, it presents different possibilities available for expressing the nominal and real effective exchange rates of CZK and the options eventually used at present. Particularly, it

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discusses the method of trade weights<sup>4</sup> in case of nominal effective exchange rate and the use of deflators to calculate the real one. Such methodology is also used to construct harmonised competitiveness indicators for individual EU Member States. Subsequently the paper looks at both nominal and real effective exchange rates and depicts their mutual link. Lastly the trajectory of the EUR/CZK exchange rate is discussed on the basis of most prominent variables that stand behind its long term path of development.

### **Definition and methodology - NEER**

The nominal effective exchange rate (NEER) is usually expressed as an index portraying the strengthening (index higher than 100) or weakening (index lower than 100) of the domestic currency vis a vis a group of selected currencies for a definite period in relation to a base period.

According to the guidelines of the International Monetary Fund (IMF) the NEER may be constructed in several ways. The most common method utilizes the weighted geometric average of nominal exchange rates, while considering the shares of country's most significant trading partners in total exports and imports.<sup>5</sup> The NEER equivalent is thus so called trade-weighted currency index (ARAD, CNB).

The NEER construction method employed by the European Central Bank (ECB) similarly comprises the shares of largest trading partners however only considers those groups of goods which less susceptible to government measures and which better reflect the level of international competitiveness achieved. Hence the trading partners' shares in exports and imports are derived from the goods turnover in groups 5–8 of the Standard International Trade Classification (SITC) (De Clercq et al. 2012).<sup>6</sup>

The NEER index is constructed on monthly and annual average basis. It is calculated for 13 currency areas in a time series based on the year 2010.

### ***Sources of data and their processing***

Based on the dataset (statistics) on the territorial and commodity structure of foreign trade provided by the Czech Statistical Office for 2010, group of countries representing approximately 90% of the Czech Republic's foreign trade was selected. In total 27 countries

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<sup>4</sup> Theoretical foundations outlined by Paul Armington, in "A Theory of Demand for Products Distinguished by Place of Production" from 1969 (published as a IMF working paper).

<sup>5</sup> The sum of these trading partners' ratios on total turnover is 89.5 % of the total exports and imports of the Czech Republic.

<sup>6</sup> The sum of these trading partners' ratios on total turnover is 90.2 % of the total exports and imports of the Czech Republic.

were chosen as the main import and export partners, naturally, not necessarily represented in both categories equally. To provide for the calculations, the euro area members are subgrouped in a single currency area, their number always corresponds to the actual state.<sup>7</sup> The weights are then calculated using the methods described above, i.e. either comprising the entire goods turnover of the Czech Republic (the IMF variant) or incorporating only four mentioned SITC groups<sup>8</sup> which, according to the ECB, better reflect the fundamentals of competitiveness attained.

As such there are 13 currency areas, and CZK exchange rates are calculated as average monthly rates from the Czech National Bank (CNB) exchange rate database. Currencies lacking history in the CNB database were used from IMF monthly statistics.

Tab. 1.: Trade weights used in construction of NEER, 2010

IMF variant	in %	IMF variant	in %
Currency area	Base year 2010	Currency area	Base year 2010
Euro area	65,4	Euro area	66,1
Russia	4,5	Russia	2,2
Poland	7,0	Poland	6,3
United Kingdom	3,9	United Kingdom	4,2
USA	2,2	USA	2,5
Japan	1,6	Japan	1,7
Hungary	2,5	Hungary	2,5
Switzerland	1,5	Switzerland	1,7
Sweden	1,4	Sweden	1,6
Denmark	0,8	Denmark	0,8
China	7,2	China	8,2
Korea	1,0	Korea	1,2
Romania	1,0	Romania	1,0
Total	100,0	Total	100,0

Source: CNB, ARAD database

<sup>7</sup> In the process of the construction of the index, the trade (exports and imports) of the euro area members is incorporated as a single weight using the EUR/CZK exchange rate (or ECU/CZK rate up to 1998 incl.).

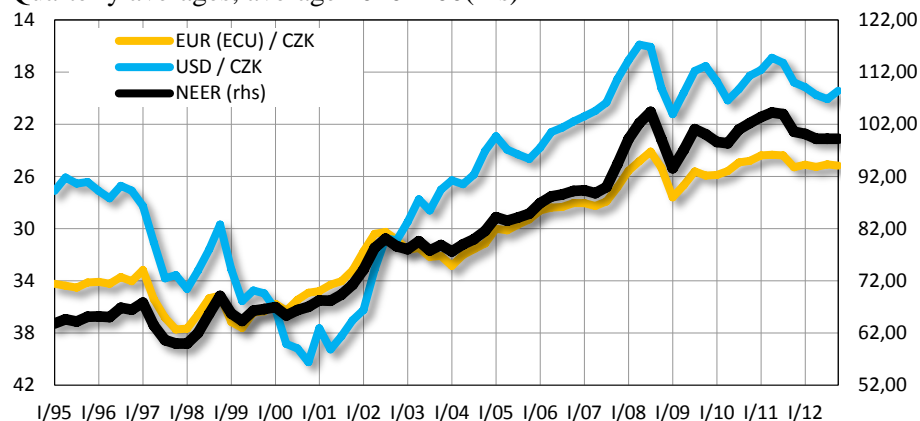
<sup>8</sup> Those are (SITC groups): chemicals and related products - group 5  
 manufactured goods classified chiefly by material - group 6  
 machinery and transport equipment - group 7  
 miscellaneous manufactured articles - group 8



Figure 1 shows the development of the nominal exchange rates of CZK towards EUR and USD, as well as the NEER line for period of 1995-2012. NEER is constructed with a help of the total trade turnover method.

Fig. 1: nominal exchange rates

Quarterly averages, average 2010=100(rhs)



Source: ARAD database, CNB, Eurostat, own calculations

### Definition and methodology - REER

The concept of the real effective exchange rate (REER) can be understood as comparison of levels of relative prices/costs stated in a certain currency, as such it signals, among other indicators, the level the international competitiveness of an economy. Deterioration or rather a downward trend in economy's competitiveness in relation to the base period is indicated by REER values above 100, whereas REER levels below 100 signals rising competitiveness of the country relative to the base period, as the level of process/costs is lower compared to external environment (Mandel et al. 2003).

In the context of REER calculations the ratio of the weighted geometric average of the nominal exchange rate index to the GDP deflator differential, with the weights given by the shares of the economy's largest trade partners in the total trade turnover (similarly to the NEER).

The REER calculation method utilizes the GDP deflators of 12 states outside of the euro area and then all euro area countries. For the sake of simplicity the euro area is identified as a single currency and price/cost area. Again, the number of euro area countries is updated to the actual state. The selected countries and their respective weights are the same to those used to compute the NEER. Over again two possible

ways of the weights construction are considered, whereas the weights can correspond either to the overall trade turnover or relate solely to the turnover selected SITC groups. The base of the time series is the average of 2010.

In the process of REER calculation similar trade data to NEER construction process are utilized, naturally, as REER is adjusted nominal effective exchange rate.

Speaking of both the NEER and REER, the choice of the base year is of particular significance. By setting the NEER/REER average for some year at 100, we can observe alterations in the currency's value as percentage changes over the base year. Thus the exchange rate calculations are, in most cases, converted into indices by taking a certain year as a base year. As such the characteristics of the base year become one of the most important issues when interpreting the developments of the exchange rates. Hence, the exchange rate movements based on different years can lead to quite different conclusions.<sup>9</sup> When setting the base year policymakers should look at both the internal and the external equilibrium which should be ideally met simultaneously in that specific year. In reality, however, the CNB follows different guidelines. Recent change of the base year dates to March 2012 when the time series base has been changed to average of 2010. The IMF recommends regular revisions of the weights structure in 5 year interval to reflect alterations in territorial structure of the trade turnover. As such 2017 will bring about next trade data revision with setting the base year to 2015 (Kipici et al. 1997).

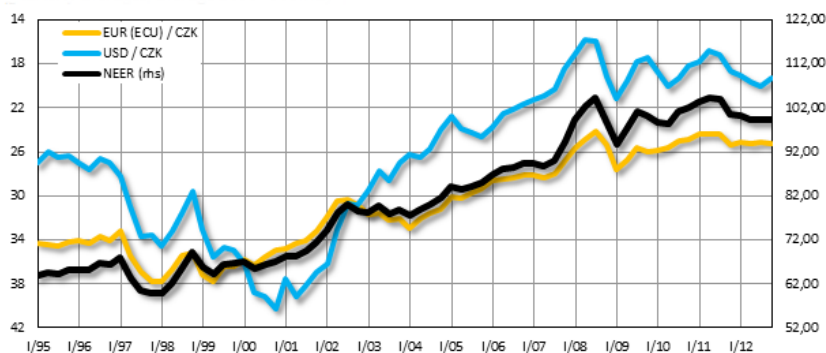
Following figure shows the trajectory of REER calculated on the basis of total trade turnover. Nominal exchange rates are adjusted by GDP deflators of respective countries. Real exchange rates are constructed vis a vis EUR and USD. Similarly to REER figure the graph shows the period of 1995-2012.

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<sup>9</sup> For example, the exchange rate in 2006 may appreciate in real terms compared to 2005. However, it may show no change in the real value when it is compared to the base year, which would be e.g. 1997.

Fig. 2: real exchange rates

Quarterly average, deflated by GDP deflators, average 2010=100



Source: ARAD database, CNB, Eurostat, own calculations

### Nominal and real exchange rate link and the “effective” exchange rates

The nominal exchange rate is expressed as the number of units of the domestic currency per a unit of a foreign currency. A drop in nominal exchange rate means nominal appreciation of the domestic currency, while an increase in this item is marked as nominal depreciation of the currency.<sup>10</sup> Nominal exchange rate measures only the numerical ratio of exchange not saying anything about important aspects such as purchasing power or competitiveness.

To allow for reflection of these aspects and to make the exchange rate more meaningful, the real exchange rate adjusts the nominal exchange rates to price levels of two respective countries. As such it implies the purchasing power of the domestic currency abroad, after the conversion with nominal exchange rate.

It follows that rather than observing the absolute value of the real exchange rate, one should give more attention to its changes. An increase in the real exchange rate signals (real) appreciation while drop in the variable is marked as (real) depreciation.<sup>11</sup> Following is the equation for real exchange rate calculation:

<sup>10</sup> Given the floating exchange rate regime.

<sup>11</sup> In contrast to the nominal exchange rate, the real exchange rate is always 'floating', since even in the regime of a fixed nominal exchange rate  $\epsilon$ ,  $Q$  can move via price-level changes.

$$Q = \frac{P_d}{E * P_f}$$

where  $P_d$  is the domestic price level,  $P_f$  is the foreign price level and  $E$  stands for nominal exchange rate (Taušer 2007).

It is worth noting that while real appreciation, as stated above, leads to an increase in the real exchange rate ( $Q$ ), nominal appreciation is observed when nominal exchange rate declines making the domestic currency nominally stronger.

When trying to assess the effect of the exchange rate on international trade it is more sensible to look at the real exchange rate rather than considering the nominal one (Frait et al. 2001). For example, if we assume the domestic price level increase by 5%, the foreign price level unchanged and the domestic currency weakening (depreciating) nominally by 5%, then the real exchange rate remains unchanged, because the ratio of prices levels remains unaffected (adjusted by nominal exchange rate) regardless of the depreciation of the domestic currency. As such, *ceteris paribus*, we would not observe any change in the demand for imports and exports within the domestic economy.

As mentioned above, NEER and REER are effective exchange rates. Contrary to nominal and real exchange rates, NEER and REER are not calculated for each foreign currency area separately. Rather effective exchange rates are expressed as indexes depicting what is happening to the value of the domestic currency against a basket of other currencies.

The monetary authorities do not dispose of the absolute control over the real exchange rate movements. Certain developments like changes in the terms of trade, foreign capital movements or productivity gains due to tech-innovations may cause movements in the real value of the exchange rate. However, such alterations are rather the consequences of the economic laws working.

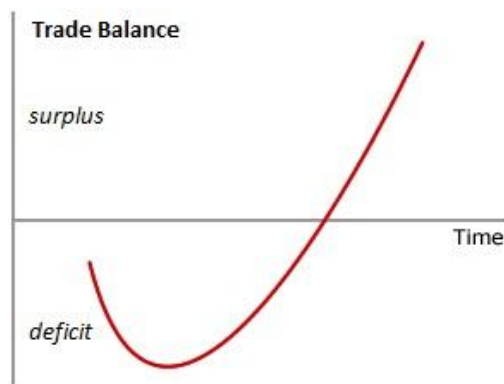
#### Real depreciation of the exchange rate

It is worth mentioning that the real depreciation of the exchange rate may have unexpected negative effects on the foreign trade balance in the short run. This is often represented by the “J-curve” effect in the literature (see figure 3). It illustrates the lagged impact of the exchange rate alterations on the price (and quantity) of imports expressed domestic currency. The main reason behind the curve is that both exports and imports would remain largely unchanged owing to prior trade deals and trade contracts. Also it takes time on the side of consumers to look for acceptable alternatives. Thus, according to economic theory, the real depreciation of the exchange rate does not

result in the expected reduction in import volume in the short run. On the contrary, due to real depreciation the value of the existing import volume in terms of domestic currency rises. As such a negative effect on the trade balance can be observed (Vintrová 2007).

In the long run, however, the real depreciation can have a positive effect on the current account as domestic consumers might find alternatives in domestic goods. Eventually the desired effect of the real depreciation is observed. However, it must be noted, that the curve progression depends on the structure of total imports (share of intermediary and investment goods), thus the real depreciation might not lead to an expected decrease in imports as anticipated by the theory (Holub et al. 2006).

Fig. 3: the “J curve” effect following real depreciation of the exchange rate



### Real appreciation of the exchange rate

The process of economic convergence is often accompanied by real appreciation of the exchange rate. However, Balassa-Samuelson effect, resulting from the different developments in productivity in the tradable and non-tradable goods, explains only part of the real exchange rate appreciation. Part of the real appreciation is also the result of the transformation process (or a correction of price distortions), or can be explained by improving the quality of products and increase of the demand for exports of the new EU member states. Empirical estimates of the equilibrium real appreciation of the EU-10 countries show considerable variance, particularly in relation to economic development and progress in real convergence (or transformation) of the economy (Komárek et al., 2010).

## **The evolution of the effective exchange rates of CZK**

This part of the paper will discuss the evolution of the exchange rate of CZK before and after the Czech Republic became a member of the European Union. Brief history of the exchange rate movements in the 1990s will be presented. Subsequently the period right before joining the EU will be described in more details. Finally, the remaining time period will be commented on with attention to post crisis adjustments of the economy. Special focus will be given to real exchange rate movements.

### ***The period until 2002***

The development of the real effective exchange rate is marked by long term appreciation trend. We can observe real appreciation of CZK since 1991, however, for different reasons in different stages. It is also important to mention, that such development occurred within different regimes of monetary policy. There had been a fixed exchange rate regime until 1997 when the central bank moved to (almost) clean floating of the exchange rate.

In the beginning of the 1990s the exchange rate system was still highly distorted by the legacy of the central planning framework. The official exchange rate was far from the one on the unofficial market (Winiiecky 1993). To stabilize the currency, the government opted for the fixed exchange rate regime with anchor to a basket of five foreign currencies. The exchange rate was meant to be the stabilizing variable of the whole transformation process. After couple of devaluations in 1990, the currency was clearly undervalued. This served as a temporary assistance to exporters until the real appreciation emerged. Later on modest fluctuation intervals were introduced as well as narrowing down the basket of base currencies to German mark and the dollar only. The currency crisis in 1997 documented the unsustainability of the regime, followed by both NEER and REER adjustments (figures 1 and 2).

At first the above mentioned devaluations of the nominal exchange rate led naturally to depreciation of the real exchange rate, however, starting from 1991 the nominal exchange rate was, as a matter of fact, fixed. Yet due to tax reforms, price deregulations and also high inflation expectations the price level rocketed above those of the trading partners. Relatively higher inflation rate resulted in appreciation of the real exchange rate. Several countries in the region, namely Poland and Hungary, witnessed a different story owing to introduction of crawling peg allowing for gradual adjustment of the exchange rates (Kopits, 1995). As a result their real exchange rate did not strengthen as much as in the case of CZK.

Following the currency crisis in 1997, when the central bank intervened strongly trying to safeguard the fixed exchange rate regime<sup>12</sup>, the bank opted for inflation targeting framework, whereas exchange rate regime was swapped to managed floating. In fact, the CNB only seldom intervened on the market making it “almost” clean floating regime. Within the new framework the CNB was able to force down the inflation to levels similar or lower to those in trading partner countries. However the existing real appreciation did not vanish and the process continued further, yet on the back of different drivers. This time the nominal appreciation of CZK vis-à-vis foreign currencies became the main driver after 1997. It is possible to observe different developments of nominal exchange rate of CZK towards EUR (ECU) and USD (figure 1), yet the weights of these currencies in the construction of NEER and REER must be taken into account.

#### *The period of 2002-2004*

In the period 2002-2004 a change in a long-term trend of the currency pair EUR/CZK can be seen. The process of the real convergence to the EU took place virtually since 1999 and was marked by systematic appreciation of the real exchange rate as discussed above. Beside main drivers of the real appreciation mentioned in previous section, other factors as increase in labour productivity in the domestic economy and increase the quality of goods can be quoted as well (Mandel and Tomšík 2003).<sup>13</sup> In early 2002, the trend of real appreciation strengthened, mainly through nominal appreciation of the EUR/CZK (figure 7) where the exchange rate stepped up to 30 EUR/CZK from 34 EUR/CZK over the course one year.<sup>14</sup> Since September 2002, however, the nominal exchange rate depreciated by approximately 10% to 33 EUR/CZK at the end of 2003 and beginning of 2004.

Indeed, in the period 2002-2003 there was a significant decline in interest rates, which was caused by expansionary monetary policy pursued by the CNB with the growth of the monetary base and consequently the growth of money supply. It is possible to detect in figure 4 that the nominal money supply in the Czech Republic (as measured by the monetary aggregate M2) has increased since September 2002 until early 2004 by approximately 30%.

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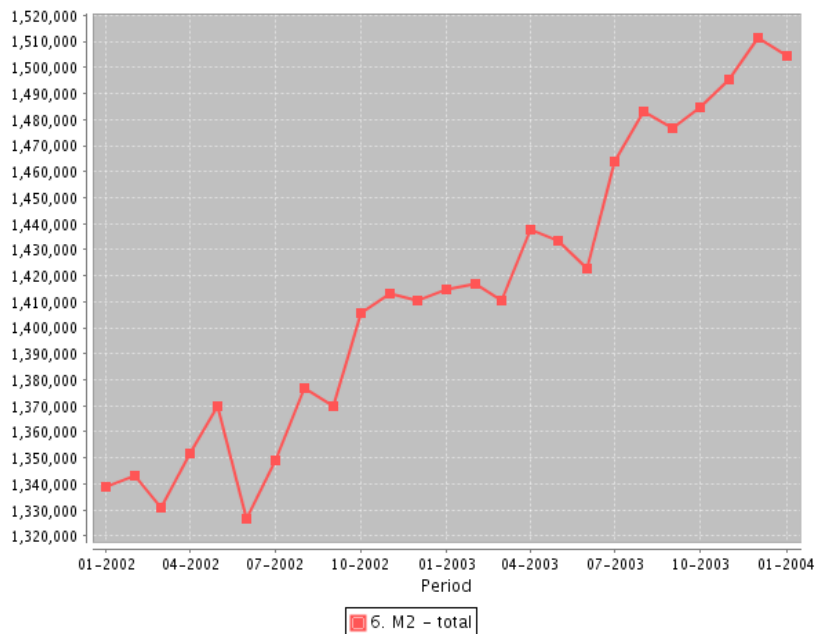
<sup>12</sup> The central bank intervened by selling 3 bil USD to halt the depreciation of CZK.

<sup>13</sup> Other factors can be referred to: Balassa-Samuelson effect, FDI effect, reducing trade barriers

<sup>14</sup> Almost 12% appreciation of CZK in one year.

Fig. 4: monetary aggregate M2 (total)  
Monthly averages, January 2002 – January 2004

**Table A41: Monetary aggregates and counterparts – monetary aggregates (levels)**



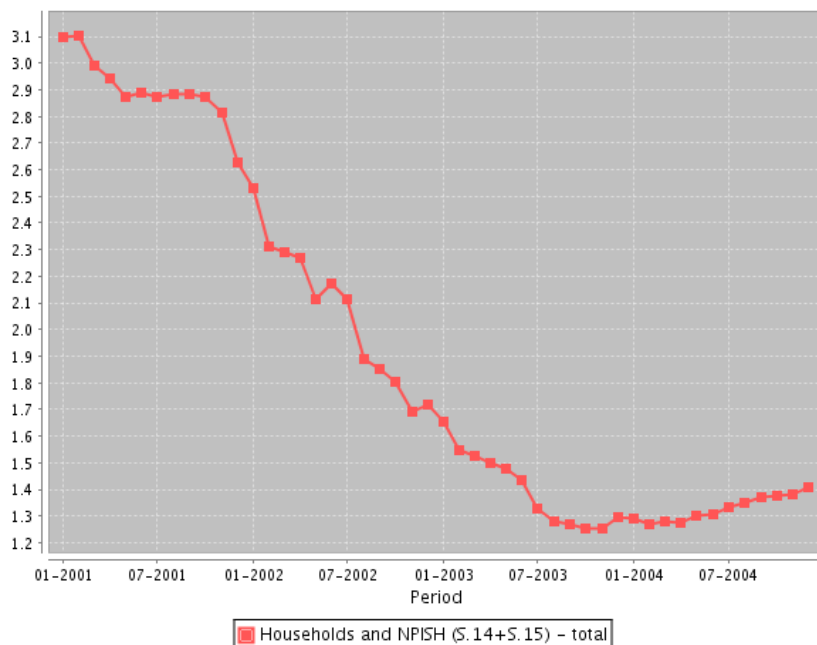
Source: ARAD database, Monetary aggregates and counterparts

This should have led in the long run to weakening of the domestic currency in accordance with the theory of purchasing power parity. As a result the depreciation expectations have increased in the currency markets which, consistently with the uncovered interest rate parity theory, implied a higher return on foreign financial assets. The currency market investors expected higher interest rates in the domestic economy. However, already low interest rates started to fall considerably in the period of 2002 - 2003. The domestic market interest rates - as measured by the interest rate on bank deposits from residents in the Czech Republic – reached its low in the fourth quarter of 2003 (figure 5).



Fig. 5: Bank interest rates

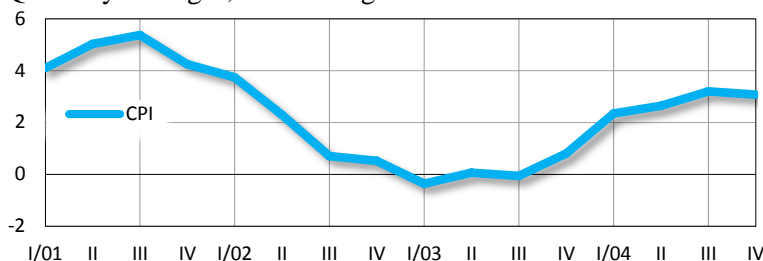
Monthly averages, January 2001 – December 2004

**Table B2.1: Bank interest rates on CZK-denominated deposits by Czech residents – outstanding amount (%)**

Source: ARAD database, Monetary aggregates and counterparts

Continuous depreciation expectations and declining domestic interest rate resulted in domestic assets denominated in CZK losing their value. However, despite such developments, investors did not turn their demand towards foreign, which was caused by signs of economic slowdown in main trade partners economies (Mandel et al. 2009). The excess of money supply would, according to economic theory, imply the price level to increase, as businesses and households are encouraged to investment and consumption. Thus higher aggregate demand would be reflected in higher prices. Figure 6 shows that the prices reached their low at the beginning of 2003 and begin to grow throughout the year and then in 2004 particularly.

Fig. 6: consumer price index  
Quarterly averages, YoY changes



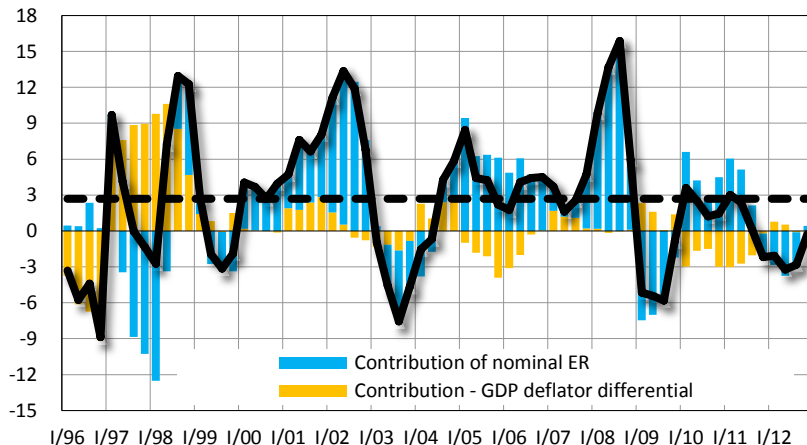
Source: Ministry of Finance database

### The period after 2004

Hence 2004 was marked by the gradual increase in domestic aggregate price level measured by the consumer price index, a gradual increase in interest rates and the appreciation of the domestic currency against EUR. In the subsequent period, the evolution of the nominal exchange rate returned to its long-term systematic appreciation trend, which can be seen in figure 1. This resulted again in real exchange rate appreciation as the nominal depreciation reduces the denominator of the real exchange rate formula stated above. The nominal appreciation was compensated by the increase in labour productivity and rise in produced goods quality and also by minimal inflation differential to main trading partners. As such both NEER and REER appreciated as shown in figures 1 and 2.

Until the economic and financial crisis both the nominal and real exchange rates stuck with their long term appreciation trend. However, this was interrupted by crisis-linked corrections caused in particular by outflow of financial assets and investment from emerging markets, resulting in nominal depreciation of CZK vis a vis relevant foreign currencies. On the other hand such movement helped the exporters to cope with negative effect of the crisis on external demand (Komárek 2010). As shown in figure 7, the fluctuations in real exchange rate to EUR were caused almost solely by contributions of the nominal exchange rate movements in the period 2008-2009. In 2009 the drop in the nominal exchange form the previous year was partly reversed due to rising confidence and reduction of the capital outflows.

Fig. 7: Real exchange rate to EUR (main trading partner), decomposition  
 Deflated by the GDP deflators, YoY growth in %, contributions in percentage points



Source: ARAD database, CNB, Eurostat, own calculations

However weak GDP growth performance of the economy and negative interest rate differential resulted in halting the general long-term trend of appreciation of EUR/CZK in 2011. In 2012 the exchange rate fluctuated slightly above 25 EUR/CZK with no significant trend of strengthening or weakening. The central bank contributed to the stagnation by reduction of the main interest rate in the second half of 2012.

## Conclusions

There has been a general long term trend of both nominal and real appreciation of CZK. While the main driving factor of the real effective exchange rate appreciation until 1997 has been the inflation differential, where prices in the domestic economy surpassed their foreign counterparts, nominal appreciation of CZK became the key propeller since then. With interruption in the period of 2002-2003, where the exchange rate depreciated both nominally and in real terms due to expansionary monetary policy and economic slowdown, we can observe such long term trend, with minor fluctuations, until 2011. Since then the exchange rate fluctuates, within the environment of weak economic performance and negative interest rate differential, in the absence of substantial appreciation or depreciation pressures.

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# THE RECENT DEVELOPMENT OF SELECTED RUSSIAN INDUSTRIES AND PERSPECTIVES FOR FOREIGN INVESTORS

Ilya Bolotov<sup>15</sup>

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## Abstract

*The paper examines the recent development of the Russian retail trade and automobile industry as the two most dynamic industries of the Russian economy by stating main companies, sales trends and current problems that persist in both industries. Apart from this, it briefly evaluates the current investment climate in Russia and perspectives for foreign, especially Czech and French, companies in general and in the mentioned industries of the Russian economy.*

## Keywords

*Russia, wholesale and retail trade, automobile industry, crisis, investment climate*

**JEL classification:** E32, M20, O52

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## Introduction

The Russian Federation, grouped together with Brazil, India, China and since 2010 South Africa, as one of the most perspective economies in the world (R in BRICS), has become an attractive destination for foreign direct investment (FDI) in the past decade. In 2012, the total stock of FDI in the Russian economy constituted 24.9% of GDP (UNCTAD data), the third biggest number among the BRICS and two and half times higher than in China and India. The global financial and economic crisis of 2008 has, however, caused an important decline in the Russian economy (-7.9%, Rosstat data), the biggest among the BRICS, and significantly affected its industries. *This paper aims to examine the two selected industries of the Russian economy (retail trade and automotive industry) and, briefly, the Russian investment climate, in order to show that Russia remains a perspective market for foreign, e.g. Czech and French, firms.*

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## Literature Review

The development of the Russian economy and its industries is not thoroughly covered in non-Russian-based literature with the exception of annual reports published by the World Bank (WB) and ad-hoc studies in working papers of the International monetary Fund (IMF) and in book publications of several authors, e.g. Letiche (2007) and Vercueil (2011). On the contrary, yearly publications of the Russian Gajdar Institute of Economic Policy in English and in Russian give an important and regular insight in the macroeconomic development of the country in question, e.g. IEP (2012). The development of individual industries is in detail examined by Russian ministries, mainly by the Russian Ministry of Industry and Trade, Minpromtorg (2009), and the Ministry of Economic Development, and, from the business point of view, by the multinational consulting companies, e.g. Ernst & Young (2012). The Russian investment climate is then assessed the country's competitiveness measured annually by the World Economic Forum (WEF) and the International Institute for Management Development (IMD), WEF (2012–2013) and IMD (2012). The necessary data is provided by international institutions and by the Russian statistical office Rosstat.

### 1. The Russian economy and its structure

In 1990s, after the break-up of the Union of Soviet Socialistic Republics (USSR), Russia experienced political instability, hyperinflation, an almost decade-long recession and a significant financial crisis (Default, “Дефолт”) in 1998. The change in economic policies since 2000 helped the country in question to economically recover and attain the pre-1991 GDP level in 2007.<sup>16</sup> The recent global financial and economic crisis has also shown that the Russian policy makers are able to solve the problems relatively efficiently: the Russian anti-crisis measures of 2009–2010 were, in relative terms, approximately as big as the ones of the U.S. despite a much deeper decline.<sup>17</sup>

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<sup>16</sup> See e.g. Bolotov (2012, chapter 4).

<sup>17</sup> In both countries, in broad terms, they constituted ca. 25–27% of GDP (Grinberg, 2011).

The Russian economy, however, has several specifics:

- *Low competitiveness of manufactured products, especially on foreign markets,*
- *Dependence on natural resources, mainly oil, natural gas, metals and wood,*
- *Dependence on imports of manufactured goods and substitution of domestic products by more competitive imports,*
- *Long-term dependence on foreign capital inflows, which are, at present, the main source of modernization of the Russian economy,*
- *Relatively high tariff protection (which should be reduced by 30 % by 2020 in reaction to the World Trade Organization, WTO, accession),<sup>18</sup>*
- *Relatively big share of state interventions into the economy (so-called “quasi-state economy” where government expenditures form up to 40% of GDP),<sup>19</sup>*
- *Relatively high share of imperfect competition (monopolies and oligopolies),<sup>20</sup>*
- *Relatively high inflation rate (in 2012, CPI inflation, however, constituted a rather modest figure, 6.6%, December / December, Rosstat data),*
- *Relatively weak banking sector (the share of bank credits in GDP in 2002– 2011 was, on average, 28.6% against the 97% average of Brazil, Russia, India and China, WB data),<sup>21</sup>*
- *Important size of the grey economy (of around 40% of the official GDP in 2011, but falling in the long run, WB data, World Bank, 2010).*

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<sup>18</sup> However, contrary to many beliefs, Russian tariffs are not the highest among the WTO members and, at the world level, roughly correspond to those of the EU and China: the average MFN rate is ca. 5–10%. The WTO accession engagement is 8.2% (WTO data).

<sup>19</sup> Russia is not building a welfare state, although its social expenditures have greatly increased since 1990s. In 2008–2012, President Dmitrij Medvedev made them one of his priorities. The majority of the biggest Russian companies is also owned by the state or state-controlled firms.

<sup>20</sup> E.g. RUSAL (100% in aluminum production), Rosneft, LUKOIL, TNK-BP and Surgut-nemegaz (73% in oil extraction), SUEK and Evraz Group (63% in coal extraction), NLMK, MMK, Severstal and Evraz Group (more than 50% share in iron ore extraction), GAZPROM (85% in extraction, almost 100% in transport and 100% in export of natural gas), Evrocement Group (39% in cement / concrete production); see Krichevskij and Inozemtsev (2009).

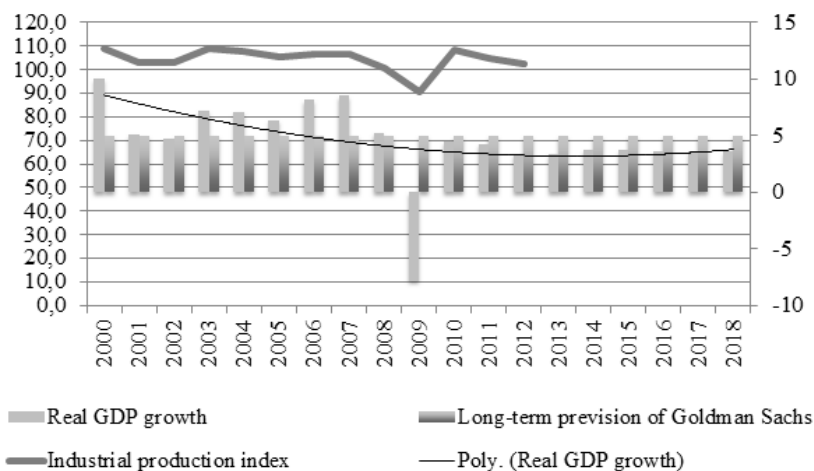
<sup>21</sup> This stimulates the growth of external debts of Russian companies and of the total country's external debt, which increased from 213 bn USD in 2005 to 545 bn USD in 2012 (CBR data).



