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CORPORATE GOVERNANCE AND PROPENSITY TO SHARE INFORMATION: THE LONG-RUN EFFECT

Anna Blajer-Golebiewska*, Leszek Czerwonka**

Abstract

The optimal corporate governance system aims to give shareholders confidence that a company is managed efficiently, to create the highest possible profit and to preserve a firm’s reputation. The aim of the research is to find out if the lower level of information asymmetry in corporate governance systems in the Polish listed companies implies higher rates of return for shareholders in the future. We put forward a hypothesis that the impact of lower information asymmetry on company’s performance is overestimated and in reality no long-run effect on the higher abnormal returns occurs. Taking into consideration the initial level of propensity to share information index we analysed future buy-and-hold abnormal returns achieved by 61 companies during the next 3 years.

Keywords: Corporate Finance and Governance, Information and Market Efficiency; Event Studies - Asymmetric and Private Information

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1 Introduction

Information is a stream of data coming to an entity, which may be converted into a resource of knowledge to help in a decision making process. The optimal decision depends on the access to relevant information. To meet its role information should be complete, certain and symmetrical. Symmetry, in this case, means equal access to information for shareholders. However, in reality information asymmetry (the situation in which there are informed and uninformed entities) is the most common case.

The information asymmetry is rooted in the Agency Theory which explains problems arisen from the separation of ownership and management. They will appear wherever it is necessary to delegate rights.

The problem is also inevitable in corporate governance systems, where managers of the company (board of directors, project managers) are in possession of rather complete information on functioning of the company, which outside shareholders do not have.

As information asymmetry leads to ineffective decisions in corporate governance system, so an effective information policy should be implemented to provide easy and equal access to information not only to shareholders, but also for all stakeholders. The optimal corporate governance system aims to give shareholders confidence that their company is managed efficiently, to create the highest possible profit and to preserve a firm’s reputation. In various codes of good practices in corporate governance, it is proposed to reduce the information asymmetry by placing certain information on the website of the company. As a result the website of the company becomes an essential tool for communication with internal and external, current and potential investors. In consequence, contributes to the reduction in the information asymmetry in corporate governance systems.

The aim of our research is to find out if a lower level of information asymmetry in the corporate governance systems in the Polish listed companies implies higher rates of return for their shareholders in the future. We focus particularly on the propensity to share information index which is the proxy for information asymmetry created by the company itself.

We put forward a hypothesis, that the impact of lower information asymmetry on company’s performance is overestimated and in reality there is no long-run effect on the higher abnormal returns. We analyse 61 companies listed on the Warsaw Stock Exchange during the last 3 years. Taking into consideration the initial level of propensity to share information index (2008) we analysed future buy-and-hold abnormal returns achieved by the companies (2008-2012).

A literature review is provided in section 2. Section 3 contains the description of the propensity to share information index. Section 4 contains the
description of the methodology of the event study, namely buy-and-hold-abnormal returns (BHAR) approach. Section 5 presents the analysis of long-run abnormal returns in companies with the lowest and the highest propensity to share information. In the last section we provide recapitulation of the most important issues.

2 Literature Review

Studies on the asymmetry of information require determining variables representing its level (proxies). In the literature, there are many approaches to the analysis of asymmetry of information in corporate governance systems.

Research in information asymmetry and corporate governance can lead to inconsistent results as there is not a single universal attempt to the problem, and research is conducted on different aspects of the relationship. For instance, there is not one established set of proxies for information asymmetry as well as for the level of corporate governance. Researchers use different proxies for these issues. As a result, the same variable is once applied as the proxy for corporate governance, but in other research as the proxy for information asymmetry. For instance, Aluchna et. al. (2005) applied the ownership structure, the share of inside ownership as the level of corporate governance, but in the research of Boumosleh and Reeb (2009) the same indicators represent the level of information asymmetry.

Similarly Bøhren and Ødegaard (2003) on the basis of analysis of companies listed on The Oslo Stock Exchange stated that companies with a high number of inside shareholders are proven to have higher Q-Tobin index (which in their research is the proxy for company’s performance). However, Huddart and Ke (2007) use a similar indicator (book-to-market ratio) as a proxy for information asymmetry in corporate governance systems i.e. between a firm’s managers and other market participants who do not have access to additional private information (Huddart and Ke 2007). Black et al. (2006) regressed Tobin’s Q against the result of their governance index. They found that this correlation is statistically highly significant.

The level of information asymmetry can be determined on the basis of a wide array of variables:

- share of inside ownership; based directly on the assumptions underlying corporate governance issues that arise from the Agency Theory (Boumosleh and Reeb, 2009; Becht and DeLong, 2004);
- analysts coverage (analysts following); number of analysts actively tracking company, its performance and stock, and publishing information about the company; the most widely used indicator (Brennan and Subrahmanyam, 1995; Cai et al., 2008; Clement and Tse, 2003; Ho and Harris, 2000; and many others);
- number of large shareholders (Allen, 1993);
- the difference between the financial results or stock forecast and the actually obtained data (Filbeck and Webb, 2001; Boumosleh and Reeb, 2009);
- participation of institutional shareholders (such as insurance institutions, pension funds, etc.);
- the book value to market value ratio;
- the frequency of losses reporting;
- expenditure on research and development;
- and others.

However, the most widely applied variables associated with the level of information in corporate governance systems are: the share of inside ownership and the analyst coverage.

In this context, an interesting question appears. Will companies with higher propensity to share information achieve higher economic performance in the future? Is it profitable in the long-run to share information?

The analysis conducted by Boloș et.al. (2010) shows that in the situation, in which information is not shared proportionally between investors, an investor could decide to become the shareholder of the company if he has information that in the next period the company would develop investments, expand business activity, so earnings growth are to meet long-term shareholder interests. Moreover, research indicates, that there are situations of positive impact of information asymmetry on company performance and company value, but sometimes information asymmetry can also have a negative impact on company performance because investors’ “expectations contrast ratio” is higher than the interest rate charged on the banking market.