The dependence on exports of natural resources, especially oil,<sup>22</sup> and rising external private debt (public debt is below 15% of GDP) are the major source of fluctuations in the Russian economy in the long run. In view of the recent crisis and the instability in oil prices, Russia will most likely underperform its long-term growth prevision of 5% stated in Goldman Sachs (2003). Still, its growth will constitute 3–4%, i.e. it will be comparable with the world average (ca. 3.57% for 2013–2018, IMF previsions).

Fig. 1 depicts the long-term growth prevision of the Russian economy by the IMF and the development of its industrial production index (2000–2012). It can be seen that both indicators are highly correlated (non de-trended correlation coefficient is 0.9067). However, as Fig. 1 shows, the growth in industrial production is still positive (2.6%) despite the recent crisis, compared with important declines in the Czech Republic (-11.6% in December 2012 against December 2011, CZSO) and in France (-3.9% in the 4<sup>th</sup> quarter of 2012 against the 4<sup>th</sup> quarter of 2011, INSEE data).

Fig. 1 Russian real GDP growth and industrial production index



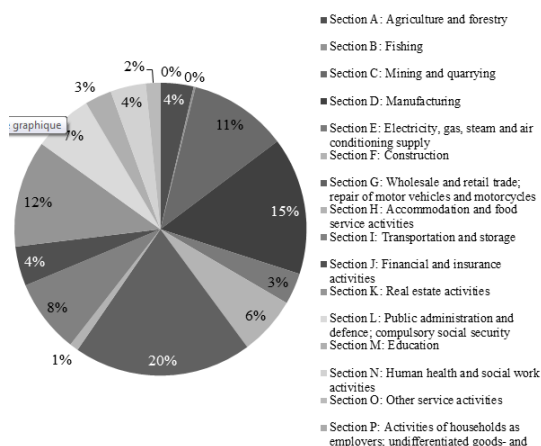
Source: IMF World Economic Outlook, Rosstat, author's own work / calculations.

<sup>22</sup> For example, according to Bolotov's (2012) and Torzhevskij's (2012) ordinary least square (OLS) estimations, the equations  $Real\ GDP = -0.2529\ P\ crude\ Russian\ oil^2 + 53.222\ P\ crude\ Russian\ oil + 1984.9$  for 2000Q1–2008Q4 and  $RTSI\ (Russian\ stock\ exchange\ index) = 16.805\ P\ crude\ Russian\ oil - 212.237$  for 2008–2010 hold for the Russian economy with the  $R^2$  of 0.828 and 0.923.

## Structure of the Russian economy

Contrary to many beliefs, the most important Russian industry in terms of value added, (according to the OKVED classification),<sup>23</sup> is not mining / quarrying, but wholesale and retail trade (Section G), followed by manufacturing (Section D) and mining / quarrying (Section C), see Fig. 2. The industries differ as to the degree of their competitiveness and presence of foreign capital. In general, Russian industries face the lack of labour productivity, compared with the OECD average (Russia is only “above” Mexico and Chile in 2011 with 22 USD per hour worked, 36% of the USA level, OECD data), and important depreciation of capacities, which need new investment.<sup>24</sup> In this paper, the attention will be focused on the retail trade (part of section G) and on the automotive industry (part of section D) for two reasons 1) retail trade, together with wholesale, is the biggest creator of value added in the Russian economy, and the automotive industry was considered to be one of the most perspective for business (see e.g. the articles in Economist, 2004–2013); and 2) big Czech and French companies are present in both industries.

Fig. 2 Structure of the Russian economy in 2012 in the Russian OKVED classification



Source: Rosstat, author's own work / calculations

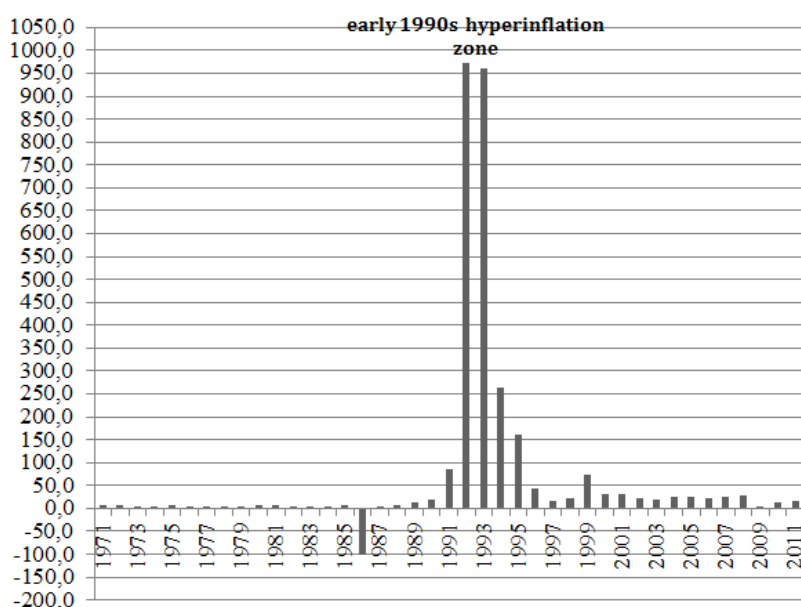
<sup>23</sup> OKVED – All-Russian Classification of Types of Economic Activities (“Общероссийский классификатор видов экономической деятельности”). The sections are similar to the ones of the EU-NACE and of the UN ISIC, but for the order.

<sup>24</sup> In 2011, ca. 52.2% and 46.7% of capacities needed to be replaced in the mining / quarrying and manufacturing industries (the total industries average was 47.9%) with the net annual renewal coefficients of 4.9% and 4.4%; and there has not been a significant change in these figures since 2004 (Rosstat data).

## 2. The Retail trade industry and its trends

Russian retail trade turnover has been developing at a relatively stable pace in the past 40 years with the exception of the transition period (1986–1994). Socialist times were marked by relatively constant figures and 2000s by a rapid growth of ca. 22% per year, which dropped to 4.7% in the crisis year 2009, but recovered to 13% and 15.7% in 2010 and 2011 attaining ca. 19,082,577.6 million RUB (457,929.8 million EUR) in 2011 (Rosstat data).

Fig. 3 Growth of the retail industry, 1971–2011

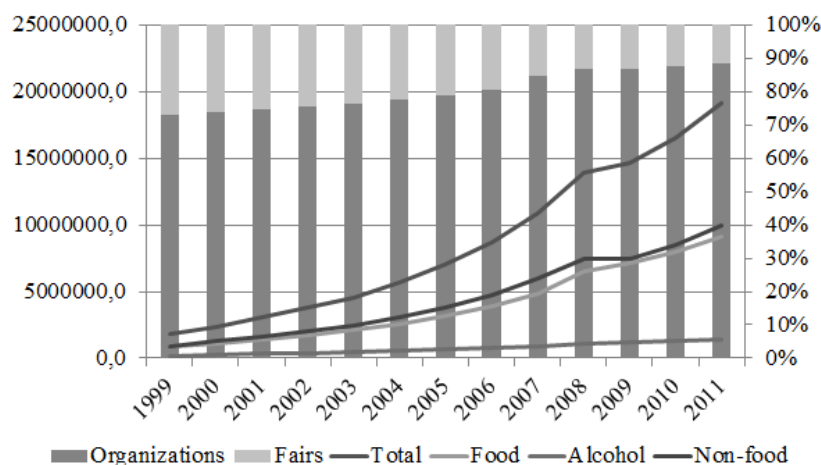


Source: Rosstat, author's own work / calculations.

The current rocketing growth concerns equally food and non-food products with a relative “normalization” in sales of alcohol (which, however, increased sevenfold between 2000 and 2011, compared to the eightfold increase in total sales);<sup>25</sup> see Fig. 3.

<sup>25</sup> Life expectancy of male population, nevertheless, remains low and constitutes 64 years, compared to 75.6 of the female population and to the both sexes average of 77.6 in the Czech Republic and to 81.6 in France (Rosstat, CIA data).

Fig. 4 Sales in the retail industry by main product groups and company types



Source: Rosstat, author's own work / calculations.

### Prices and volumes

Half of the retail industry growth is attributable to the change in prices (running inflation, see the specifics of the Russian economy), which increased threefold for food products and twofold for non-food product category; the second half – to the economic development of Russia (GDP per capita in PPP grew from 6,833 in 2000 to 21,921 USD in 2011, moving closer to the developed economies threshold, WB data). The growth in volumes (the physical quantity sold) was, however, also high and even exceeded 200% for the non-food product category; see Tab. 1.

Tab. 1 Retail industry in turnover volume and prices

а	2001а	2002а	2003а	2004а	2005а	2006а	2007а	2008а	2009а	2010а	2011а
<b>Retail trade volumes, 2000=100%</b>											
Total	111.0	121.3	132.0	149.6	168.8	192.7	223.7	254.4	241.4	256.9	275.0
Food	107.6	118.5	127.6	142.2	157.0	174.3	196.3	219.2	215.1	226.2	233.5
Non-food	113.9	123.7	135.7	156.2	179.8	209.9	250.1	288.3	264.7	285.2	316.0
<b>Consumer prices, 2000=100%</b>											
Total	118.6	136.5	152.9	170.8	189.4	206.4	231.0	261.7	284.8	309.8	328.7
Food	117.1	130.0	143.2	160.9	176.3	191.6	221.5	258.1	273.8	309.2	321.2
Non-food	112.7	125.0	136.5	146.6	156.0	165.3	176.1	190.2	208.6	219.0	233.7

Source: Rosstat, author's own work / calculations.

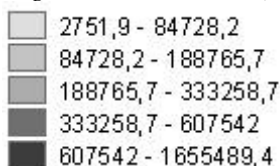
## Regions

The retail sales are also unequally distributed on the Russian territory with better results in Moscow and Moscow Region (the part of Russia with the highest prices), Sverdlovsk Region (with the capital Yekaterinburg), Krasnoyarsk Territory and other, mostly southern, regions in the Fore-Caucasus, the Ural area and in the South of Siberia, Saint Petersburg and Leningrad Region and Primorsky Territory (with the capital Vladivostok); see Fig. 4.

Fig. 5 Retail turnover in Russian regions in January–June 2012



*Legend: million RUB (one June, 30, 2012: 1 EUR = 41.3230 RUB)*



Source: Rosstat, author's own work / calculations.

## Biggest companies

The list of the eight biggest companies in the Russian retail industry in 2010 (the research is not annual) is presented in Tab. 2. The most dynamic players are Magnit and the X5 Retail Group (No. 1 and 2 in 2013, Magnit is also listed among the top 10 Russian companies with the biggest market capitalization in 2013). It can be seen that both the Czech and French companies are among the top 8 Russian retailers

with a better position of Auchan Group present in food and non-food industries. The PPF group (Eldorado) specializes in household products and, mostly, consumer electronics.

Tab. 2 Top 8 companies in the Russian retail industry in 2010

No.		Brands	Focus	Turnover, billion RUB after VAT	Number of shops, end 2010	Present in (Federal Districts)
1	<b>X5 Retail Group</b> (No. 2 in 2013)	Карусель, Пятерочка, Перекресток, Копейка	Food	396.22	2469	Central, North-western, Southern, Urals, Volga FDs
2	<b>Auchan Group</b>	Ашан, Ашан-Сити, Радуга, Атак, Леруа	Food, household goods	256.16	111	Central, Southern, Northwestern, Volga, Siberian, Urals FDs
		Мерлен, Декатлон	Repairs, sport			
3	<b>Magnit</b> (No. 1 in 2013)	Магнит, Магнит-Косметик	Food, household goods, cosmetics	236.19	4055	Southern, Central, Urals, North-western, Volga, North Caucasian, Siberian FDs
4	<b>Metro Group</b>	Метро Кэш энд Кэрри, Реал, Медиа Маркт, Сатурн	Food, household goods	170.26	104	Northwestern, Central, Siberian, Southern, Urals, Volga FDs
5	<b>M.Video</b>	М.Видео	Household goods	86.39	230	all FDs
6	<b>O'Kay</b>	О'Кей, О'Кей-экспресс	Food	82.67	57	Northwestern, Southern, Central, Siberian, Volga, North Caucasian FDs
7	<b>Eldorado</b> (owned by the Czech PPF group)	Эльдорадо	Household goods	80.00	331	all FDs
8	<b>Lenta</b>	Лента	Food	70.60	39	Siberian, North-western, Southern, Volga, Urals FDs

Source: Kommersant.ru and InfoLine, the Retailer Magazine; InfoLine, author's own work/ calculations.

X5 Retail Group, M.Video and the Czech-owned Eldorado have intensive promotion strategies and are competing with each other in

numerous TV spots and fidelity programs, while Auchan, Magnit and Metro tend to refrain from using the media. Auchan is also mostly present in central Russia and its initial starting ground (Moscow and Moscow region), and is less known in several Federal Districts. Since 2010, both foreign groups have, however, been losing their positions to Russian companies, and M.Video even attempts to take over Eldorado in the long run. One of the reasons may be less adaptive strategies of foreign companies in the concentrated Russian retail market, as well as intercultural problems.<sup>26</sup> The fast growth of the market despite the overall global decline, nevertheless, presents further possibilities for foreign investors in Russia.

### **3. The Automotive industry and its trends**

The history of the Russian automotive industry began in 1896 by construction of the first automobile. By 1912, the Russian Empire had 2 automobile factories. The oldest still existing Russian automotive company, AMO ZIL, was created in 1916. During the socialist period, automotive companies, firstly GAZ and since 1960s–1970s VAZ, operated on foreign licenses granted by the U.S. Ford Motor Company and the Italian Fiat Group, which were the main suppliers of automobile technology in the USSR.<sup>27</sup> VAZ 2101 and later models of “Zhiguli” (known more as “LADA” in Europe) and GAZ 24X and 32X series “Volga” became “people” cars in 1970s–1980s. In 1991–1992, the Russian automotive market began to open to foreign companies and nowadays comprise both domestic and foreign firms.

#### **Development of the market: reality and previsions**

Tab. 2 shows that the automotive industry production (excluding important imports) was mostly above the overall industries’ average before the crisis, but below the one of the manufacturing industries. It also experienced the deepest fall in the crisis year of 2009 (-37.2%) and the quickest recovery in 2010 and 2011 (32.2% and 24.6%) among all Russian industries, and, therefore, remains the most dynamic of them.

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<sup>26</sup> For example, Eldorado, according to the author’s point of view, attempts to apply the approach used in the Czech environment in its marketing communication, stressing lower prices and important discounts, which is less common among the Russian companies.

<sup>27</sup> Russian “people” automobiles usually copied successful European models.

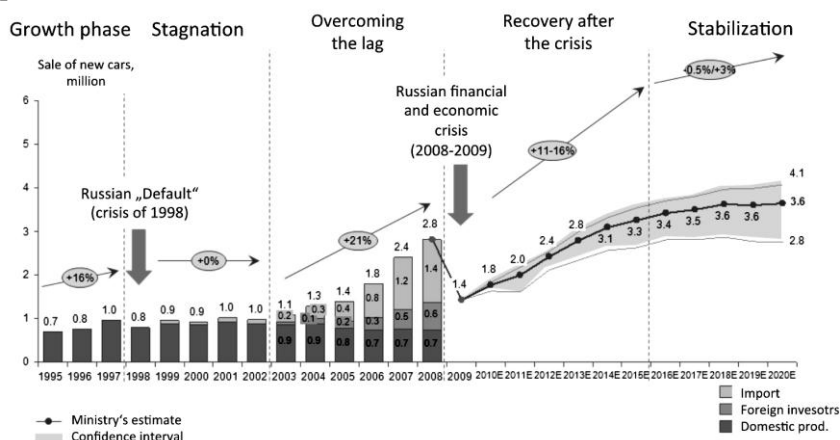
Tab. 2 Indices of industrial production, year on year changes

	2005	2006	2007	2008	2009	2010	2011
Industrial production	105,1	106,3	106,8	100,6	90,7	108,2	104,7
Manufacturing	107,6	108,4	110,5	100,5	84,8	111,8	106,5
<i>Automotive industry</i>	107,1	104,7	107,8	100,4	62,8	132,2	124,6

Source: Rosstat, author's own work / calculations.

Russian statistics distinguish between four types of vehicles: passenger vehicles (cars), light commercial vehicles, trucks and buses. In this paper, the attention is focused on the biggest of the segments, the car market (however, all segments are interrelated), the development of which (new cars) and long-term previsions are presented on Fig. 6.

Fig. 6 The development of the Russian car market and Minpromtorg previsions



Source: Minpromtorg (2009, p. 18), author's own work / calculations.

The Russian Ministry's of Industry and Trade "Strategy for the development of the automobile industry of the Russian Federation till 2020", Minpromtorg (2009), divides the development of the Russian automotive sector into four phases: the growth and stagnation of the 1990s, the lag overcoming and the crisis of the first decade of 2000s (peaking 2.8 million sales a year) and the recovery and stabilization of 2010–2020. According to the Ministry's estimates, the average growth of 21% in 2000–2010 should be replaced by the 11–16% increase in



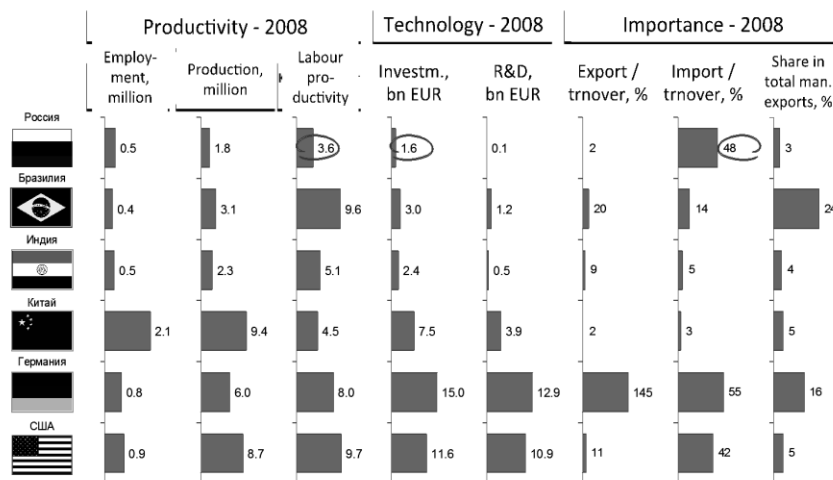
2010–2015 and -0.5–3% growth / stagnation in 2015–2020 (with the maximum of 3.6 million new car sales per year).

Ernst and Young's research (2012), however, states that after-crisis recovery is mainly created by government support and may slow down in the coming years. Government support will be reduced, inter alia, following the accession of Russia to the WTO in 2012<sup>28</sup> (Russia will, however, have a six-year transitional period for the automotive industry). These factors will mostly affect less competitive domestic (traditional) producers whose share in new car sales is decreasing in time and fell to ca. 50% in 2008. On the contrary, the share of imports and foreign-investment-based production is rapidly growing (1.4 and 0.6 million new sales in 2008). The Russian car market offers, therefore, very promising perspectives for foreign companies.

### Problems of the automotive industry

The automotive industry, however, belongs among the least competitive ones in the Russian economy and internationally (except import turnover), and has recently been surpassed by China, a non-traditional automobile producer, in all indicators; see Fig. 7.

Fig. 7 International comparisons in the automotive industry in 2008



Note: Labour productivity is measured as production per worker.

Man. (manufactured) exports = exports without raw materials.

Note: Countries from top to bottom – Russia, Brazil, India, China, Germany, the USA

Source: Minpromtorg (2009, p. 34), author's own work / calculations.

<sup>28</sup> During the crisis, Russia e.g. increased duties on imported passenger vehicles to 30%.

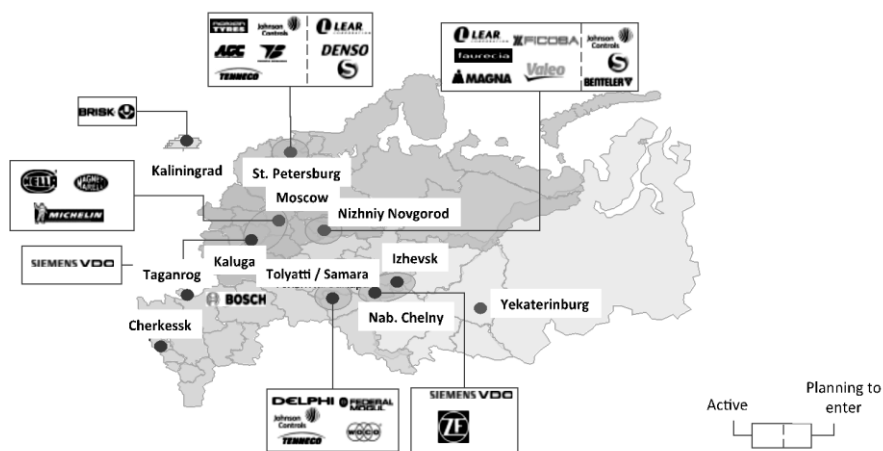
## Main segments and company types

According to Minpromtorg (2009), the automobile industry in Russia counts ca. 400 companies with 400,000 workers, extending to 4.5 million employees after including all of the industry's suppliers, and with ca. 1% share in the Russian GDP creation (a much lower share compared with the retail and wholesale trade). Russian statistics distinguish between four types of companies present in the automotive industry:

- domestic automobile manufacturing firms,
- firms controlled by foreign investors (so-called localized producers),
- producers of components and
- importers of foreign production (e.g. in Saint Petersburg and in Vladivostok).

The most scarce company type are the component producers, as, according to the Mlinpromtorg (2009), TNCs specialized in this domain are not yet eager to enter the Russian market on a large scale. The spatial distribution of TNCs is shown on Fig. 8.

Fig. 8 Foreign producers of automotive components in Russia



Source: Minpromtorg (2009, p. 25), author's own work / calculations.

Tab 3. and Tab. 4 present the biggest Russian automobile producers and the top brands in the Russian car market. It can be seen that in

2011, already 49% of the market was divided among foreign brands (LADA, however, remaining the absolute leader).

Tab. 3 The biggest automobile producers in Russia

*The biggest domestic companies*

Company	Brand	Location
AvtoVAZ (in the past VAZ)	LADA, Zhiguli	Samara Region
KAMAZ	KAMAZ (trucks)	Republic of Tatarstan
GAZ	passenger: GAZ (Volga), Light commercial vehicles: Gazelle, Sobol', trucks: Ural, buses: PAS, KAVZ, LiAZ	Nizhnij Novgorod Region

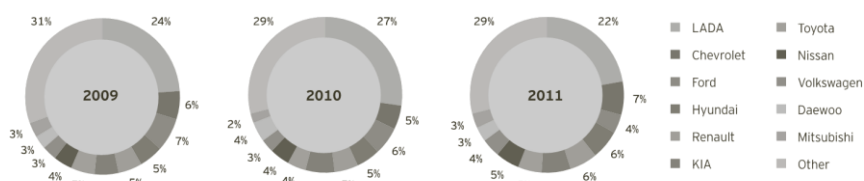
*The biggest companies with foreign participation*

Company	Brand	Location
Avtotor	BMW, Kia	Kaliningrad Region
Avtoframos	Renault	Moscow
IzhAvto	Kia	Udmurt Republic
TagAZ	Daewoo, Hyundai	Rostov Region
Ford-Vsevolozhsk	Ford	Leningrad Region
GM-AvtoVAZ	Chevrolet-Niva	Samara Region

Source: Expert.ru, companies' webpages; author's own work / calculations.

Tab. 4 Top brands in the Russian car market by market share

Market share by brand in terms of volume, %



Source: AEB; Ernst & Young estimates; author's own work / calculations.

From the point of view of foreign companies, both Renault (France) and Škoda Auto (Czech Republic) are present through FDI in the Russian market. Renault was the third most sold brand (surpassing 150,000 threshold, AEB data) and the fifth biggest brand (6% share, AEB data) in the market in 2011. Škoda showed more moderate

results, being the eleventh most sold brand (ca. 75,000, AEB data) in 2011.

Its presence in the central parts of Russia has, however, been strengthening thanks to an advantageous price to quality ratio and an efficient marketing strategy. Škoda Auto's investment in Kaluga Region also remains the biggest Czech investment in Russia (ca. 79 million EUR in 2011, Rosstat data). In general, French and Czech companies face less competition in the automotive industry than in the retail trade, which grants them greater possibility of further increasing their market shares and sales.

#### 4. Investment climate and business environment

Based on the results of the recent World Bank's Doing Business survey 2013, it is possible to state that business environment in Russia is slowly improving, however, not in favour of foreign investors; see Tab. 5.

Tab. 5 Business climate in Russia in 2013

REGION	Eastern Europe & Central Asia	DOING BUSINESS 2013 RANK	DOING BUSINESS 2012 RANK	CHANGE IN RANK
INCOME CATEGORY	Upper middle income	112	118	↑ 6
POPULATION	141,930,000	DOING BUSINESS 2013 DTF** (% POINTS)	DOING BUSINESS 2012 DTF** (% POINTS)	IMPROVEMENT IN DTF** (% POINTS)
GNI PER CAPITA (US\$)	10,400	58.7	57.7	↑ 1.0

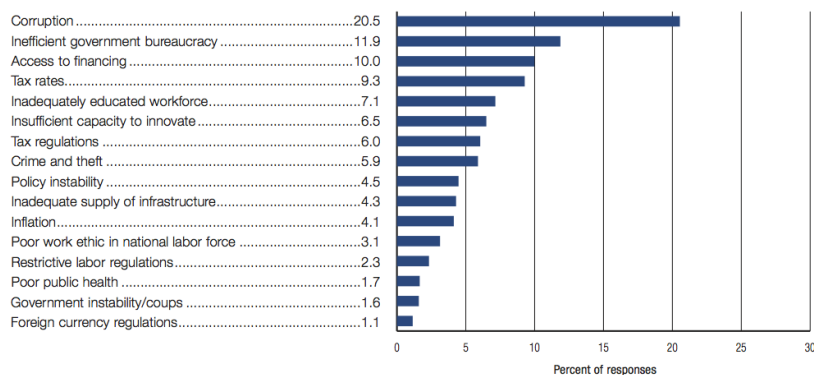
  

TOPIC RANKINGS	DB 2013 Rank	DB 2012 Rank	Change in Rank
Starting a Business	101	105	↑ 4
Dealing with Construction Permits	178	180	↑ 2
Getting Electricity	184	184	No change
Registering Property	46	45	↑ -1
Getting Credit	104	97	↑ -7
Protecting Investors	117	114	↑ -3
Paying Taxes	64	94	↑ 30
Trading Across Borders	162	161	↑ -1
Enforcing Contracts	11	12	↑ 1
Resolving Insolvency	53	61	↑ 8

Source: World Bank; author's own work / calculations.

The main obstacles to FDI remain corruption, inefficient government bureaucracy and access to finance, according to the World Economic Forum's global competitiveness survey (2012–2013); see Fig. 9

Fig. 9 TNC's opinion of the main obstacles of doing business in Russia



Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings.

Source: WEF (2013); author's own work / calculations.

In general, foreign investors in Russia (in all sectors) can benefit from two main investment incentives: the special economic zones (SEZ) created since 2005 (in 2013 19) and a simplified tax regime (often interconnected). Automotive companies can also benefit from an industrial assembly program allowing a company to import auto components at a reduced customs duty (customs duty averages 12% under the general regime of auto component import and 3% for auto components imported under an industrial assembly agreement).

## Conclusions

The Russian economy remains complicated and, in some, aspects, closed to foreign investors. Nevertheless, its dynamic is more positive than the one of the Western and Central and Eastern European countries. This is especially valid for the retail industry (which is, together with the wholesale, the biggest creator of value in Russia) and the automotive industry, both of which offer perspectives for French and Czech companies, especially for the ones already present

in the Russian market (e.g. Auchan Group, PPF group, Renault and Škoda Auto) to increase their sales and market shares.

At present, the most dynamic and “open” (in terms of competition, not of government regulation) market remains the automotive industry, which will require FDI in order to successfully face the WTO membership. The retail trade industry represents a bigger challenge for foreign firms due to higher concentration, nevertheless, its growth is also important and should not be overlooked.

### **Acknowledgement**

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**PART 2 –  
SME EXPANSION IN  
CENTRAL AND EASTERN EUROPE**





# ENTERING CENTRAL AND EASTERN EUROPEAN MARKETS THROUGH GATEWAY STRATEGIES: THE CASE OF THE FRENCH COMPANY SLAT

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## **Abstract**

*This paper focuses on the international development of SLAT, an independent SME which develops, produces and markets solutions of secured alimentations. Located in the Rhône-Alpes region, the company has 67 employees. The SME has mainly developed in international markets through export activities: it realizes 15% of its total sales abroad and its products are marketed in 37 countries. The company has recently decided to implement a sales subsidiary in Germany to strengthen its presence in international markets. In this process, the company was accompanied by ERAI (Entreprise Rhône-Alpes International), a French agency which helps companies from the Rhône-Alpes region to expand into foreign markets. The authors of this paper explain the role played by ERAI in the establishment of the foreign subsidiary and the influence of a successful accompaniment experience on the internationalization process.*

## **Keywords**

Gateway strategy, international development, SME, SLAT

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SMEs are often limited in their internationalization by their lack of experience, tangible and intangible resources, internal competencies, barriers (perceived or real), among others (Francis and Collins-Dodd, 2004). Therefore, they often choose to collaborate with specialized agencies when expanding into new geographic markets (Bouveret-Rivat and Mercier-Suissa, 2010; Zucchella and Scabini, 2007). Developed by national, regional or professional institutions, export promotion agencies aim to help companies to overcome existing barriers by providing them advice as well as financial, logistic and material support at different stages of their expansion (Goxe, 2011). SMEs collaborate with export promotion agencies for two major reasons: their market knowledge scarcity and the necessity to

penetrate foreign networks (Catanzaro et al., 2013). Promotion agencies facilitate the creation of relationships with different types of local actors - suppliers, distributors, customers, institutions etc. – and potential partner companies, thus enhancing SMEs' competencies and international competitiveness (Francis and Collins-Dodd, 2004; Catanzaro et al., 2013).

This paper focuses on the international development of the French company SLAT, an independent SME which develops, produces and markets solutions of secured alimentations. This industrial SME has mainly developed in international markets through export activities: it realizes 15% of its total sales abroad and its products are marketed in 37 countries. The company has recently decided to implement a sales subsidiary in Germany to strengthen its presence in international markets. In this process, the company was accompanied by ERAI (Entreprise Rhône-Alpes International), a regional agency which helps local companies to expand into foreign markets. The authors examine the role played by ERAI in the establishment of the foreign subsidiary and the influence of a successful accompaniment experience on the internationalization process. They first analyse the international development of SLAT (part 1) before discussing the role played by ERAI in the internationalization process followed by the company (part 2).

## **1. SLAT, an SME expanding into international markets**

SLAT is a French SME that has followed an original development path. After the presentation of the company and its activities, we will focus on the internationalization process of this industrial enterprise.

### **1.1. Presentation of the SLAT company**

SLAT is a French SME that operates in the industry of secure power supply solutions. Located in Champagne au Mont d'Or near the city of Lyon, the company has 67 employees. In 2011, SLAT achieved total sales of 12.89 million euros (+6.89% on 2010) and made a net profit of 1.17 million euros (+14.81% on 2010). The company dedicates 10% of its total sales to research and development (R&D). The development path of SLAT can be divided into three different phases: (1) the creation and development as an independent family-owned SME, (2) the integration into foreign multinational companies (Quante AG and 3M), (3) the growth as an independent SME.

Table 1 summarizes the most significant events concerning the evolution of the company since its creation.

Table 1: History of the SLAT company

Development phases	Main events
Independence (1953-1985)	1953: Creation of the Société Lyonnaise d'Appareillage Téléphonique (SLAT) 1969: Premises of international expansion (sporadic exportations)
Integration in multinational companies (1985-2009)	1985: Acquisition by a US pension fund 1988: Acquisition by Quante AG (Deutsche Telekom) 2000: Acquisition of Quante AG by 3M 2004: Nomination of André Guinet at the head of SLAT and first strategic reorientation : <ul style="list-style-type: none"> <li>- from "endured" to "controlled" exportations</li> <li>- exit from the telecommunication sector</li> <li>- development of a niche strategy</li> </ul> 2006: Creation of a sales office in Germany
Independence (since 2009)	2009: Acquisition of the company by its managers (LBO) 2011: Creation of a sales subsidiary in Germany 2012: Delineation of new vectors of growth : <ul style="list-style-type: none"> <li>- expansion into German-speaking countries</li> <li>- development of new activities</li> </ul> 2013: Exploration of the Polish market in collaboration with ERAI

Source: SLAT (2012), *Internal documents*.

Created in 1953 by Mr. Maitrepierre, SLAT (Société Lyonnaise d'Appareillage Téléphonique) initially developed and produced telephone sockets. In the post-war period, this sector expanded rapidly and SLAT became a major supplier of 'T-shaped sockets' for various industries. In the 1960s, encouraged by a growing demand for PABX telephone exchanges (Private Automatic Branch Exchange - an electronic system that connects internal telephone lines to the external telephone network and thereby allows to manage incoming and outgoing calls) and faced with the need for connections to be maintained in case of a power failure, the company moved towards manufacturing secure power supplies (battery chargers), which subsequently became its core business. For over 35 years, this small

family-owned SME mainly developed its activities on the French market.

At the end of the 1980s, SLAT lost its independence and was taken over by a US pension fund which later sold it to Quante AG (*Aktiengesellschaft* - joint stock company), a German company with 1.600 employees, belonging to Deutsche Telekom. In 2000, when Quante AG was acquired by 3M (Minnesota Mining and Manufacturing Company), an American multinational company with 70.000 employees. SLAT thus became successively a subsidiary of Quante AG and the 3M Group. In 2004, the 3M Group decided to nominate one of its marketing and sales managers, André Guinet, as a Managing Director of the SLAT subsidiary.

In 2009, SLAT regained its independence: the company was sold by the 3M Group to two of its senior managers. The realization of this purchase was preceded by long negotiations which started in 2007, since selling a subsidiary to managers is not part of the corporate culture of the 3M Group. André Guinet, Chief Executive Officer, and Isabelle Chevaux, Administration and Finance Director, finally bought the company through an LBO (Leveraged Buy Out): they acquired 30% of its capital, and the Initiative & Finance fund purchased 65%, 5% being held by employees.

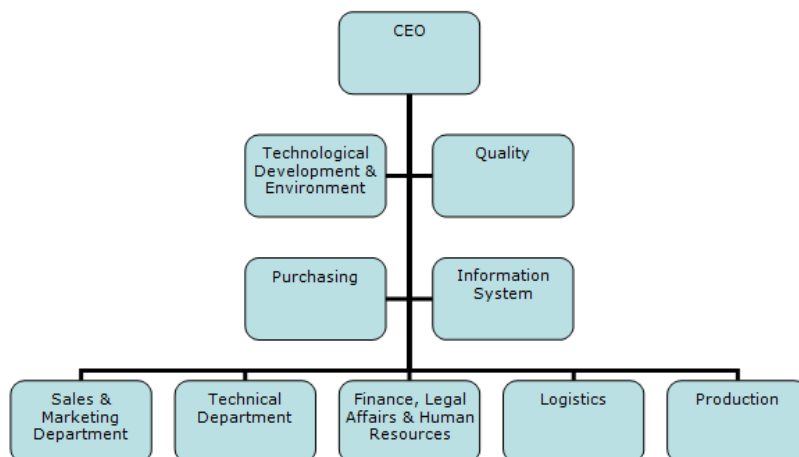
André Guinet, an electro-mechanical engineer, had gained an important international experience, namely in Germany and the Middle East, and spent a large part of his career with the 3M Group. He admits having experienced some difficulties at the beginning due to the specificities of SMEs. *“When I came here, I was Managing Director of 3M France, a kind of super sales & marketing manager. I did not know what an SME was!”* With regards to his acquisition of SLAT, he explains: *“I arrived at SLAT in 2004, assigned by 3M for a period of two years. [...] My role was to create a business plan to sell the business. It is true that I quickly became attached to the company. [...] The life of an SME is different and that is something that I enjoyed: the human qualities, the ability to make decisions without having to consult anyone. [...] 3M wanted to sell the company but was not able to. In March 2007, I said to them: 'It is time to sell'. We had grown substantially and the business plan was sound. [...] We needed until October 2008 to put the company on the market. I had made a number of offers but the group turned them down. I tried to buy the company but it was made clear that it was not at all in the spirit of 3M*

*and never before at 3M had an employee acquired a group subsidiary: it had never been done and would never be done. [...] However, due to the economic downturn, the prevailing situation allowed me to buy the company in 2009. We returned to being an independent SME in July 2009. It is never too late to go on an adventure and become an entrepreneur!"*

Since 2009, the management style of the company has been strongly influenced by the personality of the CEO, like this is often the case for SMEs (Torrès, 1997). André Guinet believes that close collaboration with employees plays an important role in making the company more flexible and responsive. He attaches particular importance to listening to employees, regardless of their hierarchical level and place in the organization. He explains: "I have a theory: if I do not have enough time it is because I am badly organised. My door is always open. Anyone can come and see me at any time. It sometimes has its drawbacks but it is a way of working. [...] I arrive at 6.00 a.m. and between 6.00 and 8.00 I do not see a lot of people. [...] It is the same for the evening, after 7.00 p.m. [...] I use this time to write business plans, etc. As an SME, you need this time to think and get things straight. It is impossible to do so during normal working hours. Some of my predecessors had a far simpler technique: they arrived in the morning and went into their office and closed the door without greeting anyone. When they needed someone they had an assistant next door who also made coffee, etc. The first thing that I did when I arrived here was to get rid of this position. Nobody understood why. They asked me how I was going to cope. I come from a US group. I have never had an assistant."

As shown by figure 1, the organizational structure of the company is of functional type. This form of hierarchical organization is often adopted by SMEs, especially when they follow a specialization or niche strategy (Mayrhofer and Urban, 2011). It seems interesting to note that the company has not created a department dedicated to export activities, which are thus managed by the different business functions. Indeed, the company's engineers collaborate closely with sales representatives, often accompanying them for customer visits, in France and abroad, to better understand and satisfy the customers' technical needs. The Executive Committee comprises the CEO and the heads of the following departments: 'Sales & Marketing Department', 'Finance, Legal Affairs & Human Resources', 'Technological Development & Environment' and 'Quality'.

Figure 1: Organisational structure of SLAT

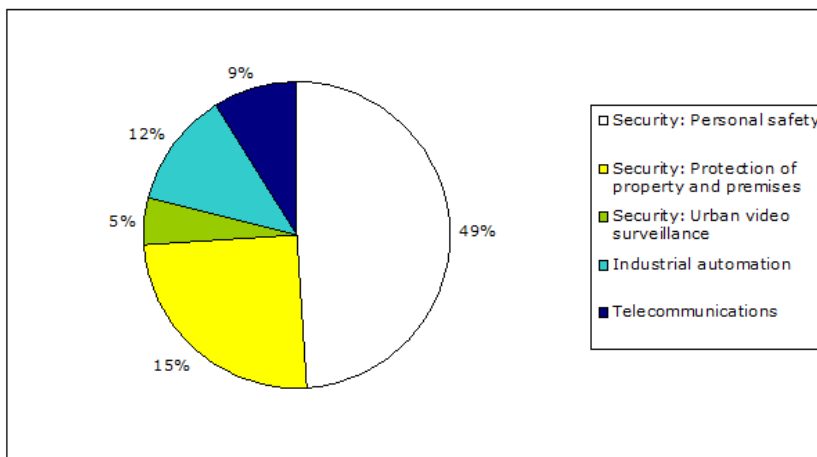


Source: SLAT (2012), *Internal documents*.

After having regained its independence, SLAT has enjoyed a period of strong growth and profitability. As André Guinet points out, a successful development plan wholly depends on a constant search for growth. *“I need profitable growth. Why? The reason is quite simple. I always give this example. [...] As a human being, try to remain standing for an hour without moving: it will be difficult. Try to walk backwards: you will not walk for long. Try going forward: you will be able to walk for miles. That is the image of growth that I always give. Given today's economic system, you do not really have any other choice but to go forward! Going forward in business means finding growth. [...] Over the past five years, we have increased our staff by about 10%, our total sales have developed from 8 million euros in 2004 to 12 million euros in 2010. The problem of an SME is that I have an important amount of variable costs which become fixed costs. We need a basic infrastructure, and today, the strategy is relatively clear: we develop a profitable growth strategy. I need a certain form of comfort, I need a cash-flow to work and results that are not ‘border-line’: if you take out 2-3% of results in a company like this one, one coughing client who forgets to pay you puts you into losses. I rather follow objectives between 10 et 15%, not to take the money to the bank, but to invest it internally, to improve our competitiveness and to finance our export strategy.”*

Since its creation, SLAT has operated in niche markets, thus working in areas where competition in France, and even in Europe, appears to be weak. Today, the company designs, produces and sells secure power supplies. As shown by figure 2, the offer is aimed at five different markets: (1) personal safety (49% of total sales), (2) security of property and premises (15%), (3) security for urban video surveillance (5%), (4) industrial automation (12%) and (5) telecommunications (9%). Personal safety (fire prevention and health) and the protection of property and premises represent the company's main fields of activity. Standards in both areas are strict and constantly evolving. Security for urban video surveillance is a new line of business which was introduced in 2010. The company's industrial automation devices mainly serve the aerospace industry, airports and car manufacturers. The telecommunications sector, which constitutes the company's historic line of business, is a declining market.

Figure 2: Breakdown of the company's activities (% of total sales in 2011)



Source: SLAT (2012), *Internal documents*.

Concerning the reorientation of business activities accomplished since his arrival as head of the company, André Guinet states: "We have lost the telecoms business. In the past, it represented over 50% of the company's business, but today I would say that it is less than 10%. [...] Since 2004, I have completely redirected the company as I soon realised after I arrived that the telecoms sector was a little 'dead'. Today, it is essentially a mass market served by South-East Asian suppliers. I decided to turn our attention to niche markets in which we



can always offer something different and, above all, be a profitable company. [...] The company's areas of growth are very simple: they are linked to buoyant markets. I draw on know-how that already exists: where can I make the best use of my know-how and get the most value out of it? Why the security sector? Because it is a buoyant sector. I produce five-year business plans. For me, it is a buoyant and growing sector. Whether for the safety of people (i.e. fire safety) or controlling access and stopping intruders, we need to protect buildings through video surveillance. Linked to this area, I work on everything associated with the ageing of the population: for instance, with home hospital care, if there is breathing apparatus and a power failure occurs, the consequences can be serious. [...] There is another area of growth which is the environment but that is a personal choice.”

SLAT has a diverse customer base: the company's twenty biggest customers account for 34% of SLAT's total sales (in 2011), 56% of the company's sales come from customers who have been working with the company for more than ten years, and 23% of sales is from customers working for the company for less than four years. Some major clients of SLAT are Bosch, Cegelec, EADS (European Aeronautic and Defence Company), Honeywell, Renault-Nissan, Siemens and Spie.

Standards and technical certification play an important role in SLAT's activities. The company is certified under various standards: NF standards (Normes Françaises - French standards), European Community (EC) standards, ISO 9001 and 14001 (International Organization for Standardization, international standards), TÜV (Technischer Überwachungsverein, a German standard) and VDS (Verband der Schadenversicherer, a German standard), which support the differentiation strategy followed by the company. André Guinet explains: *“what makes us different is that we operate in niche markets with very strict standards. Getting the products certified costs a small fortune but it allows us to stand out from the competition and enjoy a very respectable level of profit. That is our strategy. We do not operate in mass markets but in highly technical markets in which standards apply. What some might describe as a constraint, I see as an advantage and something that protects us.”*

Pursuing a growth strategy, the company aims to reach total sales of 20 million euros by 2017. Table 1 contains the growth objectives for the company's five main markets for the period 2013-2017. To

achieve these objectives, SLAT is looking to increase its market share in France, but also to accelerate its sales on international markets. “The French market is what it is but I cannot hope to reach 20 million euros in five years by only focusing on the French market”, comments André Guinet.

Table 1: Breakdown of the company's activities (% of total sales in 2011)

Activities	CAGR (Compounded Annual Growth Rate), objectives for 2013-2017
Security: Personal safety	5.1%
Security: Protection of property and premises	10.1%
Security: Urban video surveillance	22.9%
Telecommunications	-0,14
Industrial automation	2.8%

Source: SLAT (2012), *Internal documents*.

## 1.2. The internationalization process of SLAT

The internationalization process followed by SLAT can be divided into three major phases: (1) indirect exporting, (2) direct exporting and (3) creation of a sales subsidiary.

Since its foundation in 1953 until the end of the 1980s, SLAT had mainly developed its sales on the French market. Following its integration into the German Quante AG (Deutsche Telekom) and the US 3M Group, the company developed its export activities, predominantly through indirect exportation. The adopted approach consisted in accompanying clients on international markets, for example, Alcatel in the telecommunications sector and Renault for plant construction projects. André Guinet comments: “*the company has always exported in quite a particular way that I would describe as 'endured' exports. Our products were qualified by Alcatel: the main market was France but whenever they installed a PABX in Colombia, Africa, Vietnam or anywhere else, we had to deliver one or two chargers. We did not try to export. [...] Renault approached us shortly before I arrived to ask us to make industrial battery chargers for their assembly lines. We replied in 2003 and were qualified as an exclusive*

*supplier. Where do 'endured' exports come in? When Renault builds a plant, we are directly involved: in all Renault plants, there are SLAT battery chargers. In 2011, we exported to Morocco, Brazil, Mexico, India, Russia, Korea... That is how we export to the entire world, to countries which appear quite exotic.'*

Today, the company takes a proactive approach and develops direct exports by signing contracts with clients abroad. Direct exports take the form of OEM (Original Equipment Manufacturer) agreements or contracts with security system manufacturers, SLAT being a 'sub-component of the system'. In 2011, export activities account for 15% of total sales. Products are exported to 37 countries, but the main markets are European (Germany, Austria, Switzerland, Benelux and Nordic countries): almost 50% of the company's export sales concern Germany and 30% the Benelux. The relative importance of European countries can be explained by the regulatory nature of the company's products and the recognition of European standards abroad. The company also targets North Africa, Saudi Arabia, Qatar and the United Arab Emirates, particularly Dubai, where it has installed the metro's security system.

In 2011, SLAT created a sales subsidiary in Stuttgart, Germany. The decision to open a foreign subsidiary is linked to the CEO's objective to reach a "sustainable" growth and to ensure the development of foreign activities. Among the four countries studied (Germany, Spain, Italy, United Kingdom), Germany was rapidly identified as the country to host the subsidiary. The value given to standards, the high level of local technical know-how and the requirements of SLAT's historic clients regarding certification and quality influenced the choice of the subsidiary's location. As emphasized by André Guinet, *"Germany was chosen solely on the basis of market principles: it is the country that is prepared to pay for the added value of standard-based certification and to pay a fair price to have access to this certification"*. SLAT gained a sustainable competitive advantage on the German market due to its ability to adapt to local customers' needs and quality standards. Furthermore, the SME remains the unique French company in its sector able to implement measures to conform to German norms. This led the company to get certified "first rank supplier" by German multinationals such as Bosch and Siemens. *"We were the first able to bring out the norm... That is why we are working with Bosch, we were the only one... and we are still the only one! We are the only one to get products conform to their norms"*. One can

also mention that André Guinet was familiar with the German market and its characteristics, having acquired an important experience with the 3M Group in Germany, namely through a three-year assignment in Düsseldorf.

The decision to take a proactive approach on foreign markets has been beneficial for the company on several levels. First, going international is a way to learn about foreign markets: targeting a market having high technical requirements led the company to improve the quality of its entire product range. It also allowed SLAT to reinforce relationships with major local clients, increasing its credibility and legitimacy abroad, but also in France. The CEO confirms that after a long period needed to conform to German standards, SLAT manages to *“develop relationships with them where they do not see us as suppliers but as real partners, based on progress - far beyond technical - and on sharing markets”*.

It is important to note that the internationalization is constrained by local norms and standards, since adapting the company's products requires time and resources. Even if he is not fully satisfied with the internationalization achieved by the company, André Guinet recognises that, *“at least, it is adapted to our current capabilities. Today, with the capabilities I have, the resources I have and the means to implement without disturbing what already exists... You have to be careful because you are adding something which is not easy to handle with for people”*. Managing the existing differences in terms of local laws and regulation is a real challenge for SLAT. André Guinet recognises that *“in terms of investment, I am really cautious: when I am in another country, I say to myself that the local law... I don't understand it, so I need to get helped on this”*. The CEO thus decided to work with several accompaniment offices to help him overcome these perceived entry barriers.

## 2. The role of accompaniment for the internationalization process of SLAT

The entrepreneurial accompaniment can take various forms and take place at different stages. As pointed out by Czinkota (2002), accompaniment programs allow to improve the company's capabilities by transferring informational and experiential knowledge, to help financing exportations and to reduce the weight of administrative and legal formalities for the company. Provided by public or private institutions, these programs influence the development of export activities in three different ways: (1) raising the awareness about foreign market opportunities, benefits and motivation to initiate exportations, (2) understanding and responding to customers' needs by providing useful information and assisting the preparation of export activities, (3) facilitating the implementation of the company's products and services in the local market (Catanzaro et al., 2013). Export promotion agencies are of particular importance for SMEs, notably during the first steps of their internationalization, since they help them to overcome the difficulties linked to the lack of resources and capabilities, foreign market knowledge, access to local networks or distribution channels etc. (Francis and Collins-Dodd, 2004).

In France, several specialized agencies assist companies, especially SMEs, in their international expansion. In 2008, a new structure called "French Export Team" (*Equipe de France de l'Export*) was created in order to avoid the multiplication of programs and coordinate the actions of major promotion agencies. Several institutions cooperate within this new structure (Mayrhofer, 2012):

- the Assembly of French Chambers of Commerce and Industry (*Assemblée des Chambres Françaises de Commerce et d'Industrie*): they provide information and advice, offer training sessions and promote French products abroad;
- the Union of French Foreign Chambers of Commerce and Industry (*Union des Chambres de Commerce d'Industrie Françaises à l'Etranger*) : they represent French companies, offer assistance and office facilities, and organize promotion actions abroad;
- the French Insurance Company for International Trade (*Compagnie Française d'Assurance pour le Commerce Extérieur* - COFACE): it offers credit insurance solutions that aim to protect companies against financial risks;

- the French Foreign Trade Advisors (*Conseillers du Commerce Extérieur de la France* - CCEF): they represent a network of French corporate executives willing to share their international experience with other managers;
- the General Directorate of the Treasury (*Direction générale du Trésor*): part of the French Ministry of Finance, it develops the policy of international trade for the French government;
- OSEO: this agency provides assistance and financial support, mainly in the field of innovation;
- UBIFRANCE: this agency, which operates more than 80 local offices in 60 countries, provides information and assistance in local markets and helps companies to export and implement activities abroad.

Institutions affiliated with the “French Export Team” operate at the national, but also at the regional level. The network has also signed partnerships with several regional promotion agencies, such as ERAI (*Entreprise Rhône-Alpes International*) in the Rhône-Alpes region. One can also mention the existence of an important number of private consulting companies that offer their services to companies (Goxe, 2011).

French SMEs thus have the choice to work with a variety of specialized agencies and consulting companies when they wish to expand abroad. In order to accelerate its internationalization process, SLAT chose to collaborate with ERAI and COFACE. The company worked with ERAI for the development of direct exports and the creation of a sales subsidiary in Germany and with COFACE for credit insurance in order to cover financial risks.

## **2.1. The accompaniment by ERAI**

ERAI is a specialized agency helping companies from the Rhône-Alpes region to expand abroad. It was created in 1987 by the regional council to contribute to the economic development of the Rhône-Alpes region and to support the international development of local SMEs. This regional accompaniment structure has five fields of expertise: Clusters, Invest, Export, International Financing, and Cooperation & International Relations. It provides support services for initial internationalisation stages (export activities, search for local partners, etc.) and organizes targeted collective and individual assignments. The agency acts on behalf of VSBs (very small

businesses) and SMEs from the Rhône-Alpes region to integrate them into local clusters. Furthermore, it helps these companies capitalise on their know-how and their competencies on international markets and develop partnerships with various foreign actors. In order to develop its activities, ERAI has established 27 offices located in various countries: Germany, Canada, China, United States, United Arab Emirates, Italy, Japan, Morocco, Tunisia, Vietnam, etc.

SLAT first worked with ERAI to develop direct exporting and then collaborated with the agency for the creation of a sales subsidiary. Before collaborating with ERAI, André Guinet attempted several times to get the assistance of well-known business consultancy companies, but they could not provide solutions adapted for the specific context of SME's. *"We worked with X, for one year... I tried to work with them but it did not work. I told them that I was not interested in their solutions concerning the return on investment but rather on accessing to customer databases. What they were offering was not what I was looking for: I knew that they were the kind of people who never take any risks. When you have a risk, with a particular customer, it is all yours. What happens is that they tell you after that you will not be warranted for this customer as you took a commercial risk. But... wait for a commercial risk: I cannot stop like this! As long as my clients pay me, I will be really careful, but you tell me to reduce all my risks by the end of the next three months... In three months? I cannot live... So I decided to stop working with X. Then, I decided to work with Y, an informational consultancy company. They have a department dedicated to the analysis of basic financial structures, but once again, it did not work"*.

In 2006, the company started to prospect the German market with the help of the ERAI (*Entreprise Rhône-Alpes International*) office in Stuttgart. The agency supported them for the creation of a sales office and the recruitment and training of a German sales manager. The first sales contracts were signed three years later. In 2011, SLAT created a sales subsidiary for the German market which now represents 10% of its total sales. André Guinet explains: *'we started off with support from ERAI. We wanted to recruit a local person from Germany, in other words, a German from Germany. In 2006, ERAI helped us with the recruitment process, provided accommodation and even helped with functional aspects and the sales training of this manager. Our business plan was quite clear: the aim was to give ourselves three to four years to open a subsidiary. The next stage was therefore to move*

*from the sales office to the subsidiary. Our subsidiary has been operational and officially registered since 1 July 2011.'*

In 2012, the German subsidiary, SLAT GmbH (*Gesellschaft mit beschränkter Haftung* - limited liability company), whose legal structure is German, became operationally independent and achieved the break even. Two full-time employees work for the subsidiary.

SLAT GmbH is a platform that allows the parent company to access neighbouring German-speaking countries as well as Central and Eastern European markets. This new direction is justified by its geographic proximity, a strong local development potential, the value given to standards, high quality and technical requirements and the presence of certain customers in these high-growth markets. André Guinet declares: *"My aim now is to use the German platform to serve German-speaking countries, namely, Austria and German-speaking Switzerland for strategic reasons and motives connected to our customers as they are very likely to be present in Austria and Switzerland. Siemens has a technical R&D centre (fire safety) in Zug, Switzerland, for example. From the German platform, I am also starting to think about my next country with ERAI: an Eastern European country. Why? The geographic size, the development profile of these countries, which is quite attractive, and a certain awareness of standards. It should be noted that some of these countries are quite demanding with regards to standards: they have certification bodies. In 2013, I will definitely seek support as we did for Germany and hire somebody if the game is worth it. The reputation of our neighbour, Germany, can help us build a credible platform. The other particularity of Eastern Europe is that I have a direct competitor over there: that's another reason! It would be interesting to see how he 'really' behaves. I may as well attack the enemy on his land and slow him down before he gets here."* The company intends to enter the Polish market and also considers other Eastern European countries like the Czech Republic.

The location strategy adopted by SLAT can be considered as a "gateway strategy". This approach allows a company to access foreign markets indirectly by using an entity located in a peripheral country. It is a proactive - offensive or defensive - internationalization strategy where the degree of commitment is driven by the intention to get a foothold on a market to indirectly penetrate other close markets. The initial experience acquired in one market can prove to be a



springboard to other neighbouring countries. The presence of free trade and regional integration agreements (such as the European Union) encourages companies to use this type of strategy. Moreover, companies prefer to operate in transparent and stable markets whose reaction is predictable as well as to reduce their exposure to local risks such as political instability and foreign exchange risk. Using a gateway country therefore allows a company to enter new markets (geographically or culturally more remote) from a familiar environment where the company is already established (Dominguez 2013), like this is the case for SLAT in Germany.

## **2.2. The impact of the accompaniment on the internationalization process**

The accompaniment by ERAI influenced the company's internationalization process in different ways: (1) the increase of international sales, (2) the access to local information and networks, (3) the choice of location of the German subsidiary and (4) the selection of future locations.

The support of ERAI has helped the company to develop its international sales. Their significant increase has led the company to recruit experienced personnel dedicated to developing business abroad. The company's workforce increased by over 10% between 2008 and 2012, and new areas of growth were defined to serve buoyant markets. The purpose of this strategic shift is to guarantee the long-term survival of the company by diversifying both its markets and customer base and thereby reducing its exposure to the prevailing environment. *"I remain convinced that if you want to become a successful exporter, gaining a permanent foothold in a country is only possible if you use local sales representatives. In the area of exports, what makes us different is that we do not go abroad with just one customer: I do not want one customer to represent more than 10% of my total sales. Today, I have about 90 customers in Germany. I always mention prestigious companies (Bosch, Siemens etc.) but in terms of total sales, today, none of them represents more than 30%. I am still getting off the ground in Germany but the rules remain the same: expand my customer base to reduce risk. By the end of the year, my first customer in Germany will represent less than 20% of my total sales, so I am on the right track"*, comments André Guinet.

Like many SMEs, SLAT's international development was constrained by the lack of resources, market knowledge and access to local networks. As mentioned previously, export promotion agencies usually own offices abroad acting, among others, to develop and maintain relationships with local key actors. These relationships help promotion agencies to develop a strong market expertise and to identify local business opportunities. Conscious of SLAT's weaknesses, André Guinet decided to collaborate with ERAI and the COFACE in order to get access to their networks and expertise and thus benefit from their legitimacy with local partners. André Guinet claimed that going abroad accompanied is a good way to save time, efforts and resources, since the SME attempts to avoid facing the white page issue. "The white page, it is when you knock on the door but nobody knows you, you haven't got any references, no support locally to justify your arrival. [...] We met people, we needed support. What we were expecting from ERAI was to find people who are trained to help companies to develop exports. A structure providing something going further than the traditional accompaniment by doing some functional management locally". The CEO also recognises that "there were things that I was not able to apprehend at the right time, that caused some delays... Elements that my initial market studies did not tell me. I think that there is a real benefice coming from networks and relationships: we can considerably increase SMEs' efficiency abroad, in this way." Export promotion structures can also provide financial solutions and information about local customers and market conditions. Considering the opportunity to invest abroad, André Guinet decided to work with the COFACE to access the funds needed to start operations on the German market. He comments, "the COFACE is a very good financial instrument, an advance of money... I used their services for the German subsidiary, to finance the launching phase, for 300.000 euros. It is not that hard to get their support: if you come with a good file... Those people are still worried about making good use of money, but it is exactly the same when you borrow money from your bank... They are here to support you. They can also give you some advice on a country's specific level of risk and help you evaluate properly those risks".

Influenced by the presence of ERAI in Germany, Stuttgart became the subsidiary's host city despite André Guinet's extensive experience as a 3M Managing Director in Düsseldorf. André Guinet explains: "I had two choices imposed on me by those providing support. Either Düsseldorf with the Franco-German Chamber of Commerce and

Industry (which is based in Düsseldorf) or Stuttgart because ERAI is based in Stuttgart. Out of the two, my heart leant towards Düsseldorf. Why? I hardly knew Stuttgart but I know Düsseldorf quite well as 3M was based there. I visited Düsseldorf regularly over a period of ten years as I had employees based in the city. In any case, we could be in any city as the market is spread quite evenly (in light of market research) between the main platforms in Germany: Düsseldorf, the Ruhr, Frankfurt, Stuttgart... Every region could be of interest.”

Because of the successful assistance provided by ERAI on the German market, the CEO decided to continue the cooperation developed with this promotion agency for other markets. Besides other market selection criteria such as the local potential to value the norms, André Guinet favoured locations where ERAI was already established in order to benefit from the agency’s infrastructure and support. The location choice thus appears to be influenced by the local presence of the accompaniment structure. When explaining his decision to prefer a gateway approach to enter Eastern European markets, André Guinet recognises that “from the German platform, I am starting to develop my next country (Poland) with ERAI. It is just the premises in Poland. I know what I will do there: I will certainly start again with a similar accompaniment we had in Germany and recruit someone local if it is justified”.

## **Conclusion**

The analysis proposed in this paper highlights the role that export promotion agencies can play in the international expansion of SMEs. The case-study developed by the authors shows that the accompaniment by ERAI has helped the SLAT company to implement a sales subsidiary in Germany, a market characterized by high technical standards in the industrial sector which remains difficult to enter for foreign SMEs. The assistance of ERAI has also influenced the location of the subsidiary and the choice of future markets. It has allowed the company to accelerate its development in foreign markets and thus to achieve its ambitious objectives in terms of growth and profitability. The study thus validates the positive effects of promotion agencies on export activities and performance, as also emphasized by Gencturk and Kotabe (2001).

The collaboration with ERAI has had positive effects on the internationalization of SLAT, but the CEO of the company also mentions some difficulties he faced when trying to get assistance for

his international development plans: *“It is a real jungle! We are not able to have a clear picture, they are too numerous and it is turning to competition between institutions. I have other things to do than looking for their funds... Once I tried to apply to one of those funds to hire young engineers. After two months, someone told me that I could not get the funds because, yes my file was excellent, but they were lacking money and had to add an extra criterion to the condition of attribution, based on the firm’s profitability. They told me ‘your file is perfect but our choice is based on companies’ profitability: you are highly profitable but we opted for companies that are not’. I sorted out those programs. [...] We have so many accompaniment structures now, it doesn’t make any sense: SMEs are lost. You spend your time looking for funds and building the files needed is a mess (even if I am quite well organized for that). It is time consuming. We are assisted by external organisms to build the files: I don’t know if there are SMEs building themselves those files but personally, I am not able to do so. There are plenty of extremely precise criteria for which I got help from external consulting agencies: we select, together, the projects to start and they help us to write the files.”*

Despite the extensive services provided by export promotion agencies, it seems that the existing offer presents several limitations. In fact, there still exists a variety of public and private actors whose role is to accompany SMEs in their international expansion (Fayolle, 2004). Initiatives such as the creation of the ‘French Export Team’ may contribute to clarify the role of existing structures. Moreover, the services offered do not seem to match certain expectations of entrepreneurs. As recently mentioned by Catanzaro et al. (2013), it is necessary to continuously adapt the offer to the requirements of SMEs, since their approach to develop international activities is likely to change over time.

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## MARKETING ANALYTICS FOR ASSESSING SME POTENTIAL IN CZ & RU

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### **Abstract**

*Purpose – This paper aims to focus on the determinants influencing the internationalization of small and medium-sized enterprises (SMEs) in Czech Republic and Russia. The objective is to investigate and evaluate the business environment and, then, examine the importance of developing and promoting entrepreneurship to allow SMEs in Czech & Russia to develop a competitive position in the international marketplace.*

*Design/methodology/approach – An overview is provided of the current economic situation facing SMEs in CZ & RU. Then factors necessary for the expansion of the business are discussed, along with the challenges of overcoming the resource gaps identified. We have conducted empirical surveys and used SPSS statistical tools to predict the potential of revenue growth in SME sector.*

*Findings – Information is provided concerning the current situation for SMEs in CZ & RU and the challenges encountered as they face a business environment that is becoming more competitive. We also found that SMEs are more and more integrated to global economy and not limited to regional/international activities. Quantitative analysis has shown there is significant potential for SME for next couple of year despite economic uncertainty.*

*Originality/value – This paper integrates entrepreneurship, resource-based internationalization of SMEs in India, specifically focusing on the use of technology.*

### **Keywords**

*Entrepreneurs, International trade, Small to medium-sized enterprises, Europe, Marketing Analytics*

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## **Introduction**

In an exacting economic environment, small and medium sized enterprises (SMEs) have been presented with a challenge. A challenge to grow and increase the profitability of their businesses against a backdrop of often weak demand.

This report summarizes the results of research into the performance and competitiveness of SMEs in this business environment, with a specific focus on attempts by SMEs to ‘internationalize’ their businesses and how this impacts on their growth.

## **The definition of SMEs**

Small and medium-sized enterprises (SMEs) are a very heterogeneous group. SMEs are found in a wide array of business activities, ranging from the single artisan producing agricultural implements for the village market, the coffee shop at the corner, the internet cafe in a small town to a small sophisticated engineering or software firm selling in overseas markets and a medium-sized automotive parts manufacturer selling to multinational automakers in the domestic and foreign markets. The owners may or may not be poor; the firms operate in very different markets (urban, rural, local, national, regional and international); embody different levels of skills, capital, sophistication and growth orientation, and may be in the formal or the informal economy.

Statistical definition of SMEs varies by country and is usually based on the number of employees, and value of sales and/or value of assets. Due to its ease of collection, the most commonly used variable is the number of employees. The EU and a large number of OECD, transition and developing countries set the upper limit of number of employees in the SMEs between 200-250, with a few exceptions such as Japan (300 employees) and the USA (500 employees).

At the lower end of the SME sector, a large number of countries define a group, which is a mixture of the self-employed and “micro” enterprises, with less than 10 employees. Irrespective of the level of development of an economy, a significant proportion of micro and, sometimes, small enterprises are found in the informal sector or the shadow economy. Schneider (2003) compared the size of the informal sector in 22 transition (former Soviet Union and Central and Eastern Europe) and 21 OECD economies from 2000-2002 and found that the size of the informal sector amounted to an average of 16.7%, 29.2%

and 44.8% of GDP in OECD, Central and Eastern Europe and the former Soviet Union economies, respectively.

### **The importance of SMEs in a global economy**

Global economic integration is changing the competitive paradigm in which all businesses operate, requiring an international expansion strategy to positively impact long-term growth and survival (Karagozoglu and Lindell, 1998). The small business sector has become more important as they emerge as a dominant force impacting the growth of national economies (Shridhar, 2006). There are a number of disadvantages inherently faced by SMEs as they transition into international environments (Chen and Huang, 2004). Managers of non-exporting SMEs perceive the international environment as being risky, unprofitable and unmanageable, due primarily to misinformation and lack of experience with global business (Malekzadeh and Nahavandi, 1985). SMEs, due to their size limitations, often have limited financial capital and a lack of necessary human resources. Many operators of small businesses lack experience in developing an international strategy (Tesar and Moini, 1998). There are also disadvantages related to a lack of competitive power as a consequence of the size of the organization. SMEs have difficulty in influencing global pricing as they rely on a small customer base, and are limited in expansion due to minimal access to financial resources (Kalantaridis, 2004). Even though faced with the need to overcome significant weaknesses, the strategic importance of SMEs has been identified as the following: They are responsible for growing employment at a faster rate than organizations; they increase the competitive intensity of the market and reduce the monopolistic positions of large organizations; and . they encourage the development of entrepreneurial skills and innovation. Larger SMEs, in the USA, account for three out of every four new jobs and contribute to providing over half of the gross domestic product (Underwood, 2004). From 1992 to 1999, the number of SMEs that were involved in exporting increased over 100 percent, to nearly 97 percent of all exporting firms in the USA, and accounting for \$168.5 billion in value (Underwood, 2004).