The variables widely applied in various researches can differ (even in case of the same company) according to the sources of information asymmetry which are represented in these variables. Due to the above-mentioned fact, information asymmetry in corporate governance can be classified into: internal and external (Blajer-Gołębiewska 2010). External information asymmetry is created by investors (and potential shareholders) who are not interested in gathering information about the company. One of the indicators in this case is analyst coverage. Internal information asymmetry is created by the company and it can result from the managements’ conscious decisions or from the lack of actions that could reduce the asymmetry. One of indicators of this class is the propensity to share information index.

The research in section 6 considers information asymmetry created by the company’s management and the impact of the propensity to share information index on long-run abnormal returns.

3 Propensity to share information

Analysis of the behavior of companies’ prices with the lowest and greatest information asymmetry has been
carried out on a sample of companies that were the first and the last decile, of all companies listed on the main trading floor of the Warsaw Stock Exchange, in order of rate lambda, the value of which was set on January 1st 2009.

Lambda stands for the propensity to share information and it is based on the selected set of information which each company’s website should contain. Analyses of different codes of best practices in corporate governance (Code of Best ..., 2007; OECD Guidelines ..., 2005; OECD Principles ..., 2004), indicates 18 of the most important pieces of information which should be included:

1. information about independent members on Supervisory Board,
2. annual reports,
3. articles of Association,
4. regulations of the Executive Board,
5. regulations of the Supervisory Board,
6. Executives and Supervisory Board members’ CVs,
7. information about transactions with related companies, including customers and suppliers, shareholders and related entities,
8. information about company’s transactions with large shareholders,
9. management statements about their relations with significant shareholders (holders of at least 5% of the total number of votes),
10. detailed information on the general meeting, which shall specify: time, place, agenda, draft resolutions, questions of the shareholders in matters covered by the agenda, etc.,
11. current and periodic information etc.,
12. information on dividend payments,
13. information on the types of shares,
14. risk management systems,
15. information about compliance with codes of best practices in corporate governance,
16. information about the cost of the employee (management) motivation programmes,
17. English version of the website,

Taking into account all above-mentioned factors made it possible to build a lambda ratio that was used to determine the degree of asymmetry of information provided by the company.

Running the company’s website and publishing such information on it is not obligatory according to Polish Law. However the Warsaw Stock Exchange recommends it in its “Codes of Best Practice” (2007). It was recommended for companies to run their website in Polish and English version from January 1st, 2009 and to include on it information relevant for investors. The research in websites of companies listed on the WSE shows that they did not fully respect this recommendation (table 1).

Table 1. Average propensity to share information indices for 289 companies listed on the Warsaw Stock Exchange by sectors

<table>
<thead>
<tr>
<th>Sector</th>
<th>Propensity to share information index</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>0.78</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>0.74</td>
</tr>
<tr>
<td>Telecom</td>
<td>0.69</td>
</tr>
<tr>
<td>Construction</td>
<td>0.67</td>
</tr>
<tr>
<td>Electroengineering</td>
<td>0.65</td>
</tr>
<tr>
<td>Other Industries</td>
<td>0.65</td>
</tr>
<tr>
<td>Retail</td>
<td>0.65</td>
</tr>
<tr>
<td>Chemicals</td>
<td>0.64</td>
</tr>
<tr>
<td>IT</td>
<td>0.62</td>
</tr>
<tr>
<td>Media</td>
<td>0.62</td>
</tr>
<tr>
<td>Developers</td>
<td>0.61</td>
</tr>
<tr>
<td>Services – other</td>
<td>0.61</td>
</tr>
<tr>
<td>Food</td>
<td>0.60</td>
</tr>
<tr>
<td>Hotels &amp; Restaurants</td>
<td>0.59</td>
</tr>
<tr>
<td>Wood &amp; Paper</td>
<td>0.59</td>
</tr>
<tr>
<td>Metals</td>
<td>0.58</td>
</tr>
<tr>
<td>Finance – other</td>
<td>0.57</td>
</tr>
<tr>
<td>Building materials</td>
<td>0.56</td>
</tr>
<tr>
<td>Wholesale</td>
<td>0.56</td>
</tr>
<tr>
<td>Energetics</td>
<td>0.50</td>
</tr>
<tr>
<td>Light Industry</td>
<td>0.40</td>
</tr>
</tbody>
</table>

As a result, the number of relevant to investors data provided on a voluntary basis on company's website (on January 1st, 2009) designates the lambda i.e. companies propensity to share information in the corporate governance system. In other words, the propensity to share information index is the ratio of information relevant to investors to the whole set of information on each company’s website, where \( \lambda \in [0,1] \).

The highest average propensity to share information in the case of companies listed on the Warsaw Stock Exchange occurred in the Banking sector (0.78), and in Oil & Gas sector (0.74). The lowest average propensity to share information was found in the Light Industry sector. That means that on average companies in the Banking and Oil & Gas sector put the highest amount of information on their websites and companies in the Light Industry sector – the lowest.

4 Event study and buy-and-hold-abnormal returns (BHAR) approach

"Buy-and-hold abnormal return" is a tool used by the event study, the method that can help to assess the impact of certain events relating to a company on the company's share price (Gurgul, 2006). This method involves calculating abnormal returns by comparing actual returns on shares and expected returns. To calculate the expected rates of return it is required to use some model, which enables evaluating the returns. The models used in event studies are: mean-adjusted return model, market-adjusted return model, market model, CAPM model, Fama and French three factor model, reference portfolio model or matching with control firms model. "Buy-and-hold abnormal return" (BHAR) indicates what is the rate of return on shares which are purchased at the beginning of the analysis period and kept until the end of the abnormal return's measurement period – adjusted for the expected rate of return during this period (Mitchell and Stafford, 2000).

In this study Rosen’s BHAR abnormal return is used, in which the actual rate of return on shares is adjusted by dividing it by the rate of return on the stock index:

\[
BHAR_{it} = \frac{\prod_{t=1}^{T}(1 + R_{it})}{\prod_{t=1}^{T}(1 + R_{index,t})}
\]

(1)

where \( R_{it} \) – the return on the share on the day \( t \); \( R_{index,t} \) – the return on the stock index on the day \( t \) (Rosen, 2006).