SMEs typically provide capabilities that their larger customers do not have or cannot cost-effectively create, such as:

- Agility in responding to changes in technologies, markets, and trends
- Efficiency due, in part, to less bureaucracy



- Initiative and entrepreneurial behavior on the part of employees resulting in higher levels of creativity and energy and a greater desire for success
- Access to specialized proprietary technologies, process capabilities, and expertise
- Shorter time-to-market because operations are small and focused
- Lower labor costs and less restrictive labor contracts
- Spreading the costs of specialized capabilities over larger production volumes by serving multiple customers
- Lower cost, customer focused, and customized services, including documentation, after-sales support, spare parts, recycling, and disposal

### **SMEs' international competitiveness**

As trade barriers are removed and logistics and communication costs fall, small and medium-sized enterprises have adapted to new challenges to stay competitive in an international marketplace. These developments have also opened up opportunities for SMEs. Their integration into the global economy has prompted them to develop new international activities such as attempting to open new markets; adding more value to their products and services; and reducing their cost base.

Assessing an SME's international competitiveness requires consideration of the economic, political and social aspects within the SME's country of origin, as much as looking at the SME itself. Both levels of analysis have to be taken into account in this research:

- The macro level, 'national' competitive advantages, such as access to new technologies, skilled labour, market structure, logistics and infrastructure.
- The micro level, company-specific competitive advantages, such as price, quality, service, responsiveness and innovation

### **Business Environment in Russia (SME Perceptive)**

General uncertainty regarding almost every aspect of business is probably the most important single characteristic of the Russian business environment. However, this is not the only factor that makes life difficult for business operators in Russia, Transaction and start-up costs are large because of the inadequacies of Russian legal frameworks and frequent changes in regulations. Securing financial

resources, particularly at the early stage of the project, is a daunting task. Direct assistance programs and venture capitalists are all but non-existent, while a combination of state regulations and banking policies has placed credit out of reach for small and medium-size enterprises.

Of 120 trillion rubles (\$21 billion) in banking credits issued in 1996, only 1.2 percent were medium- and long-term credits to businesses (Berezanskaya 1997), Russia is characterized by mistrust between participants in business transactions. Consequently, the need for building strategic alliances has grown in importance, as even the most explicit contractual agreements are not enough to guarantee access to resources. In Russia, the tradition of relying on informal arrangements and networks as an element of business has a long history (Kuznetsov 1994), and in this period of transition, successful networking has become an even more significant factor for success.

The business environment in Russia is marred by the fact that organized criminals control much of the Russian economy. The consequences for honest entrepreneurs are manifold. Security expenses drain resources (as a case in point, in the company investigated here, 18 of its 50 employees were security staff). The strength of the Russian mafia has contributed to a blurring in the eyes of ordinary Russians between crime and business, and this has harmed the social image of entrepreneurs. At the same time, there is consensus among experts that due to a deficient tax system, few Russian businesses can avoid involvement in the "shadow" or "gray" economy. According to the Expert Institute in Moscow, up to 75 percent of firms engage in the most common forms of "shadow" activity: concealing a considerable proportion of income, placing capital abroad, and evading excise duty by smuggling (Yegiasorova 1997).

### **Czech SME sector: foundations so tiny**

Until 1989, Czechoslovakia had one of the toughest regimes concerning private enterprise among the communist countries. Private businesses were violently nationalized or collectivized in the 1950s. Any entrepreneurial activities were forced to the informal economy. The prompt revival of the SME sector in Czechoslovakia in the first years after the fall of the "iron curtain" is thoroughly analyzed in the study by Benáček (1994). Benáček claims that from the start the impact of the emerging small ventures, both legal and informal, was largely underestimated by official statistics and substantially contributed to an economically smooth transition.

We make several straightforward observations. SME account for one third of the Czech GDP and for close to two thirds of employment. This share remained more or less stable over the last 10 years. This holds for the accounting value added as well, which stayed close to 53% throughout the 10 years. On the contrary, three indicators changed significantly and suggest that the SME sector has come through an intensive consolidation. On one hand its share on exports and imports has gone up seven and six percentage points respectively, meaning that SME are now more involved in international trade. Moreover the breakthrough appears around the years 2004/2005, when Czech Republic entered the EU. On the other hand, SME invest relatively more, or they are rather correcting the underinvestment from the earlier period.

### **Time Series Model Overview**

A time series is a set of observations obtained by measuring a single variable regularly over a period of time. In a series of inventory data, for example, the observations might represent daily inventory levels for several months. A series showing the market share of a product might consist of weekly market share taken over a few years. A series of total sales figures might consist of one observation per month for many years. What each of these examples has in common is that some variable was observed at regular, known intervals over a certain length of time. Thus, the form of the data for a typical time series is a single sequence or list of observations representing measurements taken at regular intervals.

One of the most important reasons for doing time series analysis is to try to forecast future values of the series. A model of the series that explained the past values may also predict whether and how much the next few values will increase or decrease. The ability to make such predictions successfully is obviously important to any business or scientific field.

The Time Series Modeler procedure estimates exponential smoothing, univariate Autoregressive Integrated Moving Average (ARIMA), and multivariate ARIMA (or transfer function models) models for time series, and produces forecasts. The procedure includes an Expert Modeler that automatically identifies and estimates the best-fitting ARIMA or exponential smoothing model for one or more dependent variable series, thus eliminating the need to identify an appropriate model through trial and error. Alternatively, you can specify a custom ARIMA or exponential smoothing model

## Exponential smoothing Models

The following notation is specific to exponential smoothing models where:

$\alpha$  is the level smoothing weight  
 $\gamma$  is the trend smoothing weight  
 $\phi$  is the damped trend smoothing weight  
 $\delta$  is the season smoothing weight

The estimation and forecasting of the exponential smoothing is the sum of the squares of the one-step ahead prediction error,

$\sum (Y_t - \hat{Y}_{t-1}(1))^2$  is minimized to optimize the smoothing weights

Simple exponential smoothing has a single level parameter and can be described by the following equations:

$$\begin{aligned} L(t) &= \alpha Y(t) + (1 - \alpha)L(t - 1) \\ \hat{Y}_t(k) &= L(t) \end{aligned}$$

Holts exponential smoothing has level and trend parameter and can be described by the following equations:

$$\begin{aligned} L(t) &= \alpha Y(t) + (1 - \alpha)(L(t - 1) + T(t - 1)) \\ T(t) &= \gamma(L(t) - L(t - 1)) + (1 - \gamma)T(t - 1) \\ \hat{Y}_t(k) &= L(t) + kT(t) \end{aligned}$$

Brown's exponential smoothing has level and trend parameters and can be described by the following equations:

$$\begin{aligned} L(t) &= \alpha Y(t) + (1 - \alpha)L(t - 1) \\ T(t) &= \alpha(L(t) - L(t - 1)) + (1 - \alpha)T(t - 1) \\ \hat{Y}_t(k) &= L(t) + ((k - 1) + \alpha^{-1})T(t) \end{aligned}$$

Damped –Trend exponential smoothing has level and damped trend parameters and can be described by the following equations:

$$\begin{aligned} L(t) &= \alpha Y(t) + (1 - \alpha)(L(t - 1) + \phi T(t - 1)) \\ T(t) &= \gamma(L(t) - L(t - 1)) + (1 - \gamma)\phi T(t - 1) \\ \hat{Y}_t(k) &= L(t) + \sum_{i=1}^k \phi^i T(t) \end{aligned}$$

Simple seasonal exponential smoothing has level and season parameter and can be described by the following equations:

$$\begin{aligned} L(t) &= \alpha(Y(t) - S(t-s)) + (1-\alpha)L(t-1) \\ S(t) &= \delta(Y(t) - L(t)) + (1-\delta)S(t-s) \\ \hat{Y}_t(k) &= L(t) + S(t+k-s) \end{aligned}$$

Winters' Additive exponential smoothing has level trend and season parameter and can describe by the following equations:

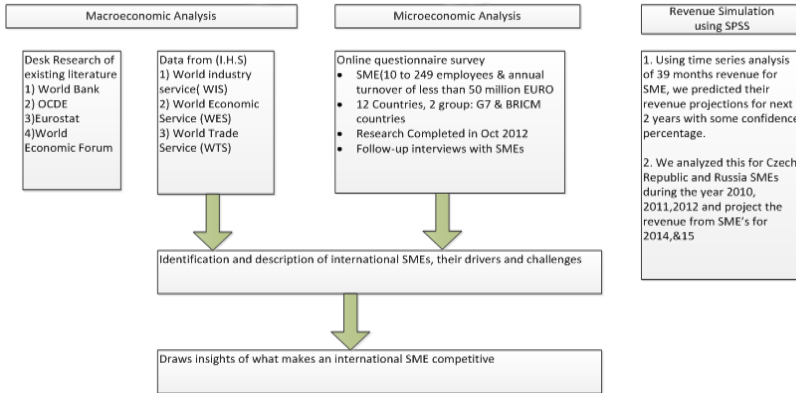
$$\begin{aligned} L(t) &= \alpha(Y(t) - S(t-s)) + (1-\alpha)(L(t-1) + T(t-1)) \\ T(t) &= \gamma(L(t) - L(t-1)) + (1-\gamma)T(t-1) \\ S(t) &= \delta(Y(t) - L(t)) + (1-\delta)S(t-s) \\ \hat{Y}_t(k) &= L(t) + kT(t) + S(t+k-s) \end{aligned}$$

Winters' multiplicative exponential smoothing has level, trend and season parameters and can be described by the following equations:

$$\begin{aligned} L(t) &= \alpha(Y(t)/S(t-s)) + (1-\alpha)(L(t-1) + T(t-1)) \\ T(t) &= \gamma(L(t) - L(t-1)) + (1-\gamma)T(t-1) \\ S(t) &= \delta(Y(t)/L(t)) + (1-\delta)S(t-s) \\ \hat{Y}_t(k) &= (L(t) + kT(t))S(t+k-s) \end{aligned}$$

## Design

The study has drawn upon recent studies of SMEs; from IHS proprietary data and reports; and most significantly from primary research of SMEs through an online survey.



**Figure 1 – Approach**

*Note: The SME sample for the primary research is based on 410 respondents – owners or members of the senior management team at SMEs having between 10 and 249 employees. The questionnaire can be found in link.*

### **Performance indicators**

We identified a group of high-performing SMEs based on their average annual growth rate over last three years.

These were defined as SMEs who have achieved:

- More than 10% average annual growth rate over last three years for G7 countries (on average, the G7 countries had a 1,58% growth in GDP)
- More than 20% average annual growth rate over the last three years for BRICM countries (on average, the BRICM countries had a 5,84% growth in GDP).
- The study also classified SMEs by key competitive advantage; were they “efficiency” or “innovation” driven. Of course, all SMEs have a mix of both criteria but, through our research, we were able to classify two groups according to their predominant business characteristic.
- Efficiency-driven companies compete on the basis of efficient production processes, quality product improvements and well-organized logistics services
- Innovation-driven companies compete by providing new or unique products / services creating their own market

### **Revenue Analysis Methodology**

We performed several revenue analyses with various statistical methods and based on different customer segmentations (e. g., customer classification according to the industry or loyalty codes) to receive the prediction with the highest possible quality.

In the end we selected 3 methods with the best performance across Russia & Czech Republic countries:

- Prediction of total revenue,
- Separate predictions of mean revenue per invoice and of number of invoices, for the whole SME sector together.

The fitting of the time series and the predictions were created in SPSS Modeler with Expert Modeler function

**Process:**

- 1) We used customer relationship management (CRM) to gather information about customers for the countries (CZ & RU) along with their account number.
- 2) Each customer is uniquely identified and it might have many account number associated with it.
- 3) The revenue per month aggregated by account number for each country for last 40 months

We identified the SME customer segment based on the revenue and run the SME revenue analysis. Also the clustering with SME was based on the following

- a. Sales channel –it is defined as *“A channel to market is the method of getting your product into the customer’s (the end user’s) hand. This can either be through direct sales, or through a reseller.”*
- b. Loyalty Code – *it is defined as “Customer loyalty is all about attracting the right customer, getting them to buy, buy often, buy in higher quantities and bring you even more customers”*

The following value was predicted using the time series model

- 1) Prediction of total revenue
- 2) Prediction of mean revenue per invoice and of number of invoices

The quality of the model could be improved if the total revenue was divided into 2 individual time series:

Total revenue = number of invoices \* mean revenue per invoice.

Number of invoices and the mean revenue per invoice are then analyzed separately. This brings also new insight into the revenue analysis, because the series usually behave differently and this knowledge can be integrated into the further decision process (e. g., although the total revenue is constant, the mean revenue is decreasing while the number of invoices is rising).

## Empirical Result & Analysis

Our first group of interests in international SME that operation in two or more countries; typically 70% of country respondents

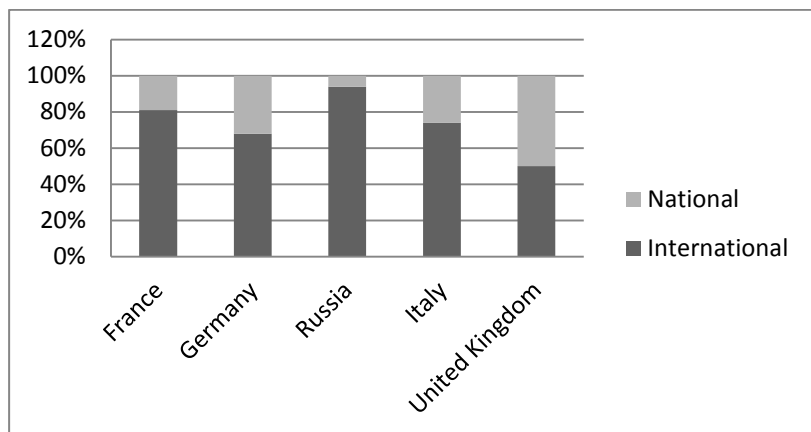


Figure 2 – Source: I.H.S Survey 2012

Table. 1: Percentage of Activities for SME in Europe

S.No	Country	National Activities (in Percentage)	International Activities (in Percentage)
1	France	19 %	81 %
2	Germany	32 %	68 %
3	Russia	6 %	94 %
4	Italy	26 %	74 %
5	United Kingdom	50%	50%

Source: HIS Survey -2012

### International SMEs have developed multi-faceted international activities

Small and medium-sized enterprises are affected by globalization and are increasingly forced to think and act internationally. The first finding of this study is that SMEs' internationalization no longer has a limited focus on exporting / importing, but has become a much more differentiated business activity encompassing subcontracting as well as technical or commercial cooperation. SMEs may be engaged in

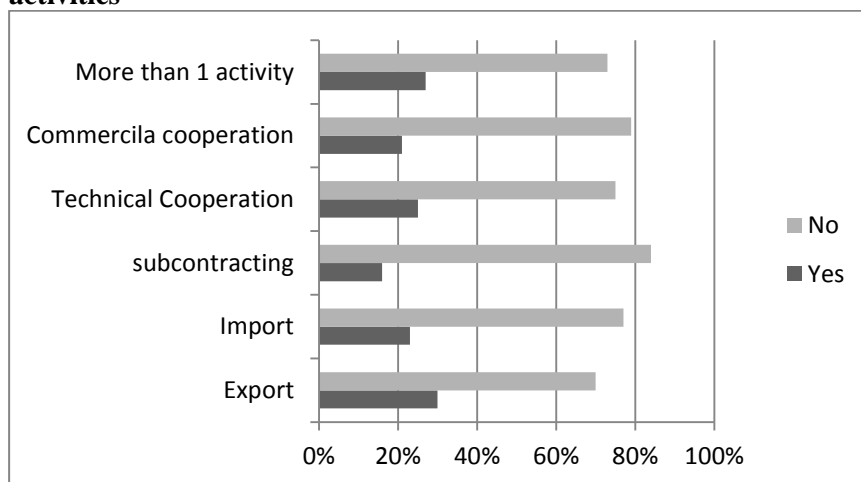


cross-border partnerships and foreign investments to capitalize on new opportunities.

Smaller SMEs are less internationalized than bigger SMEs, but even for them, internationalization is today a reality. While 80% of SMEs with 50 to 249 employees are operating at an international level, 66% of SMEs with 10 to 49 employees are international. One point to notice nevertheless is that the size difference is still marked when analyzing the share of small-sized enterprises with more complex forms of internationalization, or a combination of more than one form of internationalization.

### **The modern SME may well be engaged in international business activities beyond IMPORT/EXPORT**

**Figure 3: Percentage of SME's involved in international business activities**



Source: I.H.S Survey 2012

**Note: Technical cooperation defined for example, sharing know-how technologies etc. Commercial cooperation defined as marketing, distribution etc.**

Our survey identified a high number of SMEs having international activities within their first five years of existence. For instance, while 27% of all SMEs have more than one international activity, this indicator rises to 31% of SMEs with less than five years of trading,

despite them obviously having had less time to expand their businesses (a general assumption would likely be that the figure would be much lower for younger SMEs). This demonstrates a growing trend towards the internationalization of SMEs.

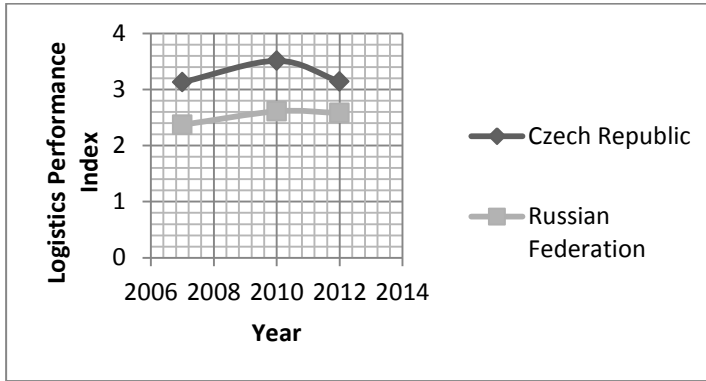
Young international SMEs are a reality of today's economy and are, in our survey, responsible for an important part of SME internationalization. In fact, recent literature points to a growing number of such firms trading internationally within the first five years of their creation. These 'born global' SMEs see themselves as international rather than national players.

Interestingly, these 'born global' SMEs are also more prevalent in BRICM countries (24%) than in G7 countries (13%). The rationale behind this could be that BRICM based small and medium-sized enterprises are strategically more focused on international markets than their G7 peers.

#### Logistics Service:

A World Bank study on logistics performance - "Connecting to Compete" - includes an index built around a survey of logistics professionals who evaluate the logistics environment in the countries where they work, providing information on the quality of infrastructures, the performance of core services, the ease of trade clearance procedures, and the time, cost, and reliability of import and export supply chains

The table below shows the logistics performance index (score) between Russia and Czech Republic.

**Figure 4: Logistics Performance Index**

Source: World Bank (2007 to 2012)

Logistics performance index: Overall (1=low to 5=high)

Logistics Performance Index overall score reflects perceptions of a country's logistics based on efficiency of customs clearance process, quality of trade- and transport-related infrastructure, ease of arranging competitively priced shipments, quality of logistics services, ability to track and trace consignments, and frequency with which shipments reach the consignee within the scheduled time. The index ranges from 1 to 5, with a higher score representing better performance. Data are from Logistics Performance Index surveys conducted by the World Bank in partnership with academic and international institutions and private companies and individuals engaged in international logistics. 2009 round of surveys covered more than 5,000 country assessments by nearly 1,000 international freight forwarders. Respondents evaluate eight markets on six core dimensions on a scale from 1 (worst) to 5 (best). The markets are chosen based on the most important export and import markets of the respondent's country, random selection, and, for landlocked countries, neighbouring countries that connect them with international markets. Scores for the six areas are averaged across all respondents and aggregated to a single score using principal components analysis. Details of the survey methodology and index construction methodology are in Arvis and others' *Connecting to Compete 2010: Trade Logistics in the Global Economy* (2010).

For BRICM SMEs logistics is seen as having a strong positive effect on their business performance

The table below shows the percentage of G7 SMEs and BRICM SMEs that consider logistics as having a “strong positive effect” on their business performance. BRICM SMEs consistently value logistics services higher than their G7 peers, often to a factor of 2 or more. On average, 14% of G7 SMEs consider logistics services as fundamental to their strong business performance compared with 27% of BRICM-based SMEs.

***Table 2 – What effect do you think logistics can have on the following aspect of your business performance?***

Business Performance	SME's	BRICM SME's	G7 SME's
Increasing Sales	27%	38%	19%
Opening new markets	26%	38%	17%
Accessing new products, materials or suppliers	21%	31%	13%
Differentiating your products or service offering	20%	28%	14%
Reducing your need for long term capital	16%	21%	13%
Reducing Operating cost	15%	19%	12%
Reducing Stock obsolescence	14%	18%	11%

Source I.H.S survey 2012

## **International competitive advantages**

### **Internationalization as a driver to performance**

Internationalization is seen as an opportunity to increase sales, but internationalization affects the firm's competitiveness in other ways too, for instance, through improved cost-efficiency by subcontracting abroad; developing know-how and technology competencies via technical cooperation; and extending product ranges through commercial partnerships.

From our survey, we observe two interesting findings:

- For 41% of SMEs, the main reason to develop international activities is to access new markets.
- For 31% of our respondents, the main reason to develop international activities is linked to long term business growth ('Access to know-how and technology' and 'Diversification of product / service portfolio').

**Table 3 – Q. What are your main reasons to increase your international business activity?**

Reason to increase international activities	International SME's
Access to new markets	41%
Access to know-how and technology	17%
Diversification of product/service portfolio	14%
Additional production capacity	11%
High labour cost in the domestic market	7%
Access to cheaper raw material	4%
Access to capital	3%
Access to labour force	2%
More flexible regulation	1%

Source I.H.S. survey 2012

Encouraged by initiatives from the World Trade Organisation (WTO) and the General Agreement on Tariffs and Trade (GATT), as well as regional agreements such as MERCOSUR and the EU Single Market, subcontracting, technical and commercial cooperation can strengthen the ability of SMEs to compete successfully at the international level while continuing to exploit their local strengths. One example of this can be found in the northern Mexican regions. Small and medium-sized enterprises there have developed a specific form of cross border partnership that takes advantage of the innovative US business environment, allowing access to know-how and technology.

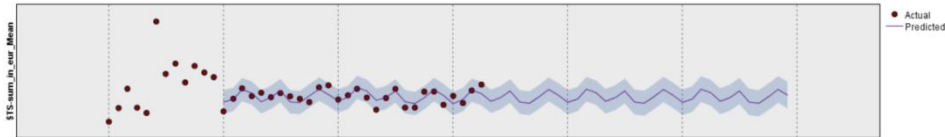
### **Revenue Analysis Result**

The following table summarises the total revenue prediction using SPSS based on the approach described above:

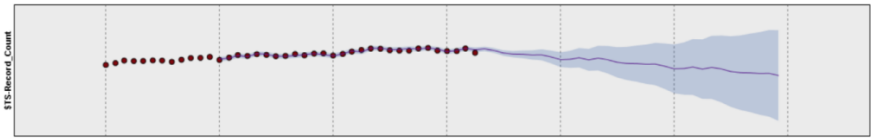
**Table 4 – SPSS Revenue Analysis for Czech Republic and Russia.**

S.No	Country	Year	Revenue Increase From 2012 in %	R2
1	Czech Republic	2013	1.9%	0.671
		2014	4.9%	
		2015	8.0%	
2	Russia	2013	16.2%	0.899
		2014	33.0%	
		2015	49.9%	

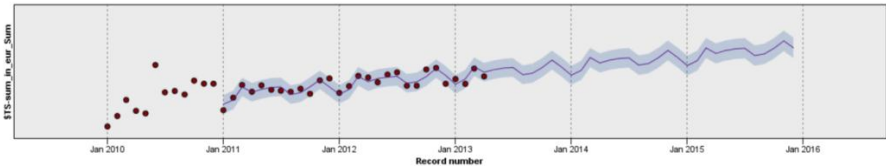
The following graph shows the prediction of the mean revenue per invoice and the number of invoice for the Czech Republic



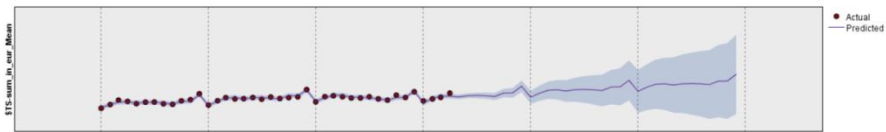
The following graph shows the prediction of the number of invoice for the Czech Republic



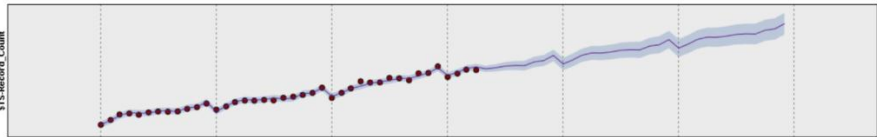
The following graph shows the prediction of total revenue for the Czech Republic



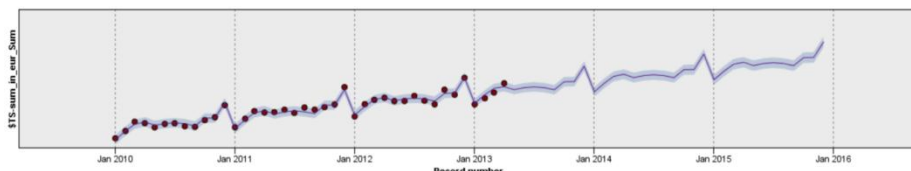
The following graph shows the prediction of mean revenue per invoice and the number of invoice for Russia:



The following graph shows the prediction of the number of invoice for Russia



The following graph shows the prediction of total revenue for Russia.



From the above graph we can conclude that the number of invoice is increasing while

### Conclusion

So, do SMEs that trade internationally perform better? Our research strongly suggests that they do.

We were surprised by the high proportion of our sample that traded internationally. Given this sample profile it is reasonable to expect that international SMEs figure significantly in our high-performers category; but they do outperform their domestic-only peers. So the idea of internationalization being a driver of business performance is certainly supported by our results. The reasons for this could be that international SMEs transfer best practice developed internationally to their overall business, as well as the idea that SMEs which expand internationally are more likely to be ambitious.

What can be said is that SMEs are more and more integrated into the global economy and not limited to regional / national activities: in fact they have gone beyond what is often the first step of internationalization, exporting / importing. Among the SMEs surveyed, 73% of companies had at least one international activity and, among them, 43% were involved in exporting activities – SMEs are not just local service providers.

Further points of interest with regard to international SMEs include:

- International SMEs perform better than the average SME – 26% of the international SMEs in the sample were high performers while 13% of the domestic-only SMEs were high-performers. In fact, more than 30% of our respondents see the increase of their international activities as a way to improve their long term business growth through acquisition of knowhow and product diversification.

- SMEs are increasingly focused on doing business internationally, with younger companies more likely to be engaged in overseas markets despite having had less time to grow their businesses. Often referred to as ‘born global’, these young international SMEs are a reality of today’s economy often exploiting the spread of inexpensive communication technologies and efficient logistics services.
- SMEs in BRICM countries are more likely to have international activities than SMEs in G7 countries: one explanation for this is that a real business driver is to set up strong business relationships with high consumption per capita developed markets. In fact, 70% of BRICM high-performing SMEs have the majority of their international clients, partners and subcontractors in developed countries. This also suggests they are better placed to respond to opportunities in new geographical markets than many G7 SMEs in the future.
- High-performing international SMEs cited three key challenges to their export efforts, ‘lack of knowledge of foreign markets’, ‘high customs duties in the destination country’ and ‘establishing contacts with foreign partners / customer base.’ Governments looking to boost the competitiveness of their SMEs should take note.
- Logistics is seen as having a positive effect or a strong positive effect on many aspects of a SMEs performance with a distinct difference between G7 countries, where logistics is seen as a way to reduce operating costs, and BRICM countries, where logistics is seen as a means to differentiate their product or service offering.

Finally, and impacting all SMEs, despite the significant contribution made by SMEs to employment (typically 35- 45% of total employment) and value added to an economy (typically 30-40% of total value added), there is a real lack of reliable and up-to-date information about SMEs on a country by country basis. This lack of information is itself a restraint upon SMEs since it restricts SMEs’ ability to organize them and present their case around credible data and information, basically to have a “voice.” Linking back to the internationalization thread of this report, as one respondent explained, banks, investors, institutions do not think of SMEs as operating at an international level. This is certainly in part due to the lack of reliable information on this subject which hinders the construction of a clear vision for such a heterogeneous group. There is clearly an opportunity



for policy makers to support this sector as a means to create more jobs, add value, and increase export earnings.

From the SPSS analysis, we could see that there is immense potential in SME sector especially in Czech Republic. If we can provide portfolio of products designed for SME can increase the revenue growth for the next couple years based on prediction by looking at their past few years performance.

### **Aknowledgement**

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# NON-FINANCIAL EXPORT PROMOTION FRAMEWORK FROM SME'S POINT OF VIEW: EXAMPLE OF THE CZECH REPUBLIC

**Stanislav Richter**

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## **Abstract**

*This article elaborates specific non-financial export promotion framework in the Czech Republic. It reviews the current literature and introduces the basic approaches and objectives that should be followed by properly established export promotion system and describes the historical as well as contemporary development of the non-financial export support scheme in the Czech Republic. Subsequent research is then conducted in order to obtain unbiased view on actual situation. For this purpose SMEs are approached to review the export promotion framework and share their opinion.*

## **Key words**

*Export promotion, SMEs, Czech export strategy.*

**JEL classification: F13, F14, F23.**

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## **Introduction and Literature Overview**

As Janda claims (2008), state export support carried out through deliberately created agencies is a standard feature of economies of the vast majority of countries, including the Czech Republic. Janda in his article (2010) examines the impacts and efficiency of state export credits on the economy as a whole based on the Gravity model introduced earlier by Tinbergen (1962) and Pöyhönen (1963) empirically analyzing the flows of international trade. These researches are particularly important for finding out the economic multiplication effects of state export credit support, however we lack comprehensive studies investigating other parts of export promotion. Some studies on export promotion programs and its benefits on companies in initial exporting stages have been conducted for instance by Freixanet (2012), as well as by Wilkinson and Brouthers (2006). They concentrated on implications of state-sponsored export promotion activities on the international marketing efforts of small to

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medium-sized enterprises, whereas Fisher and Reuber (2003) more elaborated the issue of targeting the export support to SMEs. Articles or working papers dealing with such a topic in Czech environment, apart from master theses, are difficult to be found.

On the other hand there are to be found few surveys that have dealt with the topic of export information promotion. Among the most relevant in the Czech Republic we can list the research of the Ministry of Industry and Trade (2011) that was conducted in December 2010 examining the general awareness of institutions providing export support. Another survey and article devoted to pro-export services and activities was performed by Association of Small and Medium-sized enterprises (2010) focused on overall framework, aptly complemented by subsequent research made by the same organization (2012) analyzing the respective institutions in more detail. However none of the surveys, due to the timing, was not able to capture the state of the export promotion provided by state owned institutions under the new Czech Export Support Strategy for period 2012 – 2020, as it commenced in year 2012.

Therefore a need for contemporary research of export support scheme and SME's view on the appropriateness has emerged. This article elaborates and defines the gradual evolution of the export support framework, its core stones, current stage and concept while striving to determine and interpret the general awareness among potential receivers of such a support.

### **The State Export Promotion**

State business support can be defined as a “mix of tools focusing on various areas of the economy, whose goal is to create trade and investment for appropriate economic, legislative, fiscal and social environment not only at domestic markets, but also work to support the commercial and business activities abroad” (Cernohlavkova, Sato, Tauser, 2007, p. 158).

According to Ministry of Industry and Trade (2012b) support of export, investments and active trade policy are among key priorities of economic policy of the government of the Czech Republic when coping the impacts of the global economic crisis and the comeback from recession to upturn. The task of the state in this difficult situation is to assist Czech companies in fight for the world markets and support Czech exporters to ensure comparable conditions for competition in the international market. Thus state support for exporters of goods and services is mainly focused on small and medium enterprises.

Stouracova (2008, p. 91) stated that export support is one of the sub elements, while also one of the most significant parts of economic diplomacy. Its importance is given by its basic goal wherefrom other goals are derived and to meet them involve existence of export strategy and working system of export support. The main goal, from quantitative aspect is to achieve, maintain and improve export growth with all its positive implications. From the qualitative point of view then the goal is to achieve, maintain and improve the competitiveness of domestic companies and the whole economy in the international environment. And the balance aspect pursues to achieve, maintain and improve macroeconomic equilibrium and external stability.

Derived from previous section it is clear then that a system of state export support should follow two basic rules. The first is to provide support for companies, which assures for them comparable conditions while entering new markets and enhances their competitiveness in order to establish themselves successfully. The second one, to safeguard the highest degree of efficiency possible, which in return will be reflected in improved macroeconomic indicators. When following these rules, both state and companies will gain from the cooperation. "Ultimately, what makes the difference between successful and unsuccessful trade promotion schemes is the degree of coordination and coherence of objectives among agencies. Irrespective of the actual organizational structure of individual agencies, or their nature and responsibilities, what really matters is whether the responsibilities and activities of each organization are clearly defined and assigned. Therefore there must be an efficient mechanism of coordination among various institutions" (United Nations, 2001).

### **Brief History and Current Development of the State Export Support in the Czech Republic**

The gradual creation of the export support framework in the Czech Republic is dated into the nineties, when more or less randomly, not purposefully individual institutions with pro-export focus by different Ministries as its authority were established. The uncoordinated approach of government officials and lack of clarity of government policy attitudes in export support and creation of this program was a characteristic attribute of this process. The main reason for that was the adverse attitude of government members to any activities including just a hint of interventionism. The state export support was not created as any comprehensive concept, nor as a government program supporting export activities of Czech companies and Czech

economy, but more represented individual goals, commitments and initiatives.

The first institution with a solely export support mission was founded in the year 1992. It was The Export Guarantee and Insurance Corporation (EGAP). Thereafter, in 1993, The Center of External Economic Relations (later in 1997 renamed and restructured to CzechTade – Czech TPO) followed. In 1995 Czech Export Bank (CEB) and Czech Investment and Business Development Agency (CzechInvest) were created. In the same year by the transformation of cultural centers The Czech Centers abroad were founded and Czech Tourist Authority (later CzechTourism) as well. All of the institutions were dedicated to a different extent for export support activities and investments acquisition (Stouracova, 2008, p. 92).

The current practice of Czech trade and export support development policy strives to adjust the active instruments according to the systematic principle to create a coherent and complementary set of institutions with multilateral effect. The coordination of export activities is being clarified step by step. A systematic solution was adopted in April 1999, when the Ministry of Industry and Trade submitted a concept of “Export policy”. Since that time for each particular period an Export strategy is being prepared in continuity with the competitiveness strategy and reviews on implementation are being carried out each year with outlining possible adjustments (Benes, 2004).

In the following parts the whole system of state export support that is available will be broken down into different segments according to the role and nature it represents in export support strategy.

### **Czech Export Strategy 2012 – 2020**

Since 1999, as mentioned, the export support is being carried out a bit more systematically than in previous years. Several export strategies were introduced, including strategy for years 2003 to 2006, 2006 to 2010 and the latest one for period 2012 to 2020, which seems to be the most comprehensive (MIT, 2012a). It has ambitions to exploit to the highest possible degree all synergies, which arise from various export support activities realized under public institutions, including Ministry of Foreign Affairs, Ministry of Industry and Trade, Ministry of Finance and Ministry of Regional Development with their subordinated agencies. This was based from the very beginning on the Competitiveness strategy of the Czech Republic for 2012 - 2020, which had been approved earlier, and attempts to incorporate findings and priorities presented. The ultimate goal is to become one of the 20

most competitive countries of the world by the end of this period, while currently being 39<sup>th</sup> (WEF, 2012). The Ministry of Industry and Trade is responsible for the preparation of this strategy in cooperation with several other institutions such as the Ministry of Foreign Affairs, Chambers of Commerce, Business Unions and many others.

The strategy provides 3 main pillars of the export strategy that should secure its success and fulfillment of the specific goals. These can be observed in Figure 1, with their particular fields of interest. Each pillar takes into account the existing services of public and private institutions in the area of internationalization and export promotion, but also include new types of export services that have been proven abroad and for which there is demand by the exporters.

Figure 1: Czech export strategy 2012 – 2020 and its 3 main pillars

I. Pillar	II. Pillar	III. Pillar
Information for export	Export development	Business opp. development
Simplifying access to information for export	Readiness to export and export education	Expanding the demand for Czech export
Business contacts and statistics	Advisory services for export	Investments for export
Market news and market analysis	Export financing	Marketing, branding and lobbying
Infrastructure and HR for export	Export eco-system	

Source: Ministry of Industry and Trade (2012), Czech export strategy 2012 - 2020

Under the three pillars twelve particular projects with different focus and aims are going to take place and thus contribute to the strategy. The first pillar “Information for export” should cover creation of a Center for shared services and export information (back office in the Czech Republic), One-Stop-Shop (synergies of existing support) and global diversification of control (information about markets outside EU). The second pillar “Export development” covers Services for exporters (front office, foreign countries), Export financing and insurance (special export credits and guarantees), International sources of finance and development cooperation (financing from EBRD, EIB and EU Structural funds), Clusters and export promotion initiatives (clusters in regions to establish cooperation with locals) and Control and a communication platform (interconnection and coordination of implementation of the strategy). The last pillar “Business opportunities development” takes care of implementation of Trade

policy of EU and export on EU internal market (facilitate access to the single market), Optimization of foreign institution network (revision and restructuralization of territorially unbalanced network), Foreign network services (consolidation and customization of services) and Investment and innovation for export of goods and services (to obtain investments into domestic export industries).

### **Non-Financial Export Promotion Framework**

This part of the article strives to introduce and briefly present main institutions and stakeholders involved in the information promotion scheme. There is not enough room to present profound study of each and every single agency, so basic information and objectives will be stated according to the relevance of organization in the promotion framework.

#### **Czech trade**

The Czech Trade promotion agency (CzechTrade) was established by the Ministry of Industry and Trade of the Czech Republic in May 1997. Its main objective is to promote the internationalization of Czech companies by facilitating their cooperation links with foreign entrepreneurs. Agency's head office is located in Prague and other domestic branches are located in different regions. The network of the CzechTrade's foreign offices provides practical assistance to Czech exporters abroad, and represents unique contribution to the promotion of the Czech exports. CzechTrade provides Czech companies, especially SMEs, with foreign market advisory, information, assistance and educational services (CzechTrade, 2013).

Certain services are provided exclusively to Czech companies free of charge. Some more specialized and resource demanding such as consultancy services of foreign branches or foreign market analyses are paid. The services are divided into 3 packages and are paid in the form of flat fee reflecting the size of the company and required services. Among the most frequently used services according to CzechTrade we can list verification of the interest in the product, business contacts, export assistance, abroad marketing support, database of exporters, export alliances and so forth (MIT, 2013).

### **BusinessInfo.cz**

This information and content provider is a joint project of CzechTrade and MIT. It is a place, which integrates information from different places of public administration and thus contributes to lowering administrative barriers and costs between companies and officials. These information are mainly related to start of the business, legislation, EU subsidies and business news as well as trends in export promotion. It also provides valuable information concerning international trade of Czech Republic, sources of export support, territory scans and “Exporter Manual”. Figure 2 then demonstrates increasing number of visitors over the last 5 years and outlines the escalating awareness and popularity of this portal as a source of business related information.

Figure 2: Visitors at the Businessinfo.cz (2007 - 2012)

	2008	2009	2010	2011	2012
Monthly visits (average)	196 951	248 493	274 645	302 191	518 225
Daily visits (average)	6 475	8 170	9 029	9 935	17 084

Source: BusinessInfo (2013)

### **CzechInvest**

CzechInvest is a state agency subordinate to the Ministry of Industry and Trade. Apart from attracting incoming investors and FDIs the agency generally strives to constantly increase the competitiveness of the Czech economy and supports SMEs, innovation and development of business infrastructure. Furthermore, it supports Czech firms which are interested in becoming involved in the supply chains of multinational companies and carries out activities connected with the preparation, introduction and administration of projects supported with funding from the European Union and from the state budget (CzechInvest, 2012).

The most important services provided by CzechInvest in regards to export promotion are; CzechAccelerator 2011–2014 (dispatching of Czech companies abroad) and Support for exporting investments from the Czech Republic (provide domestic companies with assistance in establishing branches and production capacities in foreign markets via the network of foreign offices).



### **The Green Line for Export**

It is a flagship of MIT's information network of export support, which is primarily designed for SMEs that do not yet have enough experience with exporting. The Green Line should serve as integrated contact point for exporters who want to inform themselves about the possible state export support. This institution is also responsible for a biannual publication "Export in a nutshell" that gathers all state support into one printed document. So SMEs can easily orient themselves in the whole system and see the conditions required.

### **SME's Review of the Non-Financial Export Promotion**

In order to gain unbiased preview on the situation how does currently obtainable export support match with ongoing needs of SMEs subsequent research has been conducted.

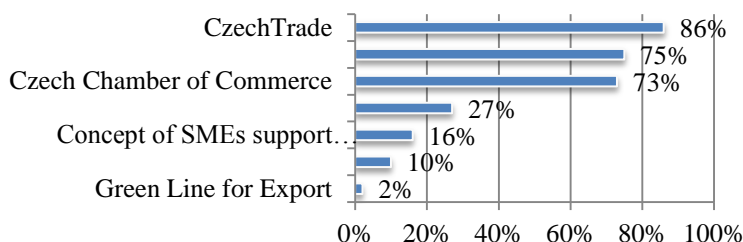
The research took place in autumn of year 2012 and encompassed addressing of 491 companies drawn at random, which were current-time exporters meeting criterion of SMEs introduced previously in the paper. Exactly 57 responses were gathered, representing 11,6% conversion rate. The selection mode and fact that companies participated voluntarily in the research should not have any negative influence on research's validity and reliability and should not cause any serious survey errors.

Responses from SMEs in particular categories were gathered and analyzed as follows: Micro companies 11 responses, Small companies 21 responses and Medium-sized companies 25 responses, representing 19%, 37% and 44% share respectively.

Following figures then represent answers that were obtained from 57 respondents considering their perception and experience with state provided non-financial export promotion.

The gathered data in Figure 3 only proves the dominant position of CzechTrade as a central pillar of the whole export promotion framework system. The vast majority of the SMEs are familiar with services and functions of this organization (86%) as well as with services of CzechInvest (75%) and Czech Chamber of Commerce (73%). Another export information provider is the online portal BusinessInfo (27%) and an ultimate dropout in this survey is represented by the project run by MIT, known as the Green Line for Export (2%). By relatively low awareness suffers the Export support strategy for 2012 – 2020, which is a very base for all the export promotion initiatives and should serve as a handbook for companies.

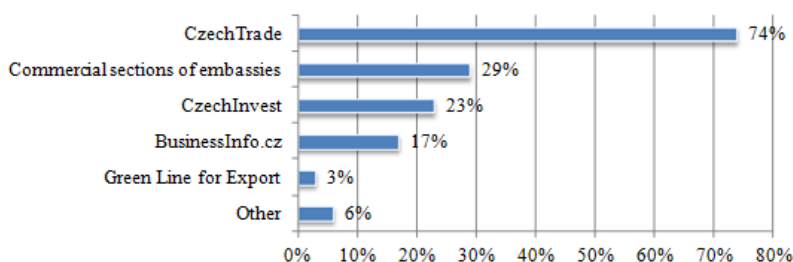
Figure 3: General awareness among SMEs of the state export support system



Source: Own research

Services provided by CzechTrade, which are presented in following Figure 4, are among the most popular (74%), including services such as verification of the interest in the product, market research, joint participation on specialized exhibitions and trade fairs abroad, financial contribution to the exhibition and contacts and meetings intermediation. Commercial sections of embassies were used in 29% mainly in order to get business contacts or market information. CzechInvest was predominantly used for receiving funds from EU. BusinessInfo portal is moderately visited and Green line for export recorded the same underperformance.

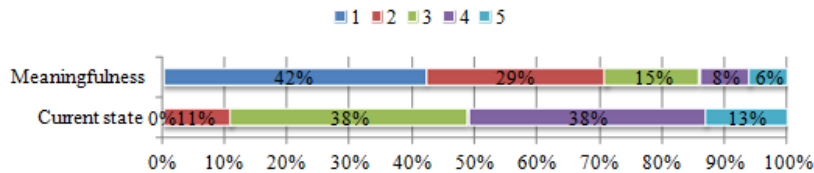
Figure 4: Usage of services of the state export support framework



Source: Own research

In Figure 5, the considerable majority of SMEs see the potential, usefulness and meaningfulness in the state export support system. Almost  $\frac{3}{4}$  feel the strong benefits resulting from the support system and only a negligible 6% see no point in such support, while the current state of the export support is perceived more negatively. It demonstrates a generally positive perception of export support, but total discontent with its execution.

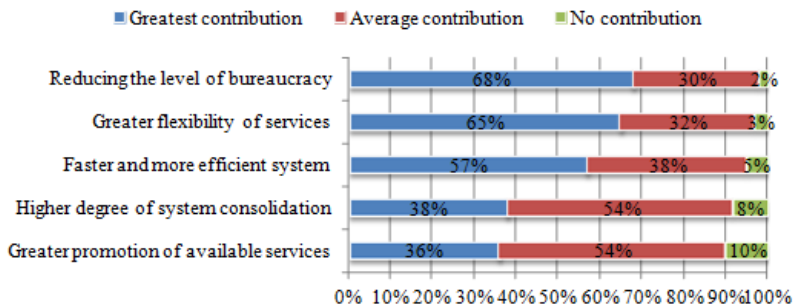
Figure 5: Perception of the meaningfulness and current state of the state export support system by SMEs (1 - the best, 5 - the worst)



Source: Own research

According to SMEs, the greatest contribution would be realized through reducing the level of bureaucracy when applying for state aid, if services would be more flexible and customizable and if the whole system would work faster and more efficiently. Conversely only an average contribution would be achieved through greater promotion of the available services and a higher degree of consolidation. The least contribution would be then realized by more active participation of the state in the exports.

Figure 6: Possible changes of the state export support system rated by SMEs

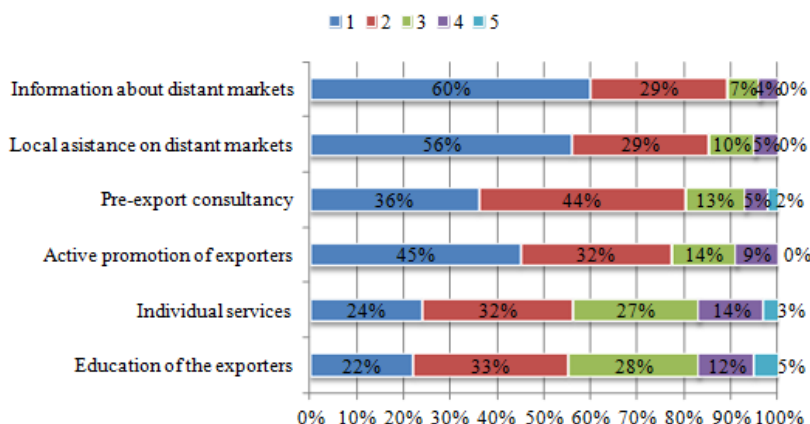


Source: Own research

As a most desired future focus of state support for SMEs are services concerning distant markets and their active promotion. On the other hand, education of exporters is perceived as the least desirable. Pre-export consultancy services are also identified as a core of the whole system and are sought by the SMEs. In conclusion, the services accenting the distant markets are currently recognized as the most accurate which is in direct relation of the companies' intentions to

shift their exports from EU countries to more remote destination to secure additional revenues. There are companies struggling with diverse cultures, habits, market and political risks lacking expert analyses and local help. A specific service framework is then necessary to mitigate these adverse conditions in order to multiply gains from trade.

Figure 7: What should be the future focus of the state export support system (1 - the most desired, 5 - the least desired)



Source: Own research

## Conclusions

The rapid and uncontrolled development of the export promotion framework has caused that whole scheme appears to be fragmented and inconsistent. Various institutions overlap each other with provided services and some operate inefficiently. However in the form of Czech Export Strategy for the period 2012 – 2020, if executed properly with, we have a promise of bright future and more comprehensive and self-reinforcing system of the export promotion. In this article the strengths have emerged as well as particular weaknesses have been revealed through lenses of the SMEs. It requires further research on the effectiveness, efficiency and benefits of specific adaptations of the strategy. With no doubts the planned merger of CzechTrade and CzechInvest that is going to take place by the end of year 2013 will have positive implications on the transparency of the provided services through united chain of foreign

branches. Additional consolidation and simplification on whole framework is highly recommended to occur as soon as possible.

### Acknowledgement

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**PART 3 -  
INTERNATIONAL MANAGEMENT  
AND CORPORATE SOCIAL RESPONSIBILITY**





# DELIVERING SUSTAINABILITY THROUGH SUPPLY CHAIN DISTRIBUTION NETWORK REDESIGN

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## **Abstract**

**Purpose** - Companies could gain competitive advantage (cost, service, green/sustainable) through the supply chain network. The goal of this article is to study how to deliver sustainability through the supply chain distribution network redesign.

**Design/methodology/approach** - A literature review is conducted to examine research relating to sustainable supply chain strategies and supply chain distribution network redesign.

**Findings** - A study of the supply chain literature reveals the importance to rethink the supply chain distribution network design and to treat sustainability as integral to operations.

## **Keywords**

*Global Supply Chain Strategies, Sustainable supply chain strategies, Distribution network redesign.*

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## **INTRODUCTION**

Due to global economy, competitive pressure, price of crude oil, rising ecology consciousness: the survival of many companies depends on the ability to continuously improve quality while reducing costs in a sustainable way.

The mounting pressure to conduct business in a sustainable fashion comes from various stakeholders – customers, shareholders, boards, employees, governments, and Non Gouvernemental Organizations – and most corporations respond in a reactive, piecemeal way.

Instead, companies - throughout the supply chain, not just at the end – should pursue broader structures changes than they typically do. Sustainability issues are adding new challenges of managing global supply chains (Lee, 2010).

Indeed, in the wake of concerns regarding climate change, pollution and non-renewable resource constraints, sustainability is becoming a key issue for supply chains.

The sustainability paradigm has opened the gate for revisiting various established strategies of supply chain management to reassess their viability with new angle of sustainability in general and greening specially (Stonebraker *et al.*2009). For many organizations, sustainability is emerging as a significant business issue. Consumers want the comfort of buying products that are meeting all possible environmental standards. Those that are successful in achieving these standards will see reduced operating costs and create competitive advantage by offering new value to their customers. As stakeholders increasingly demand higher standards, those companies that fail to take actions will leave themselves vulnerable to significant business erosion (Bernon, 2009).

In response to globalization, the ever increasing customer demands for variety and rapid delivery at acceptable costs, supply chains have a wide geographical spread and are an excellent vehicle for improving the environmental, social, and economic performance of companies and industry sectors over the long term. From purchasing decisions to reverse logistics, the whole supply chain will be reshaped by these new environmental regulations (McIntyre, 2012).

Business processes have to respond to continuous changes and sustainability requirement. The competitive and supply chain strategies must take these changes into consideration and companies have been focusing on the reconfiguration of the supply chain network design, especially the distribution channels.

Indeed, network design decisions are among the most important supply chain decisions, as their implications are significant and long lasting. The reconfiguration of the supply network needs to take into account the trends to globalization with pipelines longer and local differences in customer requirements. Therefore, the needs of local markets must be balanced against the economic advantage of standardized products. Companies have to combine global efficiency, local responsiveness and a capability to share and develop knowledge management worldwide. Besides, sustainability has become a key priority in the design an operation of supply chain (Chopra et Meindl, 2012). A focus on sustainability allows a supply chain to better serve more environmentally conscious customers while often improving supply chain performance.

Consequently, in this context, how is it possible to deliver sustainability through the supply chain distribution network?

The purpose of this study is to present how to deliver sustainability through the distribution network redesign.

First, we will present the impact of supply chain strategies on the distribution network, then we will identify how to redesign the distribution network.

## **I – GLOBALIZATION AND SUPPLY CHAIN STRATEGIES**

The purpose of this first part is to present the link between global supply chains and green/sustainable supply chains and the distribution network.

### **Globalization**

Markets have become global in the sense that the same brands and products are increasingly offered for sale around the world. Equally apparent has been the move towards global sourcing and manufacturing as companies concentrate their operations on few factories that serve the whole world and interdependencies of suppliers and customers among international companies. The global company has revised its previously localized focus, manufacturing and marketing its products in individual countries, and now instead will typically source on a worldwide basis for global production and distribution. The logic of global company is clear: it seeks to grow its business by extending its markets whilst at the same time seeking cost reduction through scale economies in purchasing and production through focused manufacturing and/or assembly operations

The trend to globalisation has a central role to play in supply chain management and has increased the complexity of the value chain with longer pipelines. Therefore, globalisation through global strategy is affecting the supply chain's structures and processes and will continue to be a pivotal issue in the context of supply chain management (Christopher, 2005).

### **Supply chain strategies definition**

In the early 1980s firms realized that their competitiveness was not just determined by what they do, but also by what their upstream suppliers and downstream suppliers were doing. Supply chain capabilities are a significant determinant of competitiveness and it can be argued that value chains compete, not individual companies

(Christopher, 2000). The key point in supply chain management is to consider the entire system of suppliers, manufacturing plants, and distribution tiers. The supply chain management can be defined as a set of interdependent organizations that act together to control, manage and improve the flow of materials, products, services and information, from the origin point to the delivery point (the end customer) in order to satisfy the customer needs, at the lowest possible cost to all members (Lambert, Stock, Ellram, 1998). The supply chain is a group of partners who collectively convert a basic commodity (upstream) into a finished product (downstream) that is valued by end customers, and who manage returns at each stage (Harrison, Van Hoek, 2005).

A supply chain consists of all parties involved, directly or indirectly, in fulfilling a customer request. The supply chain includes not only the manufacturer and suppliers, but also transporters, warehouses, retailers, and even customers themselves. Within each organization, such as manufacturer, the supply chain includes all functions involved in receiving a filling a customer request. These functions include but are not limited to, new product development, marketing, operations, distribution, finance, and customer service (Chopra and Meindl, 2010).

It highlights the reverse logistic and its importance in the supply chain. The success or failure of the supply chains is ultimately determined in the marketplace by *the end consumer*. Customer satisfaction and marketplace understanding are crucial elements for consideration when attempting to establish a new supply chain strategy. When the requirements and constraints of the marketplace are understood can an enterprise attempt to develop a strategy that will meet the needs of both the supply chain and the end customer?

*“Logistic strategy is the set of guiding principles, driving forces and ingrained attitudes that help to coordinate goals, plans and policies, and which are reinforced through conscious and subconscious behaviour within and between partners across a network” (Harrison and van Hoek, 2011, p.7).*

A supply chain strategy determines the nature of procurement of raw materials, transportation of materials to and from the company, manufacture of the product or operation to provide the service, and distribution of the product to customer...(Chopra and Meindl, 2010).

Supply chain strategy encompasses long-term objectives and it is derived from the company's or business unit's overall strategy (AT Kearney, p.18).

Aligning markets requirements with supply chain capabilities through supply chain strategy creates a competitive advantage (Hoffmann, 2010). Consequently, the primary purpose of any supply chain is to satisfy customer needs and, in the process, generate profit for itself.

Therefore, the goal of supply chain strategy is to strike the balance between responsiveness and efficiency that fits with the competitive strategy. To reach this goal, a company must structure the right combination of the three logistical drivers (facilities, inventory and transportation) and three cross-functional drivers (information, sourcing and pricing). For each of the individual drivers, supply chain managers must make a trade-off between efficiency and responsiveness based on interaction with the other drivers. The combined impact of these drivers then determines the responsiveness and the profits of the entire supply chain (Chopra and Meindl, 2010). Therefore, to understand how a company can improve supply chain performance in terms of responsiveness and efficiency, we must examine the logistical drivers like facilities, inventory and transportation drivers.

Several supply chain strategies are possible in order to respond to an increasingly complex business environment:

- Global supply chain strategies
- Green/sustainable supply chain strategies

## **I-1 - Global supply chain strategy**

### *Origins*

Globalization may enable increased revenue generation through entry to new markets and may provide access to suppliers that can provide materials and inputs more efficiently than domestic sources. There has also been an increasing trend for firms to shift from the host country to lower cost geographies to reduce manufacturing costs (Mollenkopf et al. 2010).

Firms implement global strategies that imply an overall approach and the focus on standardization, similarities and synchronization on a worldwide basis (Andersson & Svensson, 2009). "*A global strategy seeks to maximize worldwide performance through sharing and integration...*" (Yip, 1992, p.31). Global strategy like global sourcing and offshore manufacturing alter the landscape of business activity,

there needs to be a similar change in the way in which supply chain strategies are determined.

### *Global supply chain strategies definition*

The logistics dimension of internationalisation conjures up a vision of parts flowing seamlessly from suppliers to customers located anywhere in the world, and a supply network that truly spans the entire globe (Harrison, Van Hoek, 2011). Firms have restructured their supply chains to “operate on a global basis to take advantage of the international product, factor, and capital markets” (Manuj and Mentzer, 2008, p.133). The globalization of supply chains involves dimensions such as offshoring of production, inventories, suppliers and customers, and differences in economies, infrastructure, cultures and politics in the competitive environment (Mollenkopf et al.2010; Manuj and Mentzer, 2008; Schmidt and Wilhelm, 2000; Christopher, 2005).

### *Global supply chain strategies and network design*

Global supply chain management present several challenges, including differences in economic, cultural, and regulatory environments. Global supply chain literature emphasizes especially the importance of the complexity and coordination involved in managing the consolidation and regionalization of the supply chain network (Christopher, 2005).

## **I-2 - Innovative supply chain distribution network configuration: the link between global and local markets**

Consequently, whilst the logic of globalization is strong, it is important to recognize that it also presents certain challenges. Specially, world markets are not homogeneous, there is still requirement for local variation in many product categories, product may need certain customization to meet specific country needs (Christopher, 2005). Corporate and global strategies are linked to supply chains strategies and capabilities, especially on the network level (Hofmann, 2010).

Besides, critical competitive advantages can be harnessed by consolidating and regionalizing the supply chain. The trend towards sustainability today clearly underscores the intensified regionalization

of supply chains worldwide. Expert forecast that sustainability will gain further in importance which will foster the application of CO<sub>2</sub> – efficient modes of transportation (AT Kearney, 2009).

### *Definition*

Network design decisions are among the most important supply chain decisions, as their implications are significant and long lasting (Chopra and Meindl, 2010). Network design is a strategic decision that has a long-lasting effect on the firm (Simchi-Levy, 2008).

The physical supply chain consists of suppliers, plants, warehouses, distribution centers, and retail outlets as well as raw materials, work-in-process inventory, and finished products that flow between the facilities (Simchi-Levy, 2008).

Supply chain network design decisions determine the physical configuration and infrastructure of the supply chain. It includes the assignment of facility role, location of manufacturing, storage, or transportation-related facilities, and the allocation of capacity and markets to each facility (Chopra and Meindl, 2010).

Moreover, according to Gunasekaran (2001), perhaps the most important research concerning logistics that is going on is in the area of designing efficient and cost-effective distribution systems. Indeed, the distribution network takes on a wider role as the provider of the final added value. What is apparent is that distribution in the integrated supply chain has now become an information-based, value-added activity, providing a critical link between the market place and factory (Christopher, 2009). Distribution refers to the steps taken to move and store a product from the supplier stage to a customer stage in the supply chain. Distribution is a key driver of the overall profitability of a firm because it affects both the supply chain cost and the customer experience directly.

The appropriate distribution network can be used to achieve a variety of supply chain objectives ranging from low cost to high responsiveness (Chopra and Meindl, 2010).

### *Strategy*

Based on the competitive strategy of the firm, its resulting supply chain strategy must determine the supply chain design for the firm. The supply chain strategy specifies what capabilities the supply chain network must have to support the competitive strategy. A firm must



ensure that the supply chain configuration supports its strategic objectives and increases the supply chain surplus this phase (Chopra and Meindl, 2010).

Ideally organizations would like to achieve the benefits of standardization in terms of cost reduction whilst maximizing their marketing success through localization (Christopher, 2005). Consequently, in response to globalization, the ever increasing customer demands for variety and rapid delivery at acceptable costs, companies search for innovative supply chain network configuration especially for locating activities. Thus, the challenge of facilities location is to structure a supply chain that balance between global efficiency and local responsiveness that best supports the company's competitive strategy and maximize competitive advantage. It is especially the case for facilities location relating to the distribution network as it delivers the local markets.

Moreover, facilities tend to be significant consumers of energy and water and emitters of waste and green-house gases and thus offer significant opportunities for profitable improvement (Chopra and Meindl, 2012). Transportation is an another driver wherein firms are likely to find several positive cash flow opportunities. Any supply chain design innovation that lowers transportation costs also tends to reduce emissions and waste generated from transportation. This improvement through increased aggregation, a more efficient loading of transportation vehicles, and an increase in their fuel efficiency cuts both costs as well as environmental damage (Chopra and Meindl, 2012). These improvements are linked to green/sustainable supply chain strategies evolution.

### **I-3 : Green/sustainable supply chain strategies**

The sustainability issue will be taken into account to formulate the future supply chain strategy. It is now on corporate agenda of 60 percent of all participating companies. Experts see a clear need for action here. Not only sustainability must be understood as an important "to do" but also as an imperative for day-to-day operations in order to generate value by achieving sustainability (AT Kearney, 2009).

### *Origins*

Interest in sustainable supply chains has been growing for over a decade and the topic is becoming mainstream (Corbett and Kleindorfer 2003; Corbet and Klassen 2006). The organizations need to deal with environmental and social issues (e.g., Kleindorfer, Singha and Van Wassenhove 2005; Corbett and Klassen 2006). Sustainability is about ensuring long-term viability of a business model and company. Shareholders, customers, suppliers and employees, all want to see a future in their businesses (McIntyre, 2012).

### *Sustainability definition*

The Brundtland Commission (World Commission on Environment and Development 1987, p.8) defined the term of sustainability as: “the development that meets the needs of the present without compromising the ability of future generations to meet their own needs”.

Corporate sustainability has been focused with attention drawn toward the triple bottom line of “*people, profit and planet*” and promotes the view that companies have a responsibility to look beyond profit maximization and take responsibility for their environmental and social performance (Elkington, 1994). “People” element refers to the fair treatment of individuals that the organization either directly employs or interfaces with across its supply chains. “Planet” considers the impacts an organization’s activities have on the environment. Finally, “profit” is the economic benefit obtained by society through commercial activity (Bernon, 2009). The study focuses mainly on the planet and profit pillars and equally on corporate sustainability which has been defined as a business approach that creates long-term shareholder value by embracing the opportunities and managing the risks associated with economic, environmental and social developments (Elkington, 1994).

### *Sustainable supply chain strategies*

The sustainability paradigm may have influence on the supply chain and many supply chain decisions may have impacts on the environment, the social aspects, the communities and the wider supply chain.

Three distinct phases of supply chain are identified in the literature (Shukla, 2004):

- *Inbound* supply chain ensure value addition to raw materials in terms of selection, segregation, packing, transportation, cold storing, warehousing...There are host of intermediate echelons like consolidators, traders, commission agents, wholesalers, retailers, third party logistics, which results in very high complexity. It implies green-design, green sourcing...Greening the supply chain generates environmental benefits as well as financial results by reducing risk by managing a product's environmental compliance in its design rather than making any necessary costly corrections later in its lifecycle.
- *Manufacturing* supply chain or internal supply chain: value addition is done during manufacturing or production of goods. Functions like material flow, material handling and inventory management are predominant and implies green manufacturing.
- *Outbound* supply chain : the distribution channel operations like warehouse location, mode of transportation and inventory management at retail and wholesaler level...it implies green logistic and green reverse logistic. The study focuses on outbound supply chain.

The distribution channel includes the transport and warehousing operations across the supply chain network. One of the major issues for transport is associated with the emissions from freight movement. In addition, it is projected that this figure is likely to increase. In addition, in recent years the movement of goods has shifted away from the less polluting transport modes of sea and train to road and air (Bernon, 2009).

From an environmental perspective, all firms should measure and report four categories:

- energy consumption
- water consumption
- greenhouse gas emissions
- waste generation

Opportunity for improving supply chain sustainability is by matching these categories with the supply chain driver like transportation and facilities (Bernon, 2009).

Several solutions can be adopted: driver training, maintenance of vehicle fleets, alternative fuels and so on that reduces not only the emissions of vehicles, but also operating costs.

However, sustainability issues are adding complexity and risks to the already challenge of managing supply chains such as inventory, cycle time, quality, the costs of materials, production and logistics (Lee, 2010).

## **II – THE DISTRIBUTION NETWORK RE-ENGINEERING**

### **II-1: The origins of the distribution network reconfiguration**

New forces and dynamics are emerging to influence the supply chain designs of the future (Simchi-Levi and Fine, 2010). Globalization and sustainability can change the firm's supply chain strategy (Waters, 2012).

As a firm must ensure that the physical supply chain configuration supports its strategic objectives, the distribution network must be reconfigured according to all these factors and warehouse costs, number and location of distribution center (Shang and al. 2009).

The supply chain infrastructure typically needs to be reevaluated due to changes in supply chain strategy, demand patterns, product mix, production processes, sourcing strategies, the cost of running facilities and sustainability (Simchi Levi, 2008). Six main trends affecting supply chain designs have been identified by Simchi and Fine (2010): globalization, increase in logistics costs, in the level of risk, in labor cost in developing countries, in the volatility of commodity, the focus on sustainability. It's especially acute in Europe with the green supply chain. In some industries, this will play out as an increase in regulations companies have to follow, and will require thinking about how much carbon your supply chain produces (Simchi-Levi and Fine, 2010).

Thus, delivery network and workplaces must conform to recognized international standards. A major strength is the significant home delivery network with the ability to facilitate the recycling of goods, helped by an efficient "reverse logistics" capability. The rapid development of new technology creates increasing high levels of hazardous electronic and electrical waste which is the background for the WEEE Directive. Its aim is to minimize the impact of electrical equipment on the environment when those products become waste. In

order to sell products within EU manufacturers must demonstrate compliance with the regulations. This means that electrical retailers must offer take back facilities to cover all categories including smaller appliances. Some companies offer to take away two items for recycling free of charge if it makes a home delivery for large white goods. The collection items are sorted in several collection sites where they are dismantled.

The European Waste Electrical and Electronic Equipment (WEEE) Directive will have a significant and long reaching effect on the supply chain. Waste electrical and electronic equipment is one of the priority waste streams identified by European Commission alongside batteries, types, vehicles and packaging. Therefore the general objectives of the WEEE legislation are to improve waste management processes, eliminate hazardous substances, increase recycling capacity and introduce harmonizing legislation (McIntyre, 2012).

Cooper, Browne and Peters (1991) maintain that the transport and storage of goods are at the centre of any logistics activity, and these are areas where a company should concentrate its efforts to reduce its environmental impacts. The use of combined transport options such as containers using road and rail links is advocated for environmental improvement.