From the BHAR values obtained that way the value of 1 is subtracted. Therefore the positive BHAR values mean that the share prices are relatively higher than market average value while negative BHAR values mean relative loss.

The research was based on an analysis of the lambda values for about 289 companies listed on the Warsaw Stock Exchange, hence the analysis performed for the first decile was applied to 31 companies with the highest values of the coefficient lambda, while the tenth decile consisted of 30 companies with the lowest values of the coefficient lambda. The share prices and the value of the WSE Index come from the archive of Stooq.com service. Share prices published on this site are adjusted for the impact on the valuation of such operations as splits, pre-emptive rights issuing or, dividend payments.

The method used in this analysis is the BHAR method according to the formula used by Rosen (Rosen, 2006). Reference day for abnormal returns determination is December 31st, 2008, the last day on which companies were not obliged to comply with stricter information disclosure rules. The abnormal returns were determined for the next 12 quarters following the reference date. The expected rates of return were obtained using the market-adjusted model, where the index used to adjust the actual rates of return on shares of the companies to achieve abnormal rates of return, was the Warsaw Stock Exchange Index.

5 BHAR rates for companies with the lowest and highest information asymmetry

Research on the issue of information asymmetry suggests that it may have a significant impact on the economy. However, it seems that the long-term impact on the prices of companies, and thus, the wealth of shareholders, is limited. To analyse this problem the lambda ratio was used, indicating the depth of asymmetry for a specific company (Blajer-Golgbiewska, 2012), which was used to rank the companies from those least subjected to the phenomenon of asymmetry (the highest lambda), ending with the companies which were the least eager to reveal much information about themselves (the lowest lambda).

For all companies ordered in such a way Table 2 shows the results of abnormal returns BHAR, relative to the reference date which was December 31st, 2008, for the first decile of companies with the lowest degree of asymmetry. Results for subsequent quarters are positive, but statistically insignificant, so they are not significantly different from zero. This means that the results are scattered and random. Therefore, it cannot be concluded that over the next three years an extraordinary propensity to disclose information could positively influence the share prices of these companies.
Table 2. BHAR rate for companies with the greatest lambda

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Average value (%)</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>7.1242</td>
<td>0.179</td>
</tr>
<tr>
<td>2</td>
<td>9.2328</td>
<td>0.178</td>
</tr>
<tr>
<td>3</td>
<td>11.0548</td>
<td>0.121</td>
</tr>
<tr>
<td>4</td>
<td>3.7219</td>
<td>0.615</td>
</tr>
<tr>
<td>5</td>
<td>11.3377</td>
<td>0.245</td>
</tr>
<tr>
<td>6</td>
<td>10.6208</td>
<td>0.303</td>
</tr>
<tr>
<td>7</td>
<td>5.5728</td>
<td>0.603</td>
</tr>
<tr>
<td>8</td>
<td>7.7472</td>
<td>0.558</td>
</tr>
<tr>
<td>9</td>
<td>13.7787</td>
<td>0.423</td>
</tr>
<tr>
<td>10</td>
<td>13.6750</td>
<td>0.519</td>
</tr>
<tr>
<td>11</td>
<td>9.6724</td>
<td>0.636</td>
</tr>
<tr>
<td>12</td>
<td>10.4947</td>
<td>0.666</td>
</tr>
</tbody>
</table>

Source: own calculations.

Table 3 shows the results of abnormal returns BHAR, in relation to the reference date which was December 31st 2008, for the last decile of companies, ranked according to the propensity to disclose information. While by most of the period the BHAR values were statistically insignificant, the first two quarters indicate positive results for these companies, and the 11th quarter is negative. It could mean that, initially, the companies' reluctance to disclose their secrets was appreciated by investors, but later investors decided that investing in these companies is not advantageous.

Table 3. BHAR rate for companies with the lowest lambda

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Average value (%)</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>15.3521</td>
<td>0.017</td>
</tr>
<tr>
<td>2</td>
<td>13.1126</td>
<td>0.044</td>
</tr>
<tr>
<td>3</td>
<td>14.7121</td>
<td>0.122</td>
</tr>
<tr>
<td>4</td>
<td>0.7893</td>
<td>0.922</td>
</tr>
<tr>
<td>5</td>
<td>3.0576</td>
<td>0.716</td>
</tr>
<tr>
<td>6</td>
<td>0.3374</td>
<td>0.963</td>
</tr>
<tr>
<td>7</td>
<td>1.1049</td>
<td>0.897</td>
</tr>
<tr>
<td>8</td>
<td>-4.8018</td>
<td>0.528</td>
</tr>
<tr>
<td>9</td>
<td>1.1851</td>
<td>0.928</td>
</tr>
<tr>
<td>10</td>
<td>-7.6593</td>
<td>0.554</td>
</tr>
<tr>
<td>11</td>
<td>-20.7576</td>
<td>0.039</td>
</tr>
<tr>
<td>12</td>
<td>-15.4132</td>
<td>0.248</td>
</tr>
</tbody>
</table>

Source: own calculations.

However, the results may be only indirectly related to the propensity to disclose information. Table 4 presents the distribution of industries' representatives in both deciles - companies with the largest and the smallest inclination to share information. It may be noted that while some industries are poorly represented in both deciles, or similarly represented in both deciles, there are some industries which are particularly strongly represented among the companies disclosing information: banks and construction companies, while among companies non-disclosing there are many companies involved in wholesale trade and light industry (Table 4).
Table 4. The percentage of companies from various sectors in the first and tenth decile companies, in order of lambda

<table>
<thead>
<tr>
<th>Sector</th>
<th>High lambda</th>
<th>Low lambda</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Banking</td>
<td>19</td>
<td>0</td>
</tr>
<tr>
<td>Electroengineering</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Wholesale</td>
<td>3</td>
<td>13</td>
</tr>
<tr>
<td>Media</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Developers</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Services - other</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Construction</td>
<td>19</td>
<td>7</td>
</tr>
<tr>
<td>Wood &amp; Paper</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Chemicals</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Oil &amp; Gas</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Metals</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Food</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Telecom</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Hotels &amp; Restaurants</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Light Industry</td>
<td>0</td>
<td>13</td>
</tr>
<tr>
<td>Finance - other</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Building materials</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>Retail</td>
<td>0</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: own calculations.