Therefore, in addition, as a further environmental measure, the goal is to minimize the emissions from the transport operations. It implies to modify logistics operation to achieve a more efficient use of the transport fleet and many of operating companies make use of satellite navigation systems to improve their delivery schedules. This not only reduces the distance the vans and lorries travel but also provides their customers with more predictable arrival times. Initiatives like driver training are implemented with the aim of reducing fuel consumption and CO<sub>2</sub> emissions. Further savings have come from the introduction of new delivery vehicles with Euro 5 engines and “stop and start” technology. Increased use of call centres has also led to less vehicle journey to customer homes, not only improving the customer service, but also reducing the CO<sub>2</sub> emissions.

Besides, the goal is also to reduce the amount of packaging used and to ensure that it can be recycled. Companies collect all waste packaging when delivering a household appliance unless the customer requests otherwise.

Consequently, redesigning the network could particularly help the company:

- to meet sustainability goals
- to minimize the total distribution costs and to improve the customer service levels,
- to manage growth in operations while maintaining quality and service levels.

Although sustainability measures often seem worthwhile individually, they may in the grand scheme generate unintended consequences, such as higher financial, social, or environment costs (Lee, 2010). Consequently, these sustainability measures must be coordinated across every stage of the supply chain with adjacent operations. Thus, the development of sustainable has tended to focus on studies of a single function or activity as opposed to looking at the entire chain (Rao and Holt, 2005). But, companies – throughout the supply chain, not just at the end – should take a holistic approach to sustainability and pursue broader structural changes than they typically do. It is mainly important in an international supply chain.

## **II-2 : The ways of reconfiguration**

The imperatives of cost efficiency and customer responsiveness have pushed firms to aggressively pursue two business strategies: global location of production/distribution facilities and time-based competition. Both these strategies have dramatically transformed the way in which business activities are organized and carried out. But the chief difficulty that a firm faces in the implementation of these strategies is that they make somewhat contradictory demands on its resources (Bhatnagar and Viswanathan, 1999). It seems relevant to categorize reconfiguration tendencies. Two generic tendencies can be found: a reconfiguration in the direction of globalization involving an upstream positioning of operations and a reconfiguration in the direction of localization involving a downstream positioning of operations. Consequently, there is more sensible, hybrid approaches to supply chain management that combine regional and global activities (Simchi Levi and Fine, 2010).

Cooper, Browne and Peters (1991) suggest a three stage approach to improve the processes:

an environmental audit of the logistics operation, a listing of actions to reduce impacts and a priority ranking of these actions. The problem of these recommendations is that they are not stakeholders-focused, but only at fuel consumption an economic cost (Mc Intyre, 2012).

As specified before, to achieve strategic fit, a company must ensure that its supply chain capabilities support its ability to satisfy the targeted customer segments. A network designer needs to consider the strategic position, the product characteristics as well as network requirements when deciding on the appropriate delivery network, the methodology suggested by Chopra and Meindl (2010) is described as follows:

- Understanding the customer: first, a company must understand the customer needs for each targeted segment and the uncertainty these needs impose on the supply chain. These needs help the company define the desired cost and service requirements. The supply chain uncertainty helps the company identifies the extent of the unpredictability of demand, disruption, and delay that the supply chain must be prepared for (range of quantity required, lead time customer, variety of products, number of channels, service level required...).

- Understanding the supply chain capabilities: there are many types of supply chain, each of which is designed to perform different tasks well. A company must understand what its supply chain is designed to do well. It is important to discuss about the strengths and weaknesses of various distribution options. Distribution networks that ship directly to customers are better suited for a large variety of high-value products that have low and uncertain demand. These networks carry low levels of inventory but incur high transportation cost and provide slow response time. Distribution networks that carry local inventory are suitable for products with high demand, especially if transportation is a large fraction of total cost. These networks incur higher inventory cost but lower transportation cost and provide a faster response time.

- Achieving strategic fit: if a mismatch exists between what the supply chain does particularly well and the desired customer needs, the company will either need to restructure the supply chain to support the competitive strategy or alter its competitive strategy. Creating strategic fit is all about creating a supply chain strategy that best meets the demand a company has targeted given the uncertainty it faces.

Consequently, at the highest level, performance of a distribution network should be evaluated along two dimensions: customer needs that are met and cost of meeting customer needs when designing the distribution network. Thus, a firm must evaluate the impact on customer service and cost as it compares different distribution network options.

AT Kearney's approach (2011) consists of the following:

- Create a baseline. Redesigning a network requires a clear understanding of how the current product portfolio is positioned in the market, customer requirements, and the maturity of products and processes. All operations strategies begin with the markets. The focus is to analyze market requirements throughout the company's value chain (market complexity versus product maturity for all important product groups to determine the relevant local, regional, or global strategy irrespective of factor costs) to determine the correct balance between factor-cost advantages and transportation costs, to quantify scale advantages...The goal is to consolidate all required information on sales volumes, products, cost structures, headcounts and logistic flows.

- Develop corporate guidelines. Corporate guiding principles and constraints should be discussed in the early stages of every network-design initiative, both as a way to engage decision makers early in the process and to help everyone understand the internal dynamics.

- After gauging strategic fit, implementation feasibility and risks, the company's future network is crafted. Network is developing potential network scenarios. The objective is to chart a master plan in order to test each potential scenario.

Consequently, A.T. Kearney's approach to network design brings together the perspectives of sales, logistics, manufacturing, sourcing, and macroeconomics to develop fully balanced strategies for global competition.



## CONCLUSION

With the increasing level of volatility and under the pressure of different forces and trends, the days of static supply chain strategies are over (Simchi Levi and Hines, 2010). Supply chain network design must evolve according to supply chain and corporate strategies. The imperatives to deal with global and sustainable supply chain strategies imply to reengineer distribution network design. Resolving the contradictions between the requirements of globalization and local market needs in a complex supply chain design and sustainability require to redesign and to manage sustainability as a core operational issue. The restructuring of the original supply chain design could improve the overall supply chain performance. Companies throughout the supply chain, not just at the end, should take a holistic approach to sustainability and pursue broader structural changes than they typically do (Lee, 2010).

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# FOOD MARKETING TO CHILDREN - INTRODUCTION TO ETHICAL ISSUES<sup>30</sup>

Ing. Květa Olšanová<sup>\*\*</sup>

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## Abstract

*The working paper provides an overview of key stakeholders involved in the food marketing to children in Europe and in the Czech Republic. It analyzes the role of the legislation as well as of voluntary codes of conduct in the food industry. The industry part of the issue is also covered by explanation of their role and position in the obesity issue. The form of food industry cooperation at the Food Chamber through a working group of involved companies is analyzed and an example of the corporate responsibility program is shown. The paper is going to serve as a review of the issue for further exploration needs.*

## Key Words

*Advertising to children, self-regulation, ethics, food industry*

**JEL classification:** M31, M37, M38

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## Introduction

Marketing ethics is being discussed since the beginning of 1990's. From mainly academic discussions (Leigh & Murphy, 1999) the issue received the industries attention. Many businesses responded to the discussion by adopting new ways of operating their business which later developed into the voluntary codes of conduct. Advertising can be seen as one of the factors that contribute to shaping people's view of life, and the basic values, attitudes and cultural ideas that are dominant in the society (Grundey, 2007, p. 60). Currently there are many issues discussed under the theme of marketing ethics. Namely these are (Grundey, 2007, p. 42):

- product safety and liability
- advertising truthfulness and honesty
- fairness in pricing
- power within the channels of distribution
- privacy in internet and database marketing, and
- forthrightness in selling

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There is a link between the ethical issues in marketing to children and advertising truthfulness and honesty. This paper will focus on explaining key milestones of the regulation development, roles of key stakeholders and analyses of the issues regulated lately in the voluntary code of advertising in the Czech Republic.

**Definition of a child and marketing to children**

In regulations, children are variously described as “minors”, “juveniles”, “young people” or “children” (Grundey, 2007). In EU Member States a minor is defined as a person under 18 years of age, with the exception of Austria, where the upper age limit is 19 years. The United Nations Convention on the Rights of the Child defines children as persons aged 18 years and under. When specified in national broadcast legislation, the definition of a “child” typically ranges from under 12 years of age to under 16 years (Table 1).

Tab 1: Examples of the “age of a child” as defined in national broadcast legislation

Country	Age (less than, in years)
Australia	14
Canada	12
Quebec	13
China, Hong Kong	15
Fiji	15
Finland	12
Germany	14
The Netherlands	12
Norway	12
Republic of Korea	13
Sweden	12
United Kindom	16

*Source:* (Hawkes, 2004)

In the Czech Republic the “Advertising Regulation Act” gives special conditions to advertising to person below 18 years old. Therefore this age is the benchmark for advertising targeted to children in the context of this article. Making the assessment whether the campaign is or is not actually directed to children is not straightforward and easy. A TV ad, for example, could be directed at parents rather than at children, or could be targeted at teenagers but viewed by the under-12s. Most regulations do not specify criteria for defining “child-directed” marketing (Grundey, 2007).

## **Key stakeholders in regulation of advertising to children**

### **United Nations: Convention on the Rights of the Child**

In 1989 the United Nations Assembly adopted the Convention on the Rights of the Child (CRC) which has become the most widely accepted human rights treaty ever (UN, 2013). It has been ratified in 193 countries. Under the Convention, every child is recognized as a subject of rights, with the right to special protection. Equal and inalienable human rights are to be enjoyed by all children regardless of where born or to whom born, regardless of sex, religion or social origin. Article 17 deals with the media, Article 12 recognize the right of the children to express their own views on matters affecting them and Article 13 enhances the freedom to express itself.

### **European Union: Development of the audiovisual regulatory framework**

The first attempts to shape a European Union audiovisual policy were triggered by the developments of satellite broadcasting in the early 1980s. Since the adoption of the Television without Frontiers Directive (TVwF) in 1989, technological and market developments made it necessary to amend the audiovisual regulatory framework. When the Directive was first adopted there was no need to discuss how food advertising should be regulated on European level. As a result of rising levels of obesity in all EU member states the approach has changed. The Directive was revised in 1997 and 2007. With the last revision, the Directive was renamed Audiovisual Media Services Directive (AVMSD) and then codified in 2010 (The Audiovisual Media Services Directives - AVMSD).

The Directive covers both traditional television broadcasting and new, on-demand services like on demand films and news. Those two are distinguished based on who decides when a specific program is aired and whether the airing schedule exists. The “linear” services are those following a schedule prepared by a broadcaster and “non-linear” or on-demand services leave users to decide when they want to watch the program. The Directive also extends to all audiovisual media the country of origin principle, meaning that the rules of the country in which the broadcasting provider is located is the decisive factor. The providers can easily identify the rules applicable to them on a straightforward basis.

For the first time the directive addresses the issue of “fatty foods” in the commercials aired during the children’s programs. The goals of the EU coordination are defined as:

- providing rules to shape technological developments

- creating a level playing field for emerging audiovisual media
- preserving cultural diversity
- protecting children and consumers
- safeguarding media pluralism
- combating racial and religious hatred
- guaranteeing the independence of national media regulators.

The Article 9 (2) sets rules for the advertising of "unhealthy" food and drinks in children's programs by quoting that the governments and the Commission must encourage media service providers to develop codes of conduct curtailing such advertising. The codes of conducts are forced by the Directive in different fields, under the umbrella of "Self-regulation, combined with government regulation" (Article 4 (7)). The new rules require governments to encourage self-regulation in certain fields, sometimes combined with government intervention ("co-regulation") - where their legal systems allow. Such regimes must be broadly accepted by the main stakeholders and provide for effective enforcement.

### **EASA – European Advertising Standards Alliance**

European Advertising Standards Alliance (EASA) is a non-profit organization based on Brussels. It's main goals are to:

- consolidate the advertising self-regulation in Europe
- help the European countries to create a self-regulatory bodies and legislation framework
- promote self-regulation in advertising as a more flexible alternative to detailed legislation
- coordinate cross-border complaints with the aim of fast resolution

EASA members signed the Advertising Self-Regulation Charter (the EASA Charter). Doing so they should comply with the fundamental principles of the Charter, namely: (i) the nation's self-regulation should comprehensively cover all forms of advertising and all advertisers, (ii) they issue the code of ethics and will independently deal with complaints through a competent authority, (iii) the whole procedure will mean no costs for the consumer, etc.

EASA publishes the Blue Book informing the advertisers, media, advertising agencies and other stakeholders about the level of self-regulation in the member states. Additionally it provides its audience with useful guidelines on how to create the communication in accordance with these rules, as well as with detailed description of the

EU legislation with respect to the advertising regulation and their comparison with individual modifications within the legislation of the member states (EASA ALLIANCE, 2013).

### **Self-regulatory rules**

Self-regulation in the advertising sector is the recognition that the advertising industry (advertisers, agencies and the media) create advertising that complies to a set of ethical rules. According to that the advertising should be legal, decent, honest, truthful, prepared with a sense of social responsibility to the consumer as well as society as a whole and created with due respect to the rules of fair competition (EASA ALLIANCE, 2013). The ethical rules are usually in the form of a code based on the original ICC codes, meaning the Codes of Marketing and Advertising Practice, originally drawn up by the International Chamber of Commerce (ICC) in 1937, which inspired many of the national self-regulatory codes currently in use. Self-regulation exists on most of the European countries.

There are two ways to ensure that the advertising complies to the ethical rules: (i) detailed legislation or (ii) self-regulation. It is now widely accepted that self-regulation works best within a legislative framework. The law lays down broad principles, e.g. that advertising should not be misleading, while self-regulatory codes, because of their greater flexibility can deal efficiently with the detail of individual advertisements.

## **Regulation in the Czech Republic**

### **Self-regulation**

A Czech self-regulation initiative (Rada pro reklamu, RPR) was founded in 1994 by the representatives of advertisers, advertising agencies and media and since the beginning it is a member of the European Advertising Standards Alliance (EASA). The Code of Advertising Practice was agreed and adopted by the General Assembly at the meeting on November 2, 1994. Divided into two parts, general and special, the Code contains general and particular rules of advertising. The latest version of the Code was adopted at the General Assembly meeting in May 2007.

RPR consists of the General Assembly (covering all members), the Arbitration Committee, the Executive Committee, Supervisory Board and the Secretariat. Representatives of the founders, e.g. the advertising agencies, advertisers and media are members of the Executive Committee which is dealing with the issues between the



sessions of the General Assembly. In 2013 the food industry is directly represented by companies Danone, Ferrero, Nestlé and a subsidiary of McDonalds. Indirectly most of the food producers (both local and international) are represented through the Food Chamber (Potravinařská komora, PK) and the Czech Association of the Branded Goods Producers (Český svaz značkových výrobců, ČSZV) (Rada pro reklamu, 2013).

The Arbitration Committee has an exclusive right to make decisions regarding complaints received by the RPR. The Committee also reviews submitted materials and recommendations made by the Secretariat. The Arbitration Committee has 13 members, including currently 2 lawyers, 2 representatives of the advertising agencies, 2 advertisers, 4 members from Czech media, psychologist and sexologist. The committee has regular monthly meetings chaired by the President of the RPR. The remaining bodies of the RPR are focused on administration (The Supervisory Body – finance and operations, Secretariat – regular administration).

### **RPR's scope of work**

RPR's main role is the assessment of complaints regarding the advertising in press, outdoor, direct mail, audio-visual production, radio and TV, cinema and the internet. The complaints with prevailing legal issues are out of its scope as it focuses primarily on ethics. The Arbitration Committee is authorized to initiate the assessment process based on a complaint received from any public or private body in the Czech Republic. RPR can also act based on its own initiative once they realize that particular ad may violate certain provisions of the Code of Advertising.

The Arbitration Committee is not allowed to impose any financial penalties or any other sanctions. The outcome of the process has a form of decision serving as recommendation to the advertiser. If they find out that the advertiser does not follow the recommendation they may initiate a suggestion to the Regional Trade Licensing Office (Krajský živnostenský úřad, KŽÚ), who has the legal power to penalize the advertisers.

Besides the main role of assessing the advertising with respect to the Code the organization performs the following activities:

- publishes the Code of Advertising
- educates the advertisers and other stakeholders regarding the ethical and self-regulation issues
- copy advice

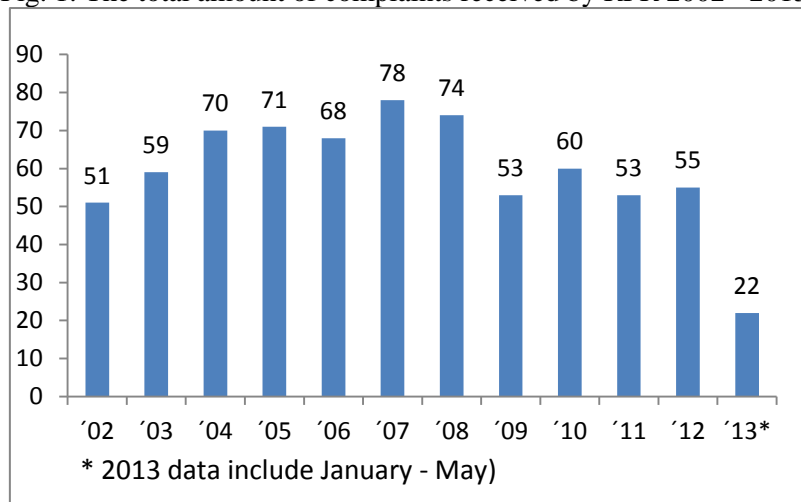
- issues expert advices and suggestions to KŽÚ's
- protects the interests of the advertising industry and contributes to the initialization, drafting and approvals of legislation affecting advertising and marketing communications
- represents its members in EASA - The European Advertising Standards Alliance

### **Complaints statistics with focus on food industry**

The code applies the same rules for advertising of food and drinks as for any other productads. Advertising should not give the impression of a need to purchase food or beverages or encourage children to persuade others to buy them. In no case it should not question the role of parents and other persons who are positive models for children regarding proper nutrition.

The amount of complaints received by RPR within the period 2002 to May 2013 is summarized in Figure 1. Based on detailed review of the complaints received we can notice that none of the complaints accepted by the RPR was not reasoned by the advertising to children part of the Code (see Table 2).

Fig. 1: The total amount of complaints received by RPR 2002 - 2013\*



Source: author's based on the data provided by RPR (Rada pro reklamu, 2013)

Tab. 2: The food brands complaints with positive decision of the RPR (e.g. defective according to the Code of Advertising)

Year of complaint	Complainant	Brand/Brand Owner/media	Issue description (if available)	Reasoning
2002				
2003				
2004	Alphaduct	Karlovarské minerální vody/Magnesia/print	Claiming more magnesium	Consumer protection
2005	Private person	Carrefour/Výprodej století (The sale of the century)/leaflets		Comparative, misleading, deceptive
	RPR's monitoring	Alphaduct/Korunní mineral water/TV ad	Sweet childhood	Consumer protection
	Private person	Pepsi Co/Pepsi/cinema ad	Kung-fu/ violence	Violence
	Private person	Tesco Stores/grilled chicken at 59.90 Czk/print		Comparative, misleading, deceptive
2006	Private person and ČSZV (Branded goods producers association)	Plus Discount/Rama vs. Rela/leaflets	Confusing brands – Rama vs. Rela at Plus Discount	Comparative, misleading, deceptive
2007	Private person	Zott s.r.o./Jogobella yoghurts/TV ad		Comparative, misleading, deceptive
2008	RPR's monitoring	TECFOOD s.r.o./Kamikaze/ Billboards		Protection of personality
	Private person	IDC/Mila brand/TV ad		Comparative, misleading, deceptive
	Private person	Walmart/SlimCup/ TV ad		Consumer protection
2009	Private person	NetMilk/milk products/billboards	Sexist advertising	Consumer protection
2010	Czech beer and malt association	Pivovar Rohovec/Skalák brand/labels	Sexist advertising	Consumer protection

Year of complaint	Complainant	Brand/Brand Owner/media	Issue description (if available)	Reasoning
2011	Private person	Kofola/extra bylinková/TV advertising	Student and teacher relation	Consumer protection
2012	Private person	Bernard brewery/Bernard/billboards	Plastic women	Sexist
2013*	Private person	Bernard brewery/Bernard/billboards	Amnesty	Protection of personality

Source: Author based on RPR data (Rada pro reklamu, 2013)

The most known issue in terms of the advertising to children was a TV spot for confectionery brand Fidorka, produced by Opavia-LU (later part of acquisition of Kraft Foods). A girl below 10 looking like an angel does not hesitate to throw a plastic doll against the car bonnet to get her favorite chocolate delicacy. Advertisement raised a wave of public coverage and television stations were penalized by The Radio and Television Broadcasting Council. One of the TV stations, Prima, appealed but the Supreme Administrative Court decided that the video could hurt mental or moral development of children and forced TV station to pay. The ad was not complained at the RPR and therefore was not found defective. The Council of the RPR in their statement recommended airing the spot after 22:00.

### **Legal framework of advertising to children in the Czech Republic**

As stated above the self-regulation is based on voluntary industry initiative. The formal legislation gives more formal borders for both advertisers and media. In the Czech Republic the Law No. 40/1995 Coll., "The regulation of advertising" (Sbírka zákonů ČR, 2013), as amended (the "Advertising Regulation Act") provides the most comprehensively the issue of advertising.

It prohibits the advertising of goods or services that are contrary to the laws of the Republic, advertising based on subliminal perception, deceptive advertising, hidden advertising, distribution of unsolicited advertising (harassing the recipient or leading to his expenditures) and the advertising is contrary to good morals. The act also prohibits the advertising directed at persons under the age of 18 years, which encourages behavior prejudicial to their health, mental or moral development, advertising of tobacco and alcohol products, as well as sponsorship of sporting events by tobacco manufacturers and reduces the spread of advertising on firearms and ammunition.

§ 2c sets rules for protection of children and juveniles. With respect to persons under 18 years old the advertising shall not:

- encourage behavior prejudicial to their health, mental or moral development
- recommend to purchase products or services by exploiting their inexperience or credulity
- encourage them to persuade their parents or legal guardians or others to purchase the goods or services
- utilize the special confidence they have to their parents or legal guardians or other persons
- in an inappropriate manner showing them in dangerous situations.

### **Relation between self-regulation and legal framework in the Czech Republic**

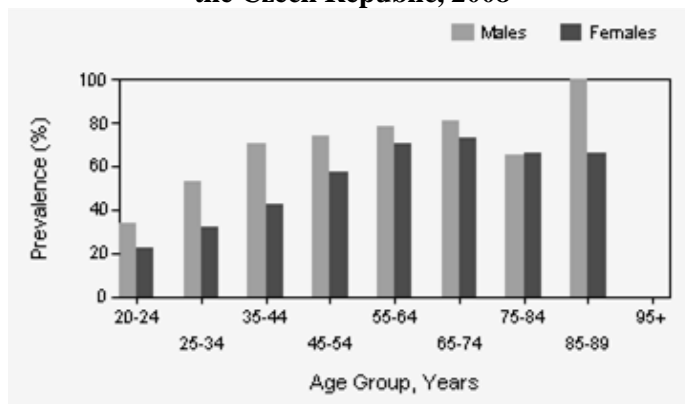
With the adoption of the Act no. 40/95 the RPR (in addition to its core business, which is evaluating the acceptability of ads from the ethical point of view) has become the institution from which the supervisory authorities of compliance with mentioned law (regional trade licensing offices, the Council of the Czech Republic for Radio and Television Broadcasting, Ministry of Health, etc.) require expert advice on the application of the above law in practice. In this context, the Council for regional trade offices of the Czech Republic issued more than 250 expert advices on compliance with advertising law to regulate advertising (Rada pro reklamu, 2013).

### **Obesity issue development and key stakeholders**

The obesity has been discussed as one of the major concerns since the World Health Organisation published the Report of Director General in 1998: “Life in the 21st century. A vision for all” emphasizing that “Obesity is increasing, especially in the younger age group. Nutritional problems, especially overconsumption of fats or sugars, are taking their toll.” (World Health Organization, Geneva, 1998, p. 88).

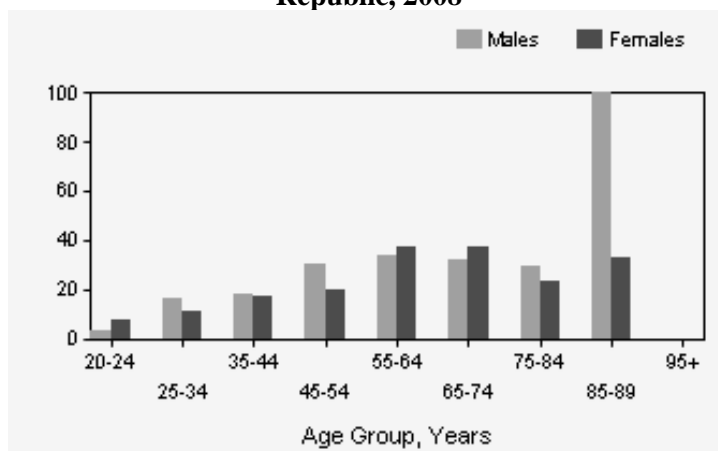
Nowadays, according to the WHO the overweight and obesity are the fifth leading risk for global deaths. More than 40 million children under the age of five were overweight in 2011 and the issue is growing in low- and middle-income countries, particularly in urban settings. More than 30 million overweight children are living in developing countries and 10 million in developed countries (World Health Organization, 2013). For illustration the obesity prevalence in the Czech republic in Figure 2 & Figure 3.

**Fig. 2: Prevalence of overweight and obesity (BMI  $\geq 25$  kg/m<sup>2</sup>) in the Czech Republic, 2008**



Source: (World Health Organization, 2013)

**Fig. 3: Prevalence of the obesity (BMI  $\geq 30$  kg/m<sup>2</sup>) in the Czech Republic, 2008**



Source: (World Health Organization, 2013)

WHO also specifies, why the obesity at childhood creates risk for future adults. Increased BMI<sup>31</sup> increases the risk of diseases such as:

- cardiovascular diseases (mainly heart disease and stroke)
- diabetes
- musculoskeletal disorders (osteoarthritis)
- some cancers (endometrial, breast, and colon)

<sup>31</sup> BMI = Body Mass Index, the measurement commonly used to classify overweight and obesity in adults, defined as a person's weight in kilograms divided by the square of his height in meters (kg/m<sup>2</sup>). The WHO definition is: BMI  $\geq 25$  overweight, BMI  $\geq 30$  obesity.

Obesity of children is according to WHO associated with a higher chance of obesity, premature death and disability in adulthood. Additionally the obese children experience breathing difficulties, increased risk of fractures, hypertension, early markers of cardiovascular disease, insulin resistance and psychological effects (World Health Organization, 2013).

### **IOTF (International Obesity Taskforce)**

The U.K. based IOTF (The International Obesity Task Force) was originally convened in 1995 by Professor Philip James to prepare the first scientific research report on the global epidemic of obesity, which served as a working draft for the first WHO expert consultation on obesity held in Geneva in 1997. The report established the criteria for assessing obesity, and was distributed to all health ministers at the World Health Assembly in 1998.

The most important milestones in the history of the taskforce are:

- “*Preventing Childhood Obesity*” published in June 2005 in cooperation with The British Medical Association, focused on recommendations for school and community programmes. The document notes the need to address inequalities and the pervasive influence of marketing on children’s food choices
- Drafting the “Sydney Principles” (in May 2006), following the WHO forum and consultation on marketing to children in Oslo, a set of rights-based principles to protect children against exposure to commercial promotions of obesogenic foods and beverages.
- A draft code, “Recommendations for an International Code on Marketing of Foods and Non-Alcoholic Beverages to Children” developed in cooperation with “Consumers International” in 2008

The IOTF provides highlights of the obesity figures in many countries, the research conducted in 2008 shows the obesity figures for adults in the Czech Republic: 42.8 percent of men (aged 20+) were overweight, 23.9 percent of men (aged 20+) were obese, 29.2 percent of women (aged 20+) were overweight and 22.3 percent of women (aged 20+) were obese. The data for children are based on 2005 survey as follows: 18.6 percent of boys (aged 6-17) were overweight, 6 percent of boys (aged 6-17) were obese. 12.1 percent of girls (aged 6-17) were overweight and 4.8 percent of girls (aged 6-17) were obese (IOTF, 2005).

### **The food industry**

Apart from the individual responsibilities of everyone for his/her own health in terms of balanced energy intake and relevant physical activity the WHO has a strong standpoint regarding the behavior of other societal stakeholders because the individual responsibility can have its effect only where people have access to a healthy lifestyle. This means not only the obvious public and private stakeholders but also the food industry. Their contribution to the promoting of healthy diets was defined as:

- reducing the fat, sugar and salt content of processed foods
- ensuring that healthy and nutritious choices are available and affordable to all consumers
- practicing responsible marketing especially those aimed at children and teenagers
- ensuring the availability of healthy food choices and supporting regular physical activity practice in the workplace (World Health Organization, 2013)

### **The food industry response – case of the Czech Republic**

The food industry leaders prove their responsibility in terms of ethical advertising to children and respect to the growing obesity trends by their active presence in the institution dealing with those issues.

#### **Potravinářská komora**

The Food Chamber (Potravinářská komora, PK) is the institution with the highest coverage of the food producers. One of their working groups is formed mainly by the international food producers (with the exception of Kofola and Agrofert): Unilever, Mars, Mondelez Czech Republic, Ferrero, Hamé, Nestlé, Coca-Cola and United Bakeries (Potravinářská komora, 2013). The working group as part of the large association meets regularly for discussion regarding latest development of the EU legislation and self-regulation. One of the outcome of their work is enrichment of the self-regulating Code (RPR) by article regarding responsible advertising of food related to children (Chapter 2 of the Code related to food and soft drinks advertising).

The food industry consensus regarding the importance of balanced lifestyle is highlighted in the sub-page of the Food Chamber called “Healthy lifestyle – balance between nutrition and physical activity” (Foodnet, 2013). Broadly acceptable references and tips are provided



there and respected nutritionists and researchers in terms of obesity and healthy diets are communicated.

Example of brand activities in line with the responsible approach

The food brands that might be potentially threatened by tighter food legislation in terms of food labeling, portion sizes, advertising and targeting, are proactively seeking opportunities to prove that the obesity has always two sides, e.g. the energy in-take and output in form of physical activity. This is the main reason why the companies support many sports as well as balanced lifestyle activities. One of the best examples is McDonald's Cup, based in 2002 as a football competition targeted to primary schools in the Czech Republic. The statistics for 2011/12 school year shows participation of 3196 schools across all regions of the Czech Republic and the number is increasing each year since launch of this activity (McDonald's Cup, 2013).

## **Conclusion**

The paper presents the introduction to the ethical issues regarding marketing to children. It defines the child and marketing to child from European perspective with deeper focus on the Czech Republic. In terms of regulation of advertising to children it analyzes key stakeholders and their approach to the issue from both legislation and self-regulation perspective. Self-regulation in the Czech Republic is introduced from the perspective of the self-regulation initiative (Rada pro reklamu) as well as from the food industry including an example of responsible approach to obesity issue of one of the industry representatives.

The complains analyses makes evident that the food industry in the Czech Republic behaves in line with the self-regulation in terms of both advertising to children and responsible approach to the obesity issues. They, on the contrary, promote balanced approach to healthy lifestyle through many activities either independently (McDonald's Cup) or through associations. The example of the Food Chamber and its working group focused on healthy lifestyle was discussed.

The analyses provide enough data for the introductory phase of further work focused on profound portfolio, communication and corporate responsibility analyses of the food industry.

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**PART 4 –  
INTERNATIONAL MANAGEMENT AND  
CULTURAL ISSUES**



# WOMEN IN MANAGEMENT RESEARCH: THEORETICAL PERSPECTIVES

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## **Abstract**

*The purpose of this literature review is to analyze the different theoretical approaches in female leadership in the global arena. The literature review comprises peer-reviewed journal articles, white papers, conference proceedings and institutional reports by multilateral organizations on the topic of women in management and career barriers for women. Firstly, we examine the theory of Fagenson, and afterward biological models, socialization models, and structural/cultural models in an organization will be discussed.*

## **Keywords**

*Women in Management, Gender Organization System, GOS*

**JEL Classification: M12, M14**

## **Introduction**

Women's advancement in management career can be influenced by the individual factors within the person, organizational factors which are located within the organization, and societal and systemic factors (Fagenson, 1990). Cultural and social attitudes towards what constitutes "male" or "female" jobs result in occupational segregation, although the extent of the problem varies from country to country and from job to job. It is important to keep in mind that there are important institutional differences between countries, notably regarding their educational and academic systems. (Women in management, Update 2004,)

Women face greater barriers and rely on strategies for advancement that are different from those of their male counterparts (Lyness and Thompson, 2000). Discrimination against women manifests itself in various forms, including: job segregation, wage gaps, sexual harassment, the denial of career development opportunities (including mentoring and poor performance evaluations), and a lack of promotion opportunities. Being a woman and working outside of the

home calls for additional education about sex and gender biases and alertness to the reality of workplace inequity. Additionally, working mothers are stereotyped as not being serious or reliable enough to take positions as managers because their priorities lean more towards raising a family; this is often presented as an either/or argument, effectively advancing the myth that successful executives are unable to manage multiple priorities.

Research on women in management has become a significant field of study within the last twenty years (Kanter, 1977; Larwood & Wood, 1977; Nieva & Gutek, 1981; Powell, 1988). The first question could be asked: Can women be managers? Why are there few women in top management? The second question emerged: Do male and female managers different attitude in organizations? Differentiations between the attitudes and behaviors of men and women in managerial positions were salient topics found in this literature (Powell, 1988; Henning & Jardim, 1977; Terborg, 1977; O'Leary, 1974; Schein, 1973). Emphasis was on comparative research studies and female managers could only be understood in comparison to male managers (Galas and Smircich, 1989).

The purpose of this study and literature review is to compare the theories views about gaps in female leadership in the global arena. The literature review comprises peer-reviewed journal articles, white papers, conference proceedings and institutional reports by multilateral organizations on the topic of career barriers for women. The study examined the theoretical approaches in the field of women in management and barriers to women's participation in global leadership.

### **1. Gender –Centered Perspective**

The gender-centered and organization structure perspectives are traditionally embraced by researchers to comprehend why women are underrepresented in top management positions (Fagenson, 1990). Researchers adopting the gender-centered perspective, which assumes that woman's traits and behavior, are 'inappropriate' for top management positions, do not consider organizational or societal factors to be relevant to their analysis.

Women, in contrast (although consistent with female socialization practices), have been conditioned to give greater weight to their personal/family lives than to their careers, value peers over their jobs and to feel little commitment to their organizations (Fagenson, 1986; Hennig and Jardim, 1977; Kanter, 1977; Reitz and Jewell, 1978; Treiman and Terrel, 1975). Whereas high-level individuals have been

rewarded for securing power, women, in contrast have been conditioned to reject power (Fagenson, 1986; Kanter, 1977).

According to the gender-centered perspective, also referred to as the person-centered view, women's behavior and limited representation in upper level jobs is attributed to factors that are internal to women, e.g., their inappropriate traits, cognitions, attitudes and behaviors (Fagenson, 1986; Harragan, 1977; Homer, 1972; Putnam and Heinen, 1976; Riger and Galligan, 1980; Terborg, 1977). According to this perspective, women have been socialized to possess characteristics that are in conflict with the demands of the managerial role and are antithetical to their being promoted to the upper ranks of their organizations (Fagenson, 1986; Harragan, 1977; Homer, 1972; O'Leary, 1974; Riger and Galligan, 1980; Schein, 1973, 1975).

Furthermore, successful managers' performance is believed to be due to "internal" factors, e.g., their abilities and efforts (Fagenson, 1986). Yet, women, attribute their work performance to "external factors," such as luck and task ease (Ayers-Nachamkin et al, 1982; Deaux and Farris, 1974; Fagenson, 1986). These attributions are consistent with women's own performance expectations and ability self-assessments: they have a relatively low level of self-confidence (Lenney, 1977; Maccoby and Jacklin, 1974).

Gender-centered theorists have attributed these differences between the sexes and the "common heritages, beliefs and assumptions" (Hennig and Jardim, 1977) within each sex to a variety of causes including: differential sex-role socialization (Hennig and Jardim, 1977) differential gender identity formation (Chodrow, 1978) and to the different ways boys and girls construct reality (Gilligan, 1982).

A major problem with the gender-centered perspective is its dependency on sex role characteristics in "defining" appropriate behaviors of managers. Sex roles are conceptualized as immutable and not subject to change. The gender-centered perspective creates simplified, binary categories that mask the complexity of the meaning of gender in organizations (Bell & Nkomo, 1992). In this approach an implied hierarchical relationship exists between men and women with one gender dominant and superior, and the other (women) subordinate and inferior (Scott, 1988). Often tautological explanations emerge within this perspective. For example, when researchers find differences between men and women in their work, the next logical question is the "why" of the differences. This can result in an explanation that essentially says "because men and women are different".



Proponents of the gender-centered approach have identified women's fear of success as an important factor inhibiting women's advancement into top management positions (Horner, 1972). Hence, it is argued that women's limited progression into the managerial ranks can be attributed to factors internal to women, such as traits, attitudes and behavior that are argued to be inappropriate for senior level positions (Fagenson, 1990, 1993; Horner, 1972; Riger & Galligan, 1980; Parker & Fagenson, 1994). The solution for women is to act and behave like men in organizations (Omar & Davidson, 2001). This perspective on its own is not adequate to explain why there are few women in top management positions especially when research findings have found women's progress in organizations remained slow even in situations where women are as qualified as men (Cleveland et al., 2000).

The basic premise of the gender-centered theory, i.e., that males and females are basically different, underlies much of the research that has been conducted in the field of women in management. The research methodology commonly used to test the gender-centered notion includes sex as the independent variable and behavioral, cognitive, personality and attitudinal measures as the dependent variables. The responses on the dependent variables are typically elicited from the men and women under study (Schneider, 1983). T-tests are typically applied to examine whether a person's gender exerts a significant effect on the dependent variable (Schneider, 1983). A significant  $t$  value for the gender variable is interpreted as support for the gender-centered view.

Part of this perspective is the notion that the token presence of women in managerial positions has contributed to gender stereotyping. Therefore, the sex differences between men and women can be explained by their different proportional representation and position in the organizational hierarchy.

## **2. Organization-Structure perspective**

The organization structure perspective is based on the premise that organization structures shape women's behavior on the job (Fagenson, 1990, 1993). According to Kanter (1977), there are 'advantageous' and 'disadvantageous' job situations. Advantageous positions, which offer job incumbents power and opportunities, are held by individuals whose gender is in the majority (that is, males). Disadvantageous positions, on the other hand, offer job occupants little power and fewer opportunities, and are held by individuals whose social category

is few in number (that is, females). Individuals in advantageous positions develop attitudes and behavior that help them to accelerate, while those in disadvantageous positions develop attitudes and behavior that reflect and justify their job situations, which offer limited advancement (Fagenson, 1990).

Kanter (1977) argued that it is because women are traditionally placed in low level positions in organizational hierarchies that feminine traits shape their behavior. Informal power and opportunity structures in organizations serve to exclude women. If women were placed in high level jobs, they would exhibit the behaviors that men have exhibited in those positions (Kanter, 1977; Riger and Galligan, 1980).

On the other hand, proponents of the organization structure perspective assume that the culture and characteristics of the organization shape women's behavior and provide greater opportunities for men, and that the person and the structure are independent factors (Fagenson, 1990).

According to this perspective, it is argued that the differences between men and women in their attitudes and behavior are due to the differences in the opportunity and power structures in organizations rather than to gender (Kanter, 1977). As noted previously, the gender-centered perspective has been criticized for disregarding situational variables (Fagenson, 1993), whilst the organization structure perspective for failing to control for factors other than the structure of the organization (Martin et al., 1983)

Most importantly, the organization structure approach assumes that the person and the structure are independent factors. As argued by Bowers (1973, p. 3) "situations are as much a function of the person as the person's behavior is a function of the situation." Schneider (1983) noted that because people tend to locate themselves in environments that are compatible with their own behavioral tendencies the two cannot be separated. It therefore follows that if people foster environments that are consistent with their own inclinations, those environments will be similar to, not separable from, the people in them (Schneider, 1983).

The structural change advocated is not a basic questioning of underlying extant power and hierarchical systems but the placing of women in pre-existing structures and relationships (Galas & Smircich, 1989). There is also an implicit assumption that women are unable to influence or decisively impact the organizations in which they work (Gerson, 1985). Given the theoretical shortcomings of earlier work on

women in management, it is important to adopt a wider and more holistic approach.

The organization-structure perspective, Its primary focus on organization structure overlooks the saliency of other important organizational factors including norms and culture, policies, training systems, promotion, and reward systems (Fagenson, 1990; Gregory, 1990). The solution to women's plight in organizations would simply be to replace men with women in senior level positions. Then gender stereotyping and sexism would dissipate. The major deficiency of the organization-structure perspective is its acceptance of the status quo.

### **3. Gender-Organization-System (GOS)**

A third perspective is the gender-organization-system (GOS) perspective, a systems-oriented approach (Fagenson, 1993), which recognizes the simultaneous interaction between the person, the organization and the society. The gender-organization-system perspective incorporates the propositions and arguments of both the gender centered and organization structure perspectives (Fagenson, 1990). However, this perspective suggests that the limited advancement of women in organizations is not due either to their gender (gender-centered perspective) or to the organization structure (organization structure perspective), but that both jointly influence and shape women's behavior at work.

The gender-organization-system perspective further contends that women's behavior is an outcome of both their gender and the organization structure (Fagenson & Horowitz, 1985). The perspective also builds on the concept of organization structure to include not only power, job situations, and the number of individuals that shape and define women's behavior in organizations, but also takes into account organizational variables such as corporate culture, history, ideology, and policies (Martin et al., 1983). According to this broader concept of organization structure, the under-representation of women in management positions may be due to the social and institutional systems in which organizations function.

The gender-organization-system perspective supports the basic premise of the gender-centered perspective that women possess characteristics that are argued to be incompatible with key managerial roles (Fagenson, 1986; Harragan, 1977; Horner, 1972). Women have been socialized to possess 'feminine traits' such as warmth, kindness, selflessness (Feather, 1984; Putnam & Heinen, 1976; Schein, 1973; Spence & Helmreich, 1978), while the profile of a promotable

manager is that of an individual who is aggressive, forceful, rational, competitive, decisive, strong, self-confident and independent (Putnam & Heinen, 1976; Schein, 1973).

The Gender Organization System (GOS) framework provides a holistic approach to study the issues relating to women's managerial advancement (Jabeen 2001). The framework emphasizes the need for reviewing personal, organizational and societal or systemic factors (Jacobson, 1995, Jabeen 2001). However, GOS approach is the most useful theoretical framework for women in management research (Omar & Davidson, 2001). This perspective argues that behavior in organizations can be understood as an interaction between gender, situations, and the social-institutional system in which these interactions take place (Martin et al., 1983).

Many variables i.e. societal and institutional practices, expectations and stereotypes regarding roles of women and men in society can affect the structures and organizational progressions (Martin et al., 1983). These variables can also influence and be influenced by women's attitudes and behavior at work (Fagenson, 1990). According to Yukongdi and Benson (2005) the fundamental statement of a number of theories is that culture does not transform, but remains fixed. But societies have experienced shifts in values regarding the role of women and the concept of gender equality (Yukongdi and Benson 2005).

Factors such as cultural values, societal and institutional practices, expectations and stereotypes regarding the roles of women and men in society can affect the structures and organizational processes (Martinet al., 1983). These factors can also affect and be affected by women's attitudes and behavior at work (Fagenson, 1990).

In sum, the gender-organization-system perspective is based on the premise that the interaction between gender, situations, and social systems is a continuous and re-iterative process (Terborg, 1981; Martin et al., 1983). The individual is affected by situations and social systems, which in turn, are affected by individuals (Terborg, 1981). The characteristics of individuals, situations, and systems jointly determine individual attitudes and behavior which affect each other over time. Hence, according to the gender-organization-system perspective, women are underrepresented and under-utilized in

organizations V. Yukongdi & J. Benson for several reasons: women have been placed in disadvantaged positions in organizations; women are socialized to display traits, behavior, attitudes that are argued to be incompatible with top management positions; and women have different expectations placed on them by society (Fagenson, 1990). These factors cannot be considered in isolation as they, in turn, affect one another.

The organizational context includes such factors as the corporation's culture, history, ideology, policies, etc., (Martin et al, 1983) as well as its structure. Thus, women's limited ability to attain high-level positions may, for example, be due to: the devastating effect a past reverse discrimination lawsuit had on a (particular) company (history); an organization's belief that individuals with military/combat experience should be promoted first (ideology); or a paternalistic culture that uses individuals' performance on the golf course rather than at work as the basis for promotion (culture and policy).

Finally, the gender-organization-system perspective suggests that individuals, organizations, and social systems change at different rates in response to environmental changes, and therefore, women in different countries have not progressed into managerial positions at the same pace (Parker & Fagenson, 1994).

The gender-organization-system explanation for women's limited progression in organizations is an interactionist approach. As such, it makes the following assumptions:

1. Behavior in organizations is a continuous interaction of feedback between person characteristics (Le., gender), situations (Le., the organizational context) and the social-institutional system in which these interactions occur (Terborg, 1981; Martin et al., 1983).
2. The individual in this interaction process, is being both changed by situations and social systems and changing them (Terborg, 1981).
3. Characteristics of people, situations and systems should be studied as joint determinants of individual attitudes, cognitions and behaviors which influence each other over time (Terborg, 1981).

An example should clearly illustrate the interactional nature of the GOS theory. As noted earlier in this study, women have been found to exhibit inappropriate traits, behaviors, attitudes, etc for assuming

high-level management positions. The GOS perspective suggests that this may be due to: women having been situated in disadvantaged work situations, their having been socialized to exhibit "inappropriate" attributes for assuming high-level jobs, and/or because of societal practices and expectations regarding women which have been carried into and acted upon within the organization by its members. All of these factors, in turn, affect one another.

All in all, the gender-organization-system perspective presents a new theoretical framework and a distinct methodology and statistical approach not suggested by — the gender-centered and organization structure formulations. That is, according to the GOS perspective, when researchers are attempting to determine why women have had limited success making it into the corporate boardrooms, they should try to identify the characteristics of the organization context, the characteristics of the social system as well as characteristics of the individuals, i.e., their gender, which could potentially be affecting women's and men's attitudes, cognitions and behaviors (Terborg, 1981).

#### **4. Biological, Socialization and Structural/Cultural Models**

Three approaches may explain the glass ceiling phenomenon or gender-related inequality in organizations: biological models, socialization models, and structural/cultural models (Cleveland et al., 2000; Bartol, 2003; Weyer, 2007). According to biological models, there are biological differences between men and women, such as genetic, hormonal, and physical characteristics, and the reasons for these differences are the result of genetic patterns evolved from adaptations to differing reproductive circumstances of early males and females. These adaptations have emerged slowly over thousands of generations, and these differences are stable and necessary for survival (Cleveland et al., 2000; Lueptow et al., 2001). Socialization models focus on observed differences between men and women. The models assume that men and women behave differently due to various social and cognitive development processes of the individuals related with life stages, such as schooling and work life. In this approach, observed differences are not stable, but on the contrary, are subject to change (Cleveland et al., 2000; Bartol, 2003). According to structural-cultural models, social structures, systems, and arrangements lead and define

gender differences due to discrepancies in status and power (Bartol, 2003).

In these models, differences exist to keep the powerful in control and the powerless without power, and these are changeable (Cleveland et al., 2000). Socialization and structural/cultural models have received more attention in the literature than biological models (Bartol et al., 2003) and have been called the most accepted explanation for gender differences (Lueptow et al., 2001).

On the other hand, it is necessary to explain expectation states theory, which is one of the most prominent theories within structural-cultural models (Weyer, 2007). According to expectation states theory, there are shared gender stereotypes within society and these stereotypes contain status beliefs (Ridgeway, 2001). Status beliefs refer to widely shared cultural beliefs or schemas about the status positions within society, such as gender, race, ethnicity, education, or occupation (Berger et al. 1980; Ridgeway, 2001; Weyer, 2007). When status beliefs develop about a status position, inequality arises between members of this status position (Ridgeway, 2001). In this context, these beliefs associate greater status, worthiness, and competence, and more valued skills with the advantaged group than the disadvantaged group within status position (Ridgeway, 2001). Thus, whereas agentic attributes are generally ascribed to men, communal attributes are generally ascribed to women (Eagly, 2001). Agentic characteristics and behaviors can be described as assertiveness, ambition, competing for attention, and making problem-focused suggestions. Communal characteristics might be described as speaking tentatively, supporting and soothing others, and being helpful and sympathetic (Eagly, 2001; Weyer, 2007).

Research explains that the emergence of gender-related behaviors in organizations generally fall into three categories: biological, socialization, and structural/cultural models (Bartol, 2003; Cleveland, 2000; Powell, 2003). Researchers conclude that the study of gender and management has resulted in a sameness/difference debate with research on women in management becoming either polarized or marginalized. Thus, they argue for attention to the “biological, social and thereby often domestic fact of being female, and how this intersects with the conditions in the workplace” (Rees, 2003).

## Conclusion

It is clearly understood that cultural beliefs or schemas about gender are an important antecedent of the glass-ceiling phenomenon in society. These beliefs, schemas, or expectancies constitute gender roles in a society, and individuals internalize these gender roles through the socialization process. Besides, these beliefs or schemas vary from society to society. At this point, the typology of Hofstede about cultural characteristics may help to understand the differences between societies about gender roles better.

The gender-centered and organization structure perspectives are utilized to comprehend inappropriate characteristics of women who have underrepresented in top management positions (Fagenson, 1990). I believe an analysis that incorporates the core elements of gender, race, ethnicity and class are critical to understanding not only her career world, but also other contexts of her life. And we need to recognize the role of history in the study of women in management.

Three theoretical perspectives were discussed in this study. The conclusions that can be drawn with respect to each were explored. It was shown that the gender-centered and organization structure perspectives, more so than the gender organization- system approach, limit the conclusions that can be drawn about women's behavior in organizations. As knowledge expansion is the goal of the women in management field, use of the GOS perspective is encouraged.

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# MANAGING CHANGE AND INCORPORATING THE LEARNING ORGANIZATION CULTURE IN ACADEME

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## **Abstract**

*This survey is based on few months of participant observation, informal exchanges, and formal interviews and explores higher education sector of Pakistan in the context of change management and Learning Organization (LO). Literature on change and learning shows that organizational learning takes place when employees and employers act as learning agents for the organization by timely responding to changes in the external and internal environments (Argyris and Schön, 1997). In other words, organizations with proactive approach towards change make “change management” an important ingredient of their culture and incorporate the learning organization principles in true spirit. Inspired with the phenomenon of “learning organization” presented by Senge (1990), James (2003), and Garvin et al., (2008), this preliminary exploratory study focuses particularly on the organizational learning and change, witnessed by higher education sector of Pakistan and sheds light on how the public sector, semi government and private sector universities have addressed this challenge. For this study primary data was collected using semi structured interviews supported by a questionnaire. However some data from secondary sources has also been used as additional sources of information. Results revealed that semi government and private sector faculty were on same page, as they have been found proactively addressing the issues of change and learning as compared to the public sector.*

**Keywords:** Learning, Change, Public Sector, Private & Semi Government University

**JEL Classification:** M12

## **INTRODUCTION**

In this era of technological advancements, customized customer preferences and tougher competition, it became more crucial than ever before for the organizations to transform to learning organizations (Garvin, Edmondson & Gino, 2008) and the discussion on learning organizations have been extensive and quite diversified during last many years (Moilanen, 2001). Considering the case of higher education sector, the mushroom growth of private sector and public sector universities in developing countries has fostered competition and organizational change in this sector (Rajarajeswari, 2010) and transformation from traditional university culture towards learning organization culture has been observed. Research on learning organizations show that most of the organizations learn as it is a fundamental requirement for their existence but some learn purposely by developing their capabilities, which are consistent with their long term goals and other learn by chance with no focused efforts and may acquire habit which may not contribute positively (Kim, 1993). Considering the case of Pakistan where this study took place, despite the fact that enrollment in higher education has been constantly increasing in Pakistan and number of public and private sector universities are also growing constantly but HEIs (Higher Education Institutes) in Pakistan witnessed mismanagement and bad governance (Memon et al, 2010). This preliminary study focuses specifically on higher education sector of Pakistan and tries to explore whether universities are really learning organizations or not? Based on the results of the survey which was conducted on three different types of universities, this study proposes some recommendations for the higher education sector of Pakistan.

## **1. LITERATURE REVIEW**

Different theories of organizational learning and change recognize that organizations are highly distinguished social systems with employees divided into groups with functional expertise and different status levels (Gardner et al., 2001) and moreover change occurs in organizations which are dynamically interconnected to social action & communication (Rooney et al., 2010). Organizational changes for example implementation of new ways of working and/or new performance standards also change the employees perceptions with reference to their identification in the organization and so they have fear of unknown (Elsbach, 2003). Learning Organizations researchers

mostly agree on the phenomenon of continuous improvement and transformation as a key ingredient of the LOs (Prewitt, 2003). Pedler et al. (1989) defined learning organization in the same context of change and transformation as the organization which facilitates the learning of all its members and transforms itself in order to meet its long term goals. Thus transformation and change has been acknowledged as a key component in LOs as one cannot learn without changing and one cannot change without learning (Weick & Westly, 1999). For many others, LO is considered as “embodiment of organizational learning systems” (Prewitt 2003, p53). Senge (1990, 1997) mentioned that learning organization is built upon five learning disciplines namely personal mastery, mental models, shared vision, team learning and system thinking. In a LO according to him, individuals for their personal development must continually focus and refocus on their personal vision. Moreover one must manage its mental models which mean identifying, testing and improving one’s internal picture of “how the world works”. The members of LO should have a shared vision i.e. a common perception and commitment to what the organizational vision really is. Team learning according to Senge (1990, 1997) is a process of synchronizing and developing the capabilities of a team to generate the results which the team members truly desire. Last but not the least is system thinking which focuses on shift of mind to see interrelationships and observing transformation processes rather than observing merely snapshots at a point of time. Most of the organizations do try to change continuously, update their skills inventory, change their structures and many a times they do “change and adapt” in short run, but do not “develop” in long run and very few achieve the ideal benchmarks of being transformed into a LO. This mostly happens when managers do not follow the precise steps for incorporating a LO culture and they also lack the tools for assessing whether their teams are learning or not and whether the learning of the teams/individuals is benefiting the organization? For this Garvin, Edmondson & Gino (2008) proposed three building blocks of a learning organization which includes a supportive learning environment, concrete learning processes and leadership that reinforces learning. According to them, organizations should assess, identify and improve the main characteristics of these building blocks in their teams if they really want to be a learning organization. James (2003) mentioned that one of the most important attribute of a Learning Organization (LO) is transformational leadership which focuses on the leadership activities at each level, with a vision of

transformation rather than routine transactional (efficiency showing) activities. Such leadership aims to incorporate the LO principles illustrated by Senge (1990) where decision making is encouraged even at lower levels. In such scenarios as knowledge workers are empowered and trained in strategic decision making, strategies can emerge from anywhere in the organization, rather than merely depending on top management James (2003). Employees tend to transform into knowledge workers, by continually upgrading their skills and abilities and moreover transfer knowledge to others. Moreover learning organizations encourage rewards and positive reinforcements motivate the employees/organizations towards behavior modification and adaptation to the new challenges with zeal and zest.

### **1.1. Universities as Learning Organizations**

Creating successful learning atmosphere plays a significant function in supporting organizational learning, modifying individual and social understandings regarding facts and developing awareness about changing socio-technical systems of organizations (Kriz 2003). Universities are considered as the most important forum where the transfer and creation of knowledge takes place and people join these to learn or involve others in learning process through research and teaching (Romainville, 1996). Universities design special courses and include topics of learning organizations, innovation and change management, leadership and team development, double and triple loop learning (White and Weathersby, 2005). No doubt about it that learning takes place round the clock in the educational institutes, but the question arises that “are these universities themselves the learning organizations or not”? Does the university really follow and practice LO principles or not? Some researchers claim that educational institutions seldom put into practice even the simplest beliefs which should be practiced by a learning organization (White and Weathersby 2005). Being the institutes of higher learning, the universities should try to incorporate the principles of learning organizations within themselves as they teach their students. Some researchers claim that usually educational institutions are bureaucratic organizations resistant and slow to purposeful change (Drugovich et al., 2004) and though these promote learning but very few of these could qualify as real learning organization (Senge 1990, Scardamalia and Bereiter 1999). While talking about the goals of a educational institute in the context of a learning organization, one can notice that universities in particular

have dual core responsibilities i.e. catering the continuous improvement and learning of their staff and moreover preparing the best students who will later on earn a respectable living in the knowledge society (Scardamalia and Bereiter 1999). Though both of the above mentioned goals of the universities are closely related but there must be a balance. On the individual level, the dual core responsibilities of a university teacher includes teaching and research (Rouinville, 1996) and thus the role of a teacher in a university is framed by performance of these two functions (Mirza et al, 2012, p.560).

## **2. ACADEME OF PAKISTAN: STUDY RATIONALE**

During the last decade, Pakistan has observed more appreciable economic, social, political and technological changes than ever before and the future of higher education in Pakistan depends on how the stakeholders respond to these changes (Rao, 2003). According to Education Statistics of Pakistan, the total number of Degree Awarding Institutes in Pakistan in the year 2000 was 77 (35 private sector and 45 public sector). It jumped to 134 in 2012 (74 private sector and 60 public sector). Similarly the number of courses being offered and student enrollments also increased with an appreciable rate. Institutes of Higher Education of Pakistan during the last ten years have observed a shift from traditional teaching oriented culture to research oriented culture. Higher Education Commission (HEC) of Pakistan incorporated much stricter hiring and promotion policies during last five years and moreover categorically defined quality standards for a university to hold their entitlement as a Degree Awarding Institutes. Unfortunately during the last five years Pakistan has observed political instability, lack of resources, and inconsistency in policies and poor implementation of policies as well. Coupled with this, the increased performance pressures to compete for international rankings, competition to get scholarships and funding from HEC were some other challenges, which forced the higher education sector of Pakistan to incrementally improve its standards, generate its own resources and incorporate the principals of learning organization in true spirit. University rankings announced by Higher Education Commission of Pakistan ([hec.gov.pk](http://hec.gov.pk)) shows that private sector and semi government universities of Pakistan have performed quite remarkably in terms of teaching and research. Despite of the fact that these two categories of universities are relatively new in Pakistan and



have less government support as compared to public sector universities, they got hold of their due share in top ten universities of Pakistan (category wise rankings). However many established public sector universities could not achieve their benchmarks in terms of rankings. Hence there is an ominous need to explore the higher education sector within the context of human resource management with particular emphasis on change and organizational learning, which is an area of main importance for universities in the developing countries like Pakistan (Rehman et al., 2011).

### **2.1. Important features of three types of universities**

Before discussing study objectives and methodology, it is important to know some important features and differences among of public, private and semi government universities. The most important difference between a public sector and private sector / semi government university (job) is the nature of job contract. Public sector employees have permanent job contracts and have some other entitlements e.g. pension benefits, accommodation opportunities within campus etc. which the private sector employees do not enjoy. Each year, there is a chunk in the federal budget for higher education which goes to public sector universities and this is the main source of their funding. Secondly they also earn from the students' registration/semester/annual fees. However the fee structure of Public Sector University is much lesser than private sector and semi government. Public sector universities have also started self-support/finance programs (mostly afternoon/evening batches) and the teachers who offer their overtime services for self-finance programs are entitled for extra pay (per hour basis). Semi government universities have little support from government particularly during initial stages but these are not fully supported by government as a public sector university usually is. In most of its features, it closely resembles the private sector university, defines its own human resource management policies but under guidance of HEC. Private sector and semi government jobs are not permanent but contractual and contracts are renewed based on the performance of the faculty member and moreover the departmental/university's requirements. The main source of funds/revenues for a private sector university comes from students' fees. For well established private sector universities and even semi government universities which have enough students enrollments each semester/year, students enrollments

and finance may not be the problem but in general for most of the private sector universities, finance is a big problem as there is no government support (through budget). Despite of the facts mentioned above, private sector university growth in Pakistan has been much faster than the public sector during last decade. It is worthwhile to mention that salary structures for PhD faculty of well established private sector universities are quite impressive and usually higher than those of public sector.

## **2.2. Study aims / objectives**

Inspired with the phenomenon of learning organization within the context of organizational development and change, this exploratory study has two main objectives:

- 4. To conduct a comparative study between three different types of universities of Pakistan categorized as public sector, private sector and semi government university and explore which out of these qualify as a learning organization.***
- 5. This study also aims to explore, how and why private sector and semi government universities (with less resources and less government support) have challenged the established public sector universities and have achieved their benchmarks in terms of university rankings?***

Based on analysis, this study will suggest recommendations to traditional universities regarding how to transform into learning universities.

## **3. METHODOLOGY**

### **3.1. Participants & data collection**

The survey was carried out in year 2011-2012, on a convenience based sample of 120 faculty members from three different types of universities of KPK province of Pakistan (details in table 01). Heads of Department/Chairmen offices have been used to provide the list of names and telephone numbers of the faculty members. Each faculty members had been requested in prior for an appointment, to complete the survey form and respond to some semi structured interviews. Strict confidentiality was insured and participants received no monetary reward for participating in this survey. Respondents have been categorized on the basis of gender, last degree, type of university and job category (post) and job contract (permanent or contractual). Each participant was interviewed (approximately 30 minutes) and his/her

responses were noted immediately. The survey form was personally delivered to all respondents and collected back by hand. Only willing faculty members have been approached in this survey to get hold of rational feedback.

**Table 01: Demographic break-up:**

Demographic Characteristics		Number	Percentage
GENDER	Male	72	60 %
	Female	48	40 %
UNIVERSITY	Public Sector	40	33%
	Private Sector	38	32%
	Semi Government	42	35%

### 3.2. Instrumentation

This research is qualitative in nature as interviews have been used to collect primary data. However in addition, a three scaled survey form was also used to get additional information regarding employees' performance, perception of change and organizational culture and various other attributes of job including the demographic information. The survey instrument has been specifically designed for this purpose and is based on personal experience, observations and informal feedback of the faculty on the academic attributes mentioned below. It covered the following attributes of academics (details in table 2)

6. *Perceptions of change in the academic world.*
7. *Pro-activeness*
8. *Perceptions regarding organizational culture & leadership*
9. *Faculty development & curriculum development.*
10. *Research initiatives*

## 4. RESULTS

As mentioned earlier, survey aimed to explore the differences among three different types of universities based on the feedback from the faculty regarding their perceptions pertaining to several different features of the universities concerned. Results are summarized below:

**Table2: Results Summary - (MA: Majority Agreed, MD: Majority Disagreed)**

<b>SURVEY QUESTIONS</b>	<b>Public Sector</b>	<b>Private Sector</b>	<b>Semi Gov.</b>
<b>Perceptions of change in academic world.</b>			
1. Have you observed too many changes (in university) imposed during last five years.	MA	MA	MA
2. Do you think that atmosphere in academic world has become over competitive	50% Agreed	MA	MA
3. Do you think that demands of academicians' job have appreciably increased?	MA	MA	MA
<b>Perceptions regarding organizational culture &amp; leadership</b>			
1. Is your university is a typical bureaucratic institution?	MA	MD	MD
2. In your university, decisions are imposed without consent from faculty?	MD	MD	MD
3. Are HoD/Chairman mostly busy in day-to-day transactional activities?	MA	MD	MD
4. Do you work as teams and always get credits for your ideas/projects from your bosses?	MD	MA	MA
5. Your HoD/Chairman take keen interest in innovation and transformational activities?	MD	MA	MA
<b>Faculty development &amp; curriculum development</b>			
1. Do you think that your department/univ. takes interest in your professional development?	MD	MA	MA
2. Your university regularly conducts seminars and workshops for professional development?	MA	MA	MA
3. The course contents of subjects you teach is updated as you regularly revise it with consent of seniors and others teaching the same course?	60% Agreed	MA	MA
<b>Research Initiatives</b>			
1. Does your University supports & motivates you financially in your research initiatives e.g. publications rewards, etc.?	MD	MA	MA
2. Is the Research cell at your university/department which is very active and updated?	MD	MA	MA
3. Do you think that research you do is a worthless effort with negligible contribution to the society/community around us?	MA	MA	MA
<b>Pro-activeness</b>			
1. Do you know the challenges ahead and are ready to cope with the "challenge of change" e.g. regularly apply for PhD/Post Doc Scholarships (Domestic and overseas), etc.?	MA	MA	MA
2. You do not worry for what happens in future and let the fate decide about your career?	MA	MD	MD
3. Do you think that one should react to problems when s/he encounters the problem (being proactive is useless)	MD	MD	MD

It is worthwhile to mention that this study did not intend to explore any correlations among the variables. This preliminary exploratory study will provide the base for future studies in the context of learning organizations and management of change in institute of higher education. The detailed results are as follows:

#### **4.1. Perceptions of change in academic world.**

##### **1. *Have you observed too many changes(in university) imposed during last five years:***

*Above 80% of the respondents from all the three types of universities agreed with this statement. Most of the public sector employees who did not agree with this statement pointed out that changes have taken place, but not too many and these changes had not been imposed forcefully but it is a question of perceptions. According to them, the changes they have observed had no effect on their status as an academician so far. However private sector and semi government faculty mentioned that they have to adapt with change, else their careers will suffer for sure.*

##### **2. *The atmosphere in academic world has become over competitive***

*Approximately 75-80% faculty members of private sector and Semi-government University agreed with this statement and blamed their research publications and doctoral studies for this competitive environment. According to them the more publications you have, the higher chances you have to win universities' scholarships and annual salary increments. Approximately 50 percent of public sector (permanent) employees agreed with it. According to them, the environment has become over competitive in the universities particularly where there is a competition and competition is faced by faculty who join such universities. But for those who want to stay in the same setup and feel comfortable within noncompetitive environment, this absolutely does not matter.*

##### **3. *The demands of academicians' job has appreciably increased.***

*Above 80% of respondents from three types of universities agreed with this statement. According to them, they have more exams to conduct, more students to deal with, extra administrative assignments to handle, more projects/reports to supervise and their work-life balance has disturbed as well. Most of the respondents mentioned that*

*performance pressures because of research have contributed much to disturbed work-life balance. Private sector faculties have been observed more overloaded with job demands and more stressed as compared to public sector.*

#### **4.2. Perceptions regarding organizational culture & leadership**

##### **1. Your university is a typical bureaucratic institution**

*Approximately 90% of the respondents from Public Sector University agreed with it and on the contrary more than 80% of the private sector and semi-government employees disagreed.*

##### **2. Decisions are imposed without consent from faculty**

*Majority of Private sector and semi government faculty members disagreed with this statement and mentioned that senior representatives from the department constitute a departmental committee and decisions are taken jointly at campus level meetings after taking into consideration the faculty's reservations. On the contrary, in the public sector there are departmental committees and even faculty unions but still there are many decisions which are imposed against the will of faculty. However, later on the faculty unions can raise their voice (strike, negotiations etc) to reverse the decisions e.g. increase in salaries as announced in budgets, claim arrears etc.*