Thus the asymmetry of information can affect companies' performance, but only indirectly. Companies in certain industries have a higher propensity than others to disclose information. Therefore, the average performances of companies disclosing or non-disclosing information are influenced rather by the results of certain industries, but not by the behaviour of specific company.

Table 5. BHAR rates for Banks sample

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Average value (%)</th>
<th>P</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>-26.3844</td>
<td>0.022</td>
</tr>
<tr>
<td>2</td>
<td>-24.8446</td>
<td>0.017</td>
</tr>
<tr>
<td>3</td>
<td>-6.6831</td>
<td>0.509</td>
</tr>
<tr>
<td>4</td>
<td>0.0840</td>
<td>0.996</td>
</tr>
<tr>
<td>5</td>
<td>-8.2369</td>
<td>0.350</td>
</tr>
<tr>
<td>6</td>
<td>-7.7356</td>
<td>0.322</td>
</tr>
<tr>
<td>7</td>
<td>-12.3393</td>
<td>0.156</td>
</tr>
<tr>
<td>8</td>
<td>-8.6303</td>
<td>0.429</td>
</tr>
<tr>
<td>9</td>
<td>-6.2060</td>
<td>0.581</td>
</tr>
<tr>
<td>10</td>
<td>-11.3005</td>
<td>0.280</td>
</tr>
<tr>
<td>11</td>
<td>-11.6039</td>
<td>0.303</td>
</tr>
<tr>
<td>12</td>
<td>-18.4188</td>
<td>0.229</td>
</tr>
</tbody>
</table>

Source: own calculations.
Table 6. BHAR rates for Construction industry sample

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Average value (%)</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>13.7811</td>
<td>0.120017</td>
</tr>
<tr>
<td>2</td>
<td>16.7954</td>
<td>0.123837</td>
</tr>
<tr>
<td>3</td>
<td>3.9008</td>
<td>0.685452</td>
</tr>
<tr>
<td>4</td>
<td>-12.9829</td>
<td>0.159393</td>
</tr>
<tr>
<td>5</td>
<td>-5.6924</td>
<td>0.611168</td>
</tr>
<tr>
<td>6</td>
<td>-9.5210</td>
<td>0.411498</td>
</tr>
<tr>
<td>7</td>
<td>-16.3205</td>
<td>0.139369</td>
</tr>
<tr>
<td>8</td>
<td>-24.0000</td>
<td>0.060481</td>
</tr>
<tr>
<td>9</td>
<td>-29.9476</td>
<td>0.042866</td>
</tr>
<tr>
<td>10</td>
<td>-35.5330</td>
<td>0.023226</td>
</tr>
<tr>
<td>11</td>
<td>-42.6582</td>
<td>0.015880</td>
</tr>
<tr>
<td>12</td>
<td>-45.8160</td>
<td>0.013669</td>
</tr>
</tbody>
</table>

Source: own calculations.

Tables 5 and 6 show that during the analysis period the bank and construction industries showed negative abnormal returns in an overwhelming majority of periods (though often not statistically significant). Thus, the overall results were not affected by the phenomenon of information asymmetry, rather, the general situation in various sectors in the analysed period.

Table 7. BHAR rates for Wholesale sample

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Average value (%)</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>-5.9204</td>
<td>0.630667</td>
</tr>
<tr>
<td>2</td>
<td>-1.5477</td>
<td>0.917153</td>
</tr>
<tr>
<td>3</td>
<td>-6.8511</td>
<td>0.504584</td>
</tr>
<tr>
<td>4</td>
<td>-24.3317</td>
<td>0.007885</td>
</tr>
<tr>
<td>5</td>
<td>-13.3323</td>
<td>0.032222</td>
</tr>
<tr>
<td>6</td>
<td>-10.6416</td>
<td>0.054077</td>
</tr>
<tr>
<td>7</td>
<td>-14.6441</td>
<td>0.035777</td>
</tr>
<tr>
<td>8</td>
<td>-34.7429</td>
<td>0.009587</td>
</tr>
<tr>
<td>9</td>
<td>-28.0504</td>
<td>0.031633</td>
</tr>
<tr>
<td>10</td>
<td>-25.3702</td>
<td>0.075617</td>
</tr>
<tr>
<td>11</td>
<td>-33.5218</td>
<td>0.068312</td>
</tr>
<tr>
<td>12</td>
<td>-38.0373</td>
<td>0.025234</td>
</tr>
</tbody>
</table>

Source: own calculations.

Table 8. BHAR rates for light industry sample

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Average value (%)</th>
<th>P-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>-0.7244</td>
<td>0.842754</td>
</tr>
<tr>
<td>2</td>
<td>-2.0903</td>
<td>0.670094</td>
</tr>
<tr>
<td>3</td>
<td>25.4641</td>
<td>0.574926</td>
</tr>
<tr>
<td>4</td>
<td>-2.0804</td>
<td>0.942786</td>
</tr>
<tr>
<td>5</td>
<td>-1.8644</td>
<td>0.948384</td>
</tr>
<tr>
<td>6</td>
<td>-1.9752</td>
<td>0.915824</td>
</tr>
<tr>
<td>7</td>
<td>9.9612</td>
<td>0.800341</td>
</tr>
<tr>
<td>8</td>
<td>20.1684</td>
<td>0.486645</td>
</tr>
<tr>
<td>9</td>
<td>19.7405</td>
<td>0.426329</td>
</tr>
<tr>
<td>10</td>
<td>5.0768</td>
<td>0.846527</td>
</tr>
<tr>
<td>11</td>
<td>-15.0035</td>
<td>0.497247</td>
</tr>
<tr>
<td>12</td>
<td>0.8202</td>
<td>0.985027</td>
</tr>
</tbody>
</table>

Source: own calculations.
Similar results as in Tables 5 and 6 can be seen in Tables 7 and 8. Since these results do not differ noticeably, it can be concluded that for the event which was introduction by the WSE the new recommendation about information on companies websites, an approach of public companies to fulfill the disclosure obligations had no effect on their prices during the analysed period. For investors the current stock market situation was much more important in this period.