##### **3. HoD/Chairman/Bosses are mostly busy in day-to-day transactional activities and departmental politics**

*Approximately 74% of the public sector faculty agreed with this statement and even mentioned that HoD/Chairman have been found more busy in departmental politics rather than daily academic/transactional activities. Majority of the private sector and semi government staff mentioned that daily transactional activities are mostly carried by Departmental Coordinators and Course Coordinators under supervision of senior faculty. However they ultimately report to HoD/Chairman. Departmental politics is strictly discouraged at each forum.*

##### **4. You work as teams and always get credits for your ideas/projects from your bosses.**

*Concerning teamwork, approximately 81 percent of the respondents from Public sector university mentioned that they have teams “in documents” but real teamwork has been seldom observed. So far, majority of them have had very little chance to work in team and prefer solo flight. Their ideas/projects are mostly welcomed by their bosses but have never seen any of these being implemented. Even for projects they have devoted a great deal of energy are ignored (because of organizational politics). The private sector faculty mentioned that they prefer to work in teams, they have regular team meetings and they try their best to submit projects jointly for acquiring research grants. For this they need support from their bosses which encourage them to get involved in such projects. Ideas are welcomed and appreciated but not always implemented because of shortage of resources or non-availability of sponsors. Semi government employees also revealed their inclination towards team work and their intreprenurial ideas have always been appreciated by top management.*

#### **5. HoD/Chairman/Bosses take keen interest in innovation and transformational activities.**

*Majority of public sector employees mentioned that innovation and transformational leadership seldom exists in their university. Bosses seem to be working as “busy bees”, busy with routine day to day activities. Both the semi government and private sector faculty considered innovation and transformation as an important ingredient of their university’s culture. They regularly organize workshops and conferences and go beyond routine transactional activities at campus.*

### **4.3. Faculty development & curriculum development**

#### **1. Your department/university takes interest in your professional development.**

*Approximately 81% of Public sector employees mentioned that university/department did not care for professional development and they have to care for themselves. University offers scholarships for higher education but because of bureaucracy, favoritism and legal bonding, they felt reluctant to invest time on it. However majority of private sector faculty mentioned that their university constantly announced faculty development scholarships and other training programs but qualifying for such scholarships seemed to be quite difficult and time consuming. **Faculty development culture in semi***

***government university has been found even more than the private sector.***

***2. Your university regularly conducts seminars and workshops for professional development (which were fruitful as you learned much through such workshops)***

*More than 70% of the public sector faculty members agreed with the fact that their university/department organized workshops but mostly they were required to follow training sessions that did not correspond to their interests. Majority of the private sector and semi government employees mentioned that they have gone through initial faculty orientation workshops. Moreover they had a chance to attend faculty development workshops or seminars (at campus or outstation) at least once an year. Different departmental teams also organize customized training sessions at campus particularly before the start of the semester.*

***3. The course contents of subjects you teach is updated as you regularly revise it with consent of seniors and others teaching the same course.***

*Regarding course contents, 62% of the public sector faculty agreed with the fact that they use to update it, compare it with other faculty member teaching the same course. In some cases the camera ready course contents (dossiers) have been given to faculty members for the sake of uniformity. In private sector, more approximately 85% of faculty agreed to it that course contents are updated on regular bases, faculty members must submit the course plan before the start of the semester, senior faculty members thoroughly browse the course plans particularly if the courses are “pre-requisite” for the higher level courses. Senior faculty member (program coordinators and HoDs) of both semi government and private sector university mentioned that they maintain a regular check on the faculty member to make sure that they teach according to the course plans already discussed and finalized before the commencement of the semester. It is worthwhile to mention that the semi government university offered portal services, where the courses plans, books, notes, handouts, assignments, quizzes and their solutions can be uploaded / downloaded without any wastage of time and resources. Concerned program managers/HoDs can access and browse the portal status and this can be shared even in different campuses. Parents can even check the status of their children using such portals.*



#### **4.4 Research Initiatives**

**1. University supports you financially in your research initiatives e.g. publications and there is a financial reward for faculty members who publish papers.**

*71 % of the public sector faculty disagreed with the statement regarding university's financial support and financial rewards against the publications. However many of the senior faculty mentioned names of few other universities (public & private sector), which introduced the financial support/reward policies for staff who published in journals of good repute. They also mentioned that few departments have funds for such heads but usually these are not fully utilized for the same purpose. Approximately 80% of the private sector and semi government faculty agreed with the statement regarding university's policies to support and appreciate the research publications of their faculty through rewards and/or payment for subscription/registration fees. Semi government faculty members even mentioned that special prize distribution events have been organized to award monetary rewards to good researchers.*

**2. Research cell at your university/department is very active and updated.**

*Majority of the public sector faculty disagreed with this statement and categorically mentioned that their research contributions are because of their personal efforts. Research teams/cells (if any) only shares information whatsoever they have through emails or notice boards. According to them, such research cells cannot be termed as very active and updated. Research & Development department allocates funds for higher studies but as usual, there are many bureaucratic bottlenecks. On the contrary, majority of the semi government and private sector faculty mentioned that they have departmental research teams and campus level Research & Development department. Departmental research teams regularly meet and share information they have and even organize research workshops and conferences on regular basis. Research and Development department in coordination with HR department allocate funds and send researchers to other universities on split PhD / Post Doc programs.*

**3. *Research you do is a worthless effort with negligible contribution to the society/community around us.***

*Surprisingly more than 83 % of all the three categories agreed to this statement and mentioned that the only motivation behind their research publications is to improve/update their CVs so they will be in a better position to get promotion and/or switch over to a good paymaster. Those who did not agreed to this statement were mostly the researchers from engineering and life sciences departments who mentioned that these small contributions in research finally make a big positive impact on the lives of living beings around us.*

**4.5. Pro-activeness**

**1. *You know the challenges ahead, are ready to cope with the “challenge of change” and regularly apply for PhD/Post Doc Scholarships (Domestic and overseas)***

*Majority of the respondents mentioned that they knew the challenges ahead for example an MS/M-Phil and/or PhD degree requirement will be demanded from them in near future by the parent organization or Higher Education Commission. For a faculty to teach in a university, they should have these higher level degrees/diplomas else they shall not be considered eligible for teaching and promotion as well. They will definitely face stagnation in their careers and due to this reason they are in search of PhD scholarships. Majority of the faculty interviewed during this survey had already got themselves registered in same or some other university for MS/M-Phil leading to PhD.*

**2. *You do not worry for what happens in future and let the fate decide about your career.***

*To this statement majority of the Public sector faculty showed a favorable response based on the fact that “they are permanent employees”, so they do not worry much for what happens to their job in future. Most of them revealed external locus of control as a personality trait, with very little worries about their carriers/jobs and describing external (uncontrollable) factors responsible for whatever will happen in future.*

*On the contrary, private sector employees have been observed more worried for their future (even more than semi government) and majority of them did not agreed with this statement. According to them, private sector university owners have created a corporate culture/environment in their universities where hard work and*

*performance shall decide about your career growth rather than fate or luck. This has also caused the private sector employees more stressed and burned-out, with more work-life balance issues than the public sector.*

**3. *One should react to problems when s/he encounters the problem (being proactive is useless) or being proactive is the key to success.***

*All the categories have been found on the same page regarding the question on pro-activeness. The Majority of them disagreed that one should wait for the problem to arise and then tackle the problem. They agreed that planning ahead of time and being proactive is the key to success. According to them social/management support and pro-active planning two of the most important coping strategies to overcome the problem situations. However, to what extent these strategies can be used varies from person to person and job to job.*

## **5. DISCUSSION & CONCLUSION**

Educational institutions are considered as learning organizations based on the fact that they advance and promote learning but only few of these would qualify as learning organizations in the real sense of what the learning organization actually means (Senge, 1990). Moreover educational institutions are often considered as bureaucratic institutions exemplifying controlling structures with more hierarchies, resistant to change, competitive rankings and lack of teamwork in teaching and research (White and Weathersby 2005). But do all the educational institutions exhibit same features or there are some exceptions as well? Based on the initial results presented above, we shall discuss the public sector and private sector universities in the context of change management and organizational learning.

### ***Perceptions of change in academic world and Pro-activeness :***

Public sector faculty though realize the facts regarding change in the academic world e.g. demands/expectations from academicians' job has been increased and initiation of a competitive environment in academe but still they revealed that these changes have little effect on their status as an academician. Moreover it has been observed that most of the public sector employees are reluctant to switch over to private sector, even if offered with higher salary. As a matter of fact, they feel much comfortable with "secure" jobs, in less competitive environment even at lesser salary and prefer long term benefits. On

the contrary, private sector employees have been observed as responding to change positively, upgrading their portfolios in terms of research even at the cost of their work-life balance. As a matter of fact, it is a question of their survival i.e. “survival of fittest”, so they are striving hard. However it has also been observed that turnover intentions of private sector faculty were quite high as compared to public sector, which is not a good indicator.

Interestingly if we note the attribute of pro-activeness with particular reference to public vs. private university and semi government university, public sector faculty has been observed less pro-active with little worries about their job and mostly believed in the external factors which drive/decide about their future in university. Though they believe in the fact that hard-work and proactive planning is the key to success in general, but while talking about the career prospects, their point of view changed and this may be due to the perception of their organizational culture (which may not be absolute reality). Semi government and private sector faculty seemed more pro-active and worried as well because of organizational pressures which according to them resembles close to “corporate culture”. Whether public, semi government or private, majority of the faculty interviewed during this survey had already got themselves registered in same or some other university for MS/M-Phil leading to PhD which shows their pro-active efforts to overcome the challenges of future.

Most of researchers have identified LOs the organization where knowledge workers learn, create and transfer whatever they have learned and help their organizations to adapt to the new environments much faster than their competitors (Garvin, Edmondson & Gino 2008). In this context the results reveal that semi government and private sector universities being more proactive to change actually have tried their best to adapt to change and to incorporate learning organization culture. Argyris and Schon (1997) somehow mentioned the same as organizational learning takes place when employees and employers act as learning agents for the organization by timely responding to changes in the external and internal environments. No doubt that one may find many of the public sector faculty members to be very proactive in their individual capacity, but because of lack of learning organizational culture in university, individual efforts do not go in the right direction.

### Organizational culture, structure, leadership & quality improvement:

One of the most important attribute of a learning organization is transformational leadership which focuses on the leadership activities at each level and strategies can emerge at any level/anywhere in the organization (James, 2003). Public sector university has been revealed by their faculty as a typical bureaucratic institution where decision making is mostly centralized, coupled with political manipulation and lack of team spirit. They also revealed that many a times, their bosses have been found tackling the day to day transactional activities, departmental politics and least bothered to think about transformational decisions. Semi government and private sector has been found less bureaucratic, where self managed teams could take decisions, transactional tasks assigned to selected officers reporting to HoD, their ideas usually welcomed and directly or indirectly everyone is contributing towards slow but steady transformational process.

In addition public sector faculty members showed their concerns regarding indifferent attitude of their university/department towards faculty development and improvement in other aspects of academic life. Private sector faculty feedback through this survey revealed the element of continuous improvement/development through customized training programs, conferences and workshops, curriculum development, use of information technology i.e. course portals etc. Same holds true for semi government university.

Browsing the above mentioned features of public, semi government & private sector universities, one can judge that in semi government and private sector universities transformational leadership, team spirit and quality improvement principles of learning organization are quite dominant as compared to public sector. At departmental level, there might be many departments in the public sector universities where the HoD/Chairman focuses on transformations, development and quality improvements but again solo flight does not matter unless all the departments (heads) are on same page and contribute jointly towards over all mission of the university with the same vision under transformational leadership of the Vice Chancellor. However public sector universities are much larger in size (number of departments, faculty, and students etc) so it is quite challenging for the Vice Chancellors to manage it effectively, the way private sector universities are managed by their Vice Chancellors/Rectors/Directors. Thus Learning Organizations (LO) researchers mostly agree on the phenomenon of continuous improvement and transformation as a key

component of the learning organizations (Prewitt, 2003) and focusing within the context of change and transformation LOs facilitates the learning of all its members and transforms itself in order to meet its long term goals (Pedler et al. 1989).

#### Research initiatives and performance:

Performance and ranking of a university is judged by quality of research conducted by its faculty. Particularly for the good rankings and accreditations, semi government and private sector universities have introduced many research initiatives for the faculty to grab research projects, publish papers etc. On the other hand well established public sector universities already have many departments, some centers of excellence, research labs/funding etc.

Results revealed that comparatively public sector universities do not offer many incentives to their researchers as others do. It may not be true for all public sector/private sector universities. However category wise ranking of Higher Education Commission of Pakistan (HEC) shows that many private sector universities have outclassed some public sector universities, despite of fact that most of private sector universities are new and face funding/finance problems. One can conclude that only active research cells/teams at departmental levels working under supervision of research gurus can achieve benchmarks. Now the universities are competing for international rankings and research is no doubt one of the most important criteria there as well. In addition, private sector faculty revealed that there exists a performance appraisal system which appraises many aspects of the teacher's job (at different levels) and the most important among these is "research". For outstanding performers (as per annual appraisal results) the university announces salary increments (double increments) and/or honorariums. In this survey, these sorts of compensation (variable pay) benefits for quality teaching and research outcomes have not been observed in public sector. This may also be one of the reasons that few of the semi government and private sector universities have outclassed even well established public sector universities because faculty members get motivated and invest their time and efforts in result oriented tasks. So one can conclude that even if the faculty members are capable to come out with good outcomes in terms of quality teaching and research but there is no patronage/support of the parent university, good performers may lose motivation and may not work with zeal and zest next time.

## 6. RECOMMENDATIONS

Many organizations, which had been considered the most appropriate in 20<sup>th</sup> century because of its emphasis on specialization and efficiency, failed to adapt to rapidly changing environments in 21<sup>st</sup> century (James 2003). Such organizations are vulnerable to fail to become learning organizations without incorporating a change in their fundamental beliefs. Thus it is very important for the captains of HEIs to play their role as charismatic leaders (rather than administrators) and try their level best to incorporate change in the fundamental beliefs of their employees at each and every level. Vice Chancellors, Directors, Chairmen, HoDs and other office bearers must be a role model for others and should have a common perception and commitment to what the organizational vision really is (Senge, 1990). They should regularly disseminate their vision of learning and change through different sources e.g. workshops, seminars etc that everyone in the university must know the realities and challenges of change and no one should take it for granted.

Negative organizational politics should also be discouraged at all levels and it can be achieved by taking decisions purely on merit. If everyone has a common perception regarding the merit decisions, they will try their best to perform well rather than to depend on favoritism or unethical maneuvering. This will inculcate internal motivation to learn and grow. It is thus suggested that universities with traditional bureaucratic structures must try to avoid centralized decisions, should encourage team learning, system thinking (Senge, 1990) and introduce team rewards. In this way they will be actually facilitating and encouraging knowledge sharing which is one of the important ingredients of learning organizations.

An important ingredient of organizational development and LO is continuous improvement (Prewitt, 2003). Any university which aims to be a true learning organization must incorporate the continuous improvement phenomenon in each and every dimension of academic life. Universities should firstly focus on quality intake e.g. hiring teachers who have aptitude towards teaching & research and inducting students purely on merit. 2ndly universities must educate the students with quality curricula and make sure to provide quality infrastructure and resources. To incorporate organizational development and learning organizational culture, universities should have Quality Cells to monitor the quality aspects and to continuously improve/upgrade

the processes. Regarding research, universities should have clear policy statements. Being the most important criteria of university ranking particularly in 21<sup>st</sup> century, universities must facilitate and motivate the faculty members who prove to come out with good research publications. Universities should adopt a holistic approach to promote strong research culture and they should have their mission statements clearly emphasizing the value of research in academe (Mirza et al., 2012)

As mentioned earlier, faculty members have been observed focusing much more on research but neglecting the quality teaching aspect (avoiding students). The main function of university level education is to transfer skills and prepare the students for future responsibilities (as entrepreneurs or intrapreneurs) so they should play their role in the generation of economic activities. Overestimating the research aspect and underestimating quality teaching particularly during the performance appraisals may prove harmful in the long run so there should be some balance. Many teachers proposed that teaching aspect should also be given equal weight-age as research so those who are very good at teaching but not at research should also have chances of career growth. It is worthwhile to mention that faculty members of all three categories considered research as a worthless effort, just contributing towards their good profiles/CV but with no impact on community. This notion if persists for a longer period of time is not good for the researchers as they will have little motivation for something they claim to be worthless. They need clear guidance regarding selection of research topics and the impact of their research on community.

## **7. LIMITATIONS**

As mentioned earlier, this was a preliminary exploratory survey primarily based on participant observation, informal exchanges, and formal interviews which tried to explore higher education sector of Pakistan in the context of change management and learning organization. This research is subject to many limitations e.g. no statistical quantitative methods have been used in this study nor have we used triangulation as a qualitative technique. The interviews conducted were not “in-depth interviews” and results have been analyzed and discussed based on percentage findings only rather than advanced qualitative or quantitative techniques. Moreover this survey was based on a cross sectional data at a point of time rather than the longitudinal. Only three universities have been considered in this



survey based on convenience which can be increased in future research in this domain. Preliminary results from this exploratory survey can be used to design the questionnaires in alignment with the questionnaires already used for such surveys and thus the results can be quantified using quantitative statistical tools.

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# A COMPARISON OF THE CONDITIONS OF THE 1980'S AND AT PRESENT, CULTURAL DIFFERENCES, THE IMPACT ON CURRENT BUSINESS ACTIVITIES IN IRAQ

Miloslav Hostaša<sup>32</sup>

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## Abstract

*Brief characteristic of business of Czechoslovak companies in Iraq in 1980's during the period of rule of S. Hussein, evaluation of Iraqi businessmen, way of doing business. Roles of the personnel of the commercial department of the Czechoslovak Embassy. Current situation and the way of doing business in private and in state sector under the new conditions in Iraq. Comparison of both periods, conclusions and recommendations.*

## Keywords

*Way of doing business, 1980's, commercial department, presence, comparison, conclusions and recommendations*

**JEL classification: M16, M14**

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## Introduction

The following Article is focused on comparison of conditions for doing business in Iraq in 1980's and at present. To make a comparative analysis of the conditions for doing business with Iraq in the 1980's and today, it is necessary to set clear criteria for assessment. The main sources of information are my own findings of author, drawn from the memories of Czechoslovak direct participants<sup>33</sup> in business dealings at that time, interviews with local business partners, who remember the period under examination, and from other available resources.

I can personally evaluate the presence from my visits to Iraq at least once per quarter and from the ongoing negotiations on a major export business case. In addition, during my business trips to Iraq, I held

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<sup>33</sup> For example CS diplomats and technical – administrative personnel acting in Iraq at the 1980's at the Czechoslovak embassy in Baghdad.

direct interviews with some smaller companies <sup>34</sup> that gave me a clear picture of the current situation in the country, business skills and business possibilities. To evaluate the differences between the two periods, I am presenting a few introductory remarks:

**a. Brief characteristic of Iraq of 1980's**

- Assumption of power by S. Hussein, strengthening of the authoritarian military regime
- High price of oil on world markets resulting in high income of the state budget of Iraq
- Non-existence of processing industry in Iraq
- Existence of market economy based on the export of oil and partially also oil products
- Agriculture based on the developed watering system
- Developed business relations and links, existence of retail market as well as wholesale market
- Knowledge of business issues and standard business conditions

**b. Brief characteristics of Iraq at present**

- Democratization of the country, government and parliament arisen from free elections
- Incapability of the government to ensure general consensus of all political parties and groups, sectarian commotions, discontentment of population
- Considerable ethnic-religious discrepancies between population, various political groups, both on the central and on the regional level
- Almost a civil war in the country
- Very bad security situation
- Significant corruption, especially in the state sector
- Iraq has sufficient income from oil export so that to be able to finance the renewal of infrastructure, health care, and other social services (the annual budget is composed as almost balanced one). Unfortunately due to incapability of the state

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<sup>34</sup> The main interview was performed by the author directly in Baghdad and in Erbil in June 2012 during the official visit of the CS minister of industry and trade to Iraq and the company of entrepreneurs, which the author personally participated in.

apparatus, it is not able to realize the expense side of the budget.

- Financing of investments is prioritized through foreign investments over direct payments from the state budget of Iraq. Distribution of installments to for example ten-years long installment calendar is required especially in bigger investments just because of the reason of pressure to cash flow.
- Restructuring of the army, security forces, and state administration proceeds very slowly, in a disorganized and chaotic manner
- From the point of ensuring higher security, Iraq has large surplus of military technology, which is on the technical and technological level of the 1980's, for example the air force is almost non existent
- Very weak and non-functional electric energy transmission system<sup>35</sup>, leading to often blackouts and to the necessity to build backup sources at all buildings (diesel generators)
- Slowly recovering retail and wholesale networks
- Very backward agriculture based on human work and utilization of obsolete technology of the 1980's
- Disorganized education system, low level of knowledge, limited number of educated specialists
- Very low knowledge of business issues, bank operations, standard business conditions

When comparing the situation in Iraq from the point of view of business practice in 1980's and today and considering the above notes, it is clear, that the current situation is by no means encouraging.

Whereas in the 1980's, the business – taking in mind all specifics of Arabic world – was based on respect and abidance with usual business custom and on the knowledge of business methods and the way of trading, the current situation is exactly the opposite.

Moreover, the difference between contracting a refinery and a contract for delivery of textile goods was not very different from the point of business practice.

In the 1980's there were limited communication means available, a business letter (written on a typewriter) was of the essential

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<sup>35</sup> Connected to this is also the insufficient capacity of the Iraqi power stations, which is now on the level of 1/3 of the consumption assumed.

importance, some of the companies had their teletype station <sup>36</sup>. Also usage of telephone connection <sup>37</sup> was very limited. From today's point of view, the process of negotiations on contracts and other business activities were time-demanding and they required perfect preparation. Iraqi businessmen were characterized by all attributes of Arab traders, i.e.:

- Tough but correct in negotiation, they were always negotiating about everything
- They respected the time of meetings agreed, as far as time, they were not always punctual, but one could count on the negotiation to be realized within the range of one hour
- Response to requests and other business correspondence took fourteen and more days in average, according to the importance assigned to it by the Iraqi partner, and according to the utilization of available communication means and channels of that time.
- The price needed to be negotiated, couple of days of bargain was normal, various "barter" and compromises on both sides were everyday manners of trading, final discount was a matter of course
- The course of negotiation was classical Arabic, i.e. until the last moment, the negotiation was tough about each detail of the contract
- The number of negotiating persons for the Iraqi side was usually limited to 2 to 3 businessmen and additional accompanying personnel (according to the characteristic of the contact); these were often family members (father and son); women did not take part in the business
- Business partners were aware of basic business terms and conditions, i.e. they understood the Letter of Credit, the knew

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<sup>36</sup> Teletype was a technical mean of communication, where the connection between the two points was conducted through telephone or telegraph lines. The sender was writing the text on the keyboard (without diacritics and other special characters); the text was sent, when the connection was established. The advantage was the message transmitted confirmation.

<sup>37</sup> The prices of phone calls at that time were very high; the author remembers that a call to Iraq in 1980 was approximately 180 Kčs (Czechoslovak crowns) per minute. For a comparison, the average monthly salary in the socialistic sector of the state economy – without JZD (Uniform Agriculture Cooperative), in the sector of insurance, (foreign trade was not statistically monitored) in the year 1980 was 2770 Kčs (Czechoslovak crowns) per month – source: Federal Statistic Office of the CSSR (Czechoslovak Socialist Republic): Historical Statistic Year-Book of the CSSR, page 154.

INCOTERMS, i.e. they knew who pays what costs connected with the delivery of the goods; they mostly used only the CIF or FOB condition and did not solve details

- If the negotiations took place in Iraq, they were very hospitable as hosts, they wanted to "enjoy" the business negotiation itself; related to this was also the fact that it was not clear until the last moment, whether the contract would be concluded at all or whether the parties would part without an agreement.
- The finish of the negotiation and concluding the contract was scheduled to the moment shortly before the CS delegation leaving; in prevailing number of cases the signature of the contract or also concluding the contract by handshake and agreement on the conditions was organized on the last day before the flight departure.

To understand the manner of doing business with foreign countries in the 1980's, it is necessary to remind, that the foreign trade monopoly existed at that time, the management of which was assigned to the Ministry of Foreign Trade. Foreign trade activities could be performed only by specialized organizations "Foreign Trade Companies" (PZO – "Podniky zahraničního obchodu"). Czechoslovakia had very strongly staffed commercial departments in many countries within the framework of its representative bodies.

Selected employees of foreign trade companies were sent to long-term stays abroad, this either as administrative-technical employees of these commercial departments with the service passport<sup>38</sup>, or in some countries and in justified cases also in the diplomatic position of "business attaché"<sup>39</sup>. Commercial department abroad was managed by the commercial counselor.

The activities of the delegates differed according to the country of assignment. In developed capitalist countries<sup>40</sup>, the activity of the delegates was oriented to collection of information, statistics, monitoring of local economic press, friendly or formal meeting with customers, overall support of commercial activities in the territory,

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<sup>38</sup> Normally, these people were identified as "delegates".

<sup>39</sup> Diplomatic passport was issued especially to the personnel of Omnipol, a foreign trade company, which exported "special" materials and services, i.e. weapons and military technologies. To some countries with security risk, the personnel was also sent under diplomatic coverage.

<sup>40</sup> In the 1980's completely used identification of the countries as the Federal Republic of Germany, France, Italy, northern countries, U.S.A., Japan, etc.



participation in fairs, and other marketing activities. However, most of the delegates did not solve in details the individual business cases.

The activity of the delegates in less developed countries, countries of Near and Middle East and in distant countries (South America, Mesoamerica) was concentrated on creating prerequisites for penetration of the goods and service on the markets processed by them in the specific country. Another of the tasks was to ensure all business activities and relations with the customers in the given territory, ensure participation in fairs, exhibitions, providing the businessmen and personnel from the central office in case of their stay with all the services during their stay in the territory (transportation, assurance of accommodation), and to take part in the specific negotiations. Very often these delegates had also written authorization from their companies to negotiate and conclude deals <sup>41</sup>.

Most of the deals were done through mediators, representatives, ad hoc representatives.

The current situation of trading with Iraq can be divided to two levels, and each of these levels has its specifics and dissimilarities:

The first group consists of ordinary businessmen in the area of retail and wholesale. Compared to the 1980's, the behavior of this group did not change much, but certain differences may be defined as follows<sup>42</sup>:

- Most of the deals are concluded outside the territory of Iraq, the most often in Amman in Jordan, or in Dubai (United Arab Emirates) because of the security situation in the country
- Most of the deals are financed from abroad, commercial banks do not provide sufficient level of services
- Business knowledge and skills of Iraq businessmen are very weak
- The deals are done through mediators, representatives
- Another specific of trading with the current Iraq is that the Czech businessman usually, in the first stage, encounters a mediator and not directly the customer; related to this is a

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<sup>41</sup> The activities of the administrative-technical personnel ("delegates") is set within the Article No. 3, Section e) of the Vienna Convention on Diplomatic Relations of 18th April 1961, which states, that the functions of a diplomatic mission consist inter alia in promoting friendly relations between the sending State and the receiving State, and developing their economic, cultural and scientific relations. However, it is not resulting from this wording that these personnel could directly perform foreign trade activities (for example concluding contracts).

<sup>42</sup> Direct research of the author in v Baghdad during his business trips. Data acquired from discussions with local professionals and companies in the period from August 2012 to March 2013.

problem to distinguish between seriously meant request from the effort of the mediator to negotiate a participation in the business case. In connection with this, it is necessary to warn against payment of any advance payments of various type (monthly lump sum to cover the costs of the mediator, etc.)

- Missing continuity of relations from the previous years
- The telephone connection with the most of the country was not renewed yet; related to this is a fact that it is impossible to negotiate something without the businessman having a mobile phone number of the business partner, there is practically no change to get in contact with the partner, telephone exchanges are almost nonexistent.

Correspondence method of negotiation is almost excluded; everybody who wants to succeed in Iraq must arrive to the country and negotiate on site or negotiate close abroad, where the Iraq businessman can travel.

Every Czech businessman starting doing business with Iraq has a basic problem at the present time to get a visa to travel to the country. The second group is formed by doing business with the state sector<sup>43</sup>, which represents the foundation stone of the economics of the country<sup>44</sup>.

Unclear and strained political situation in Iraq is unfortunately negatively projected also to the business. By the fall of S. Hussein, the country lost an unambiguous leader. Moreover, the dictatorship regime did not make possible to create the elite of people in the country to be able to takeover the power and start governing after the fall of the dictator.

The behavior and conduct of the personnel of state institutions generally at present time is stigmatized by extensive corruption and related to it is also the approach of the Iraq negotiators to any negotiations. A representative of a company that wants to negotiate contract conditions is unfortunately depending on the arbitrariness of the Iraqi party, or possibly to whether the competent personnel or state administration allow them to come to the negotiation at all.

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<sup>43</sup> Author is negotiating for a long time with one Iraqi ministry, and the information shown in this part of the work are authentic, they originate from the direct findings of the author.

<sup>44</sup> 80 % of the turnover of goods and services is formed by the orders of the state sector.

Some of the ministries and state bodies are localized in the part of the town, where free entry is not possible<sup>45</sup>, but all the state bodies have very strong regulations for accepting visits from abroad.

It is possible to say that if the Iraqi party has no interest in the negotiation and progress of contracting negotiations, it is almost impossible to get to the competent ministry at all, not speaking about the negotiations with the responsible personnel.

Another specific of trading with the current Iraq is that the Czech businessman usually, in the first stage, encounters a mediator and not directly the customer; related to this is a problem to distinguish between seriously meant request from the effort of the mediator to negotiate a paid participation (various lump sum compensations and success fee) in the business case. In connection with this, it is necessary to warn against payment of any advance payments of various type (monthly lump sum to cover the costs of the mediator, etc.) Such a fictive case often serves as a mean to obtain a Schengen visa for the travel to the Czech Republic and subsequently to the countries of the Schengen system.

Owing to the existing chaos in the country, also the fictive business issues of the same type as the famous "Nigerian letters"<sup>46</sup> occur.

Another specific, which is probably not occurring anywhere in the civilized worlds, is that the Iraq state officers do not like introducing themselves, they do not say their position and their decision authority, and if they do so, it is hard to verify their statement<sup>47</sup>.

Probably due to a lack of knowledge of written English and due to poor technical equipment (computers) and insufficient capacity and coverage by Internet, they also do not like to communicate and respond to e-mails. It is apparent in case of state officers that they

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<sup>45</sup> Baghdad is divided by the concrete wall to two security zones, the so-called green and red zone. The entry to the green security zone is possible based on a special permission, the obtaining of which is not easy.

<sup>46</sup> Nigerian letters have become a phenomenon of the 1990's in the Czech Republic and they are known as a utility of fraudulent elicitation of funds from private individuals and companies. It was a bid to acquire large sums of money from Nigeria, allegedly inherited by the Nigerian traders – understand cheaters, and who chose Czech entities to help them in getting the funds. This was always associated with a requirement to send an advance payment for "anything". There is a case known, where such a fraudulent action ended up by shooting a Consul of Nigeria to death by a desperate citizen of the Czech Republic, when he discovered that he was a victim of fraudsters, but unfortunately invested in advance all his savings for retirement.

<sup>47</sup> Who is the "decision maker".

solve the situations and requirements only when it is advantageous for the Iraqi party, and even better, for themselves.

The author alone experienced completely contradictory situations, when an audience on the level of a minister was successfully managed during one visit, and during the next visit, properly announced, he was not allowed even to handover the modified texts of the offer during one week of stay in the hotel.

Also the very bad security situation in the country contributes to this. It has been verified from many sources<sup>48</sup> that it is not recommended for any foreign businessmen to move around Baghdad and other places of Iraq, except of Kurdistan without a professional team of guards. There are more than 200 specialized security agencies acting in Iraq with the license of the Ministry of Internal Affairs of Iraq that ensure security of foreign businessmen on the contract basis and on a very professional level. The author alone had a chance to familiarize with the work of these guards during the last fair, which took place in Baghdad in March 2013. A series of bomb attacks in the center of Baghdad and firing of one assassin directly in the building of the Ministry of Justice occurred during the fair. The practice of the guards was very professional, the person guarded was quietly led over to the armored car, accompanied by personal bodyguards, other two cars performed outer protection, and the person was safely transported to the hotel with the recommendation not to walk out of the hotel<sup>49</sup>.

The Iraqi side officially requests that the negotiations with state institutions, ministries, and other state organizations to be carried out without mediators. The factual situation is that the company that wants to successfully sell their goods and services to the state sector must always have a silent and hidden consultant who will be able – through his ways through the people he knows – to influence the course of the matters and to ensure for the decisive actors their satisfaction with concluding the contract.

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<sup>48</sup> One of them is for example a private security agency composed of the former members of special forces of Great Britain.

<sup>49</sup> Fully equipped armored (hardened) vehicle with bullet-proof windows, bullet-proof vests, independent radio-communication including radio-locator, armed staff of the vehicle, are the matter of course.

**Conclusions and recommendations:**

- Doing business in the current Iraq is still very risky, except of the area of Kurdistan (Erbil).
- Input costs to obtain a contract are very high, in comparison of the total amount of contract they do not correspond to usual percentage of marketing costs in other countries.
- It is not possible to start from that the Iraqi customer will understand and comprehend the matters and contract conditions the same way as the seller.
- It is necessary to offer for each contract also a package of related services (training of operators, delivery of documentation in Arabic language, guarantee and after-guarantee service, method of financing, etc.).

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# TRENDS

## IN INTERNATIONAL BUSINESS

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The papers focus on four topics of the international management field: (1) Doing Business in Central and Eastern Europe, (2) SME Expansion in Central and Eastern Europe, (3) International Management and Corporate Social Responsibility, (4) International Management and Cultural Issues.

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