6 Summary and Conclusions

According to the research conducted, the hypothesis that the impact of lower information asymmetry on company’s performance is overestimated and in reality no long-run effect on the higher abnormal returns occurs should not be rejected. The research shows that for the first decile of companies, i.e. companies with the highest propensity to share information, there is no long-term impact on the prices of companies, and thus, the wealth of shareholders. In the case of the last decile, i.e. companies with the lowest propensity to share information, initially, the companies’ propensity to disclose information attracted investors, but after two quarters they decided that investing in these companies is not advantageous.

Moreover, it was found that companies in particular industries have a higher propensity than others to share information. The highest propensity occurs in the case of companies operating in the Banking sector, and the lowest propensity is in the case of companies in the Light Industry sector. The relation can be noticed not only in the number of companies with the highest propensity to share information indices, but also in the averages of the indices in each sector. It can be concluded, that the average performances of companies disclosing or non-disclosing information are influenced rather by the results of certain industries, but they do not result from the behavior of a specific company.

As the results obtained in BHAR analysis do not differ noticeably, it can be concluded, that the fact that a company’s management was willing to share information and in fact reduced information asymmetry had no effect on prices of analysed companies in the long-run.

References:


THE PERCEIVED IMPACT OF RESTRUCTURING ON SERVICE QUALITY IN A HEALTH CARE ENVIRONMENT

Lisebo Ntsatsi, Sanjana Brijball Parumasur*

Abstract

This study evaluates health care employees’ perceptions of service quality in a hospital environment after the process of restructuring and assesses whether their perceptions are influenced by biographical profiles. A sample of 143 clinical and non-clinical employees from three of the largest regional hospitals within the Ministry of Health in Lesotho was drawn using cluster sampling. Data was collected using an adapted version of SERVQUAL whose psychometric properties were statistically determined. Data was analyzed using descriptive and inferential statistics. The results indicate that employees were fairly convinced that the process of transformation undertaken in the health care organization led to enhanced service quality in terms of improved empathy, assurance, responsiveness, tangibles and reliability, although in varying degrees and, reflect areas for improvement.

Keywords: Service Quality, Tangibles, Reliability, Responsiveness, Assurance, Empathy, Business Strategies, Integrated Delivery Network

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1 Introduction

Health care is a government priority as it is in the interest of every country to have a healthy nation. Health services are fundamental to every health system and identifying strategies to improve health services is vital (Loevinsohn & Harding, 2005). There are some key resources that health service delivery relies on, such as motivated staff, equipment, information, finance and adequate drugs. Some of the aspects that assist in health service delivery are improving access, coverage and quality of health services and these can be determined by the ways in which services are organized and managed and on incentives influencing providers and users (Clancy, 2006).

Loevinsohn and Harding (2005) note that many countries allocate more resources towards health services which do not necessarily address the problem of service delivery. Mehrotra and Jarrett (2002) assert that health service delivery is fundamental for the community specifically those people who are in the rural areas where health services are not accessible. They further emphasize that the quality of health services provided at grassroots level are poor due to lack of adequate resources and inefficient political will to ensure proper functioning. Improving health service delivery requires efforts from stakeholders within the health systems such as policy makers in the ministries of health, finance and public administration, health service managers and workers, public and private providers, clients as well as the communities (WHO, 2012).

This paper aims to evaluate health care employees’ perceptions of service quality in a hospital environment after the process of restructuring and to assess whether these perceptions are influenced by biographical profiles.

1.1 Health care provision and service delivery

Walshe and Smith (2006) describe that the provision of health care services within a regional or national health care system can be classified into three sectors, namely, primary, secondary and tertiary care. The sectors can be modeled as subsystems of the whole health care system, even though in some countries the boundaries between these sectors are often unclear and many times shift as health services provision moves from one sector to the other. The three sectors overlap and a patient can be expected to move from one sector to another depending on his or her clinical needs. For example, a patient may begin from the first sector where the patient is diagnosed and this is where primary health care takes place. The patient can later be transferred to secondary care to be hospitalized or access some services not provided at primary care level. Tertiary care plays an important role in cases where a patient requires specialized care which cannot
be provided at secondary level. The movement through the sectors increases costs for the patients. This situation brings more pressure on health organizations to manage the increasing health care costs and require attempts to develop the capacity of primary health care providers and facilitate the ability of the patients to provide self-care (Walshe & Smith, 2006).

1.2 Constraints in delivering health services

Oliveira-Cruz, Hanson, and Mills (2003) maintain that some of the constraints within health service delivery operate on five levels, namely, Community and household level, Health services delivery level, Health sector policy and strategic management level, Public policies cutting across sectors and, Environmental and contextual characteristics. Other constraints that were analyzed include the lack of demand for effective intervention and, barriers to the use of effective interventions. In addition, the constraints of health service delivery such as shortage and distribution of qualified staff, poor technical guidance and supervision, inadequate drug and medical supplies, lack of equipment and infrastructure as well as poor accessibility are issues of concern which have to be managed by health sectors. Travis, Bennett, Haines, Pang, Bhutta, Hyder, Fielemeyer, Mills & Evans (2004) add that financing and the use of information are further problems facing health systems. Oliveira-Cruz, Kurowski, and Mills (2003) emphasize that improved health care services can be realized through national and international commitment to enlarge access to priority health interventions.

1.3 Strategies to strengthen and improve the delivery of health services

According to Shi and Singh (2008), health professionals should not only focus on their roles at the workplace but should also have a better understanding of forces outside their profession that can affect their current and future practices. Furthermore, they emphasize that policy makers should not only focus on one health care sector when they deal with certain problems as the impact may be felt in the entire system. Peters, El-Saharty, Siadat, Janovsky, and Vujicic (2009) suggest that some of the strategies that can be implemented to strengthen the health services are the expansion and involvement of community health workers, the establishment of user fees and community management, decentralization, performance incentives, social marketing and re-organizing outreach workers.

Nauert (2002) mentions that the health care industry has been denying patients quality health services and there are certain business strategies that the health industries had to put in place to curb such poor service delivery. Such business initiatives include key components like environmental assessments of market wants, needs and demands, strengths and weaknesses as well as external threats and opportunities of the health industries. According to Healey and Kuehn (2011), technology plays an important role as an innovation element in health service delivery for the reason that records are easily kept and electronic communication assists in collecting, analyzing and disseminating health related information. The other two innovation elements are a business model for health care system in which more emphasis will be on wellness and prevention, performance outcomes and development of a value network that is sustainable and will probably need an external catalyst. Battacharyya, Khor, Mcahan, Dunne, Daar, & Singer (2010) suggest marketing strategies that can be implemented to improve health services especially for the poor such as social marketing, tailoring services to the poor, franchising, high volume and low unit cost. Social marketing involves implementing marketing techniques to attain behavioural change by creating training and peer education programs that concentrate on behavior change in schools, prisons, the sex industry and the public. Tailoring services to the poor focuses on tailoring services and products towards the needs of the poor while franchising, high volume and low unit cost concentrate on the enlargement and sustainable distribution of products and services of specific quality in reproductive health with low costs.

Battacharyya et al. (2010) added that other marketing activities involve operating activities and financial strategies which aim to provide products and services at lower costs while maintaining quality of services. These financial strategies include lower operating costs through simplified medical services, high volume and low unit costs, cross subsidization and income generating mechanisms. Leggat, Bartram, Casimir, and Stanton (2010) similarly emphasize that improvement in health service delivery substantially relies on job satisfaction and empowerment of health workers and found that improved autonomy, decision making and empowerment were linked to lower patient mortality rates. Similarly, Mukherjee and Malhotra (2006) emphasize that freedom to plan one’s work, participation in decision making, role clarity and psychological support from supervisors motivates employees to improve service delivery. The need for efficient health services is a concern for countries worldwide but in the end people have to be provided with quality services within an integrated delivery network (coordinated continuum of services) that are not fragmented (Ramagem, Urrutia, Griffith, Cruz, Fabrega, Holder & Montenegro, 2011). Some of the benefits of an integrated delivery network include improved access to health services, decreased inappropriate costs, prevention of duplication of infrastructure and services, reduction of costs and responding better towards people’s health needs (Ramagem et al., 2011).
Travis et al. (2004) elaborate that strengthening health systems is fundamental to attain enhanced service delivery, but stress that strengthened health systems cannot achieve expected results unless they are effective. Shortell (2004) describes that health systems requires advanced knowledge that should be put into action to attain the improved health services. Travis et al. (2004) argue that the problem is not putting the existing knowledge into practice but identifying effective health systems that will lead to expected outcomes. Vertical approaches (planning, staffing, management and financial systems) and horizontal approaches (operate within the existing health system’s structures) are used with the aim of improving services.

There is a need for policy relevance and innovations techniques, more focus on strengthening commitment and investment in terms of research capacity of the developing countries (Travis et al., 2004). Stable (2000) argues that health care services can be improved through transparent processes that take place during the engagement of the new model for effective delivery of service and highlights four phases that should be considered for effective service delivery, namely, identification of a problem, community profile (the population group to whom the services are delivered), implementation (services required, quality of services, costs and challenges must be known) and evaluation (expectations of what is required should be clear).

Effective communication and consultation are regarded as key elements that need a careful consideration in any change process taking place in an organization (Stable, 2000). Wright and Baker (2005) maintain that using appreciative inquiry allows easy transition from conversation to action and provides energy as well as motivation for the health workers in order to improve health services as it allows them to feel a sense of ownership and responsibility for both their decisions and actions. Similarly, Conner and Finnemore (2003) suggest same time/same place (face-to-face collaboration) and same time/any place methods of communication (phone and video conferencing, team room and digital collaborative technology). Although the former saves time and costs, it limits social and physiological benefits but the latter is beneficial for health care providers where working with shifts is concerned and results in improved work efficiency and improved service delivery. Furthermore, effective communication across the structural departments within an organization enhances successful implementation of its plans (Greenhalgh, Robert, Macfarlane, Bate, & Kyriakidou, 2004). McCallin (2001) explains that teamwork cannot function well without proper communication among health workers; hence, team effectiveness relies on effective communication. According to Robinson, Gorman, Slimmer & Yudkowsky (2010), factors that contribute to effective communication among nurses and physicians include, but are not limited to, clarity and precision of message that relies on verification, collaborative problem solving, maintenance of mutual respect and authentic understanding of the unique professional role. Working together as a team to solve problems and respect for one another contributes a lot to good relationships and effective communication (Robinson et al., 2010).

Unlike other countries that have opted for other health reforms for improved health services, Cambodia used contracting as an approach to improve health service delivery (Soeters & Griffiths, 2003). Campinha-Bacote (2002) acknowledges the various models that have emerged to overcome the challenges of health service delivery and believes that the cultural competence model may add more value in health service delivery. She explains her model as a continuous process whereby health care providers should make an effort to attain the ability to work within the cultural context of the customer. The model needs health workers to be culturally competent. The model is categorised into five parts, namely, cultural awareness, cultural knowledge, cultural skill, cultural encounters and cultural desire.

Cultural awareness is about self-examination and indepth exploration of one’s own cultural and professional background. It includes individual’s recognition of biases, prejudice and assumptions about other people who are different and helps to avoid the risk of cultural imposition. Cultural knowledge involves learning or acquiring educational foundation from different cultural and ethnic groups. Health providers have to take into consideration knowledge of clients’ health-related beliefs and cultural values, disease incidence and prevalence and treatment efficacy which will eventually allow them to understand the clients’ world view (Campinha-Bacote, 2002). Brown and Busman (2003) share the experience of Saudi Arabia whereby more expatriates are employed due to high population growth and low number of health workers which affects the health service delivery due to the cultural and communication barrier between the patients and the expatriates. Some mechanisms such as education and training for Saudi Arabian health workers have been implemented but they cannot reach the number that is needed. On the other hand, cultural skill assists health providers to gather relevant data concerning the clients’ prevailing problem and performing a culturally based physical assessment. Cultural encounters provides an opportunity for health providers to interact with clients from different cultural backgrounds and, therefore, helps them not to be stereotyped when it comes to other individuals’ culture and values. Through Cultural encounters, health workers can identify clients’ linguistic needs and find an interpreter where necessary. Cultural desire has to do with the health providers’ care towards the clients since people are concerned about
how much one cares than how much one knows (Campinha-Bacote, 2002).

Enor and Cooper (2004) mention that some of the interventions implemented by different countries brought significant changes in health service delivery. Those interventions are education and information provided to community educators through training, funds provided to reduce transport costs for patients who travel to the health centres and maternity waiting homes near districts hospitals. Community educators are basically women in the target communities who can encourage or influence families of the importance of maternal care and help to facilitate admission to hospital during emergencies. Basic education plays a key role to some extent to increase the desire and actual use of health services. Education yet again assists individuals to make informed decisions concerning their lifestyle, that is, they can take care of their health themselves without relying on health services. This implies the need to implement methods of improving literacy. Countries such as Zimbabwe and Ethiopia report high use of hospitals and decreased rates of complications for the subsequent delivery as a result of these interventions. On the contrary, Ghana and Zaire also established maternity homes but were not positively received because they were located in isolated areas without facilities to prepare food. The need for consultation with the community is essential before implementation of any intervention. Burundi invested in roads with the aim of improving access to health care. Bangladesh implemented a door-to-door provision of family planning services and it has been successful in overcoming consumer costs and social objections to women obtaining services outside the home. However, it has been reviewed as it was expensive. Recent policy re-oriented the focus to delivery of services to the community clinics as opposed to door-to-door provision (Ensor & Cooper, 2004). Powers and Jack (2008) advocate the use of volume flexibility which is categorized into internal and external strategies. Volume flexibility has to do with the organization’s ability to efficiently manage output levels in response to the fluctuations in demand for its current products or services without incurring high transition penalties or large changes in performance outcome. The internal strategies in this regard are based on the resources, processes and capabilities that the organizations own. On the other hand, external strategies that include outsourcing (provided that the outsourcing strategy is understood) and strategic alliances, risk pooling, managed care controls as well as pricing and rationing strategies can be implemented. Demand management strategies (promotion programs, induced demand techniques) can be used to reduce demand uncertainty (Powers & Jack, 2008).

During the transformation that took place in South Africa in 1994, the new government established three service delivery initiatives with the aim of improving service delivery. The first initiative was Bathopele which means people first. This initiative was published in 1997 and has eight principles: (1) to regularly consult with customers about a level and quality of public service they get (2) To set service standards so that people will be aware of what to expect in terms of level and quality of services they have to receive (3) To increase access to services to allow citizens to have equal access to the services to which they are entitled, (4) To ensure high level of courtesy and consideration, (5) Provision of more and better services and information for people to be well informed of services that they ought to receive, (6) Increasing openness and transparency about services (7) To remedy failures and mistakes and (8) give possible value for money (economical and efficient provision of services) (Russell & Bvuma, 2001). The second initiative was Public Private Partnerships which aimed at improving services and cost effectiveness. The third initiative was Alternative Service delivery. It includes Information Technology, significant management improvement, accelerated training and development of staff at all levels, redeployment of resources in the budget to higher priority areas, effective review and accountability measures and seeks to focus attention on innovative delivery solutions at the customer end (Russell & Bvuma, 2001).

1.4 Challenges experienced in health care service delivery

Some of the challenges faced in health care delivery systems are improving quality, increasing access and reducing costs (Andaleeb, 2001). McIntyre and Klugman (2003) share the challenges that South Africa experienced during the restructuring of health services. They explained that there is a lack of effective communication between the senior provincial officers and local government representatives especially in policy decisions which eventually affects their daily planning and delivery of services. Jacobs, Lauderdale, Meltzer, Shorey, Levinson & Thisted (2001) take this concept further by pointing out that communication is not only a barrier among health workers but also a problem between a health worker and a patient. Jacobs et al. (2001) explain that a language barrier still exists in many hospitals. Various studies that have been undertaken reveal that patients who are unable to speak the English Language well receive unsatisfactory health services and this denies them to receive preventive and other services. Although interpreter services are introduced, they are not adequate in number and in some cases untrained nonclinical employees have to interpret which result in negative clinical consequences such as breach of patient confidentiality, misdiagnosis and inadequate or inaccurate treatment (Jacobs et al., 2001). Kulwicki, Miller, and Schim (2000) agree that there is lack of bilingual health care providers and there is a need for
cultural awareness, for example, in some countries, culturally, female patients cannot be diagnosed by male health providers. Duncan and Breslin (2009) assert that it is difficult for health workers to provide innovative services due to inadequate incentives. Some of the challenges facing the United States of America within the health care systems are the rise of value and services delivered of which they include quality and cost features (Shortell, 2004). Shortell (2004) points out that health systems also face challenges at managerial level. Also, several health reforms do not have explicit objectives and this makes it difficult to evaluate the success and failures in attaining the objectives (Preker & Harding, 2003).

1.5 Decentralization of health services: Experiences from International and local countries

There are some benefits that are obtained from decentralization of services such as being able to make decisions based on people’s needs since decision makers are much closer to the people and their needs. This helps local decision makers to align the services and public expenditure with their local needs and preferences. Eventually this may lead to improved service delivery (Saavetra-Costas, 2009). The decentralization involved in South Africa’s process of restructuring of health services was in two forms, namely, the devolution of authority to provincial and local governments and, the decentralization of services from provincial health to health district. National government in this regard was responsible for policy development while provinces had a responsibility of service provision and hospital services with more focus on curative primary health care. Some of the challenges faced during the restructuring process were uncertainties about responsibilities and line of accountability, the health workers had to account to both provincial and facility managers, poor staff morale and working conditions, problems concerning infrastructure, availability of drugs and, staff attitude towards patients. According to the analysis of the study, people believe that the focus was on restructuring and transition and less on service delivery (McIntyre & Klugman, 2003).

Regmi, Naidoo, Greer, and Pilkinson (2010) mention that many countries opt for decentralization of services with the aim of improving service delivery in aspects such as accessibility, reduction of costs and community participation. A successful decentralization of health service experienced by Nepal reports the benefits of improved availability of drugs due to pressure from local representatives, ability of community to communicate their needs and expectations to the public health representatives locally, reduced absenteeism for the reason that local representatives are around physically to assess the situation and an increase in community satisfaction with the services (Regmi et al., 2010). However, a failure in Nepal is that little fiscal decentralization took place which led to more resources still being controlled and managed at central level.

Sakyi (2010) identified some of the shortfalls during the decentralization of services that took place in Ghana as lack of effective and timeous communication, inadequate information concerning reforms, lack of participation of and consultation with health workers, the top-down style of communication and the communication gap between district managers and relevant stakeholders that affected service delivery. Eggleston, Ling, Qingyue, Lindelow, and Wagstaff (2008) report that changes in China’s health sector were only seen in urban areas and only improved quality to a certain degree and results indicate that China requires improvement in health service delivery with regard to quality, responsiveness to patients, efficiency and equity.

According to Ramani and Mavalankar (2006), India implemented health reforms in 2004 which took place in nine states and improvements reported include the establishment of logistic management system to coordinate the purchase of drugs, storage and distribution of drugs and medicines. Following its success, the system was replicated in over 450 government hospitals in one of the states where health reform took place. The Telemedicine Centre plays a key role in improving health service delivery. The country, however, still experiences challenges especially in rural areas in terms of access, affordability and equity of services. According to Aksan, Ergin, and Ocek (2010), Turkey embarked on health reforms with the aim of addressing issues such as inequalities in access to health services and fragmentation in financing and delivery of health services. Restructuring of the Ministry of Health in Turkey was done with the aim of enhancing the stewardship function. Some of the health services like laboratory and radiodiagnostic services were outsourced to improve health services. The government also incorporated private hospitals by increasing incentives for investment.

1.6 Measuring the quality of services

Service quality is defined as “the valuation that the consumer makes of the excellence or superiority of the services” or “discrepancy between consumer’s perceptions of services offered by a particular firm and their expectations about firms offering such services” (Zeithaml, Berry, & Parasuraman, 1988). According to Ramsaran-Fowdar (2008), theoretical perspectives on service quality were developed in 1980s. There are two types of service quality, namely, technical quality which refers to core service delivery or service outcome and, functional quality which involves service delivery processes or the manner in which customers receive the service. Lu and Liu (2000) add that in the health care environment, technical quality involves factors such as average
length of stay, re-admission rates, infection rates and outcome measures whilst functional quality includes factors like doctors’ and nurses’ attitudes towards patients, cleanliness of facilities and quality of food given to patients.

Jensen and Markland (1996) emphasize that it is critical for individuals who deliver services to be assessed because good service is determined by their performance and any changes made, affects their work. Jensen and Markland (1996) advocate that organizations should evaluate quality measurement systems like SERVQUAL and identify the one that will best suit the needs of the organization. Babakus and Mangold (1992) believe that SERVQUAL has been known for its potential usefulness in the hospital environment and mention that service industries identify quality as the main determinant of cost reduction, market share and return on investment. This instrument can also be used internally to understand the employees’ perceptions about the service quality with the aim of improving services (Fedoroff, 2012). This instrument comprises of five dimensions: (1) tangibles - physical facilities, equipment, and appearance of personnel (2) reliability - ability to perform required services dependably and accurately (3) Responsiveness - willingness to assist customers and provide prompt services (4) assurance - knowledge and courtesy of employees and their ability to inspire trust and confidence and (5) empathy - caring and individual attention given to the customers (Carrillat, Jaramillo & Mulki, 2007). Assessing these dimensions in a health care environment is critical as they repeatedly surfaced as challenges and areas for improvement in the preceding discussions.

Hence, this paper aims to evaluate health care employees’ perceptions of service quality (tangibles, reliability, responsiveness, assurance, empathy) in a hospital environment after the process of restructuring and to assess whether these perceptions are influenced by biographical profiles (gender, job category, age, tenure, qualification) respectively.

2 Research design

2.1 Respondents

In this study the population comprises of employees from three of the largest regional hospitals within the Ministry of Health in Lesotho who were in the employ of the organization from before the restructuring, making up a population of approximately 800 clinical and support staff. It must be noted that management for clinical and support staff is already included in the population of 800. The researcher used a sample of 143 employees. The adequacy of the sample was determined using the Kaiser-Meyer-Olkin Measure of Sampling Adequacy (0.883) and the Bartlet’s Test of Sphericity (1696.124, p = 0.000) for the five sub-dimensions assessing service quality after the process of transformation, which respectively indicated suitability and significance. The results indicate that the normality and homoscedasticity preconditions are satisfied. A computer programme was used to select employees from the Ministry of Health staff list who were in the employ before and after the restructuring took place. Managers of the respective departments distributed the questionnaires to the selected subjects during one of their weekly meetings.

The composition of the sample may be described in terms of age, gender, job category, tenure and education. With regards to age, 36.4% of the participants were between 26-35 years followed by those between 36-45 years (33.6%), thereby indicating that the majority of the sample (70%) was between the ages of 26-45 years old. There were more females (81.1%) than males (18.9%) and more clinical services staff (72%) than non-clinical services employees. The majority of the respondents served the organization for 11-20 years (33.6%), followed by 1-5 years (25.9%), followed by 6-10 years (23.8%) thereby indicating that 83.3% of the sample have a tenure of 1-20 years. The majority of the participants have a diploma (51%) and a further 27.3% hold a degree.

2.2 Measuring Instrument

Data was collected using a questionnaire that was adapted from both SERVQUAL developed by Parasuraman, Zeithaml and Berry (1988) and SPUTNIC (undated) and comprised of two sections. Section A comprised of biographical data relating to age, gender, job category, tenure and education and was measured using a nominal scale. Section B consisted of 22 items pertaining to the perception of employees of the sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance, empathy) after the process of restructuring. Subjects were reminded that the items relate to their perceptions of the sub-dimensions of service quality after the process of restructuring. Section B was measured using a five point Likert scale ranging from (1) strongly disagree, (2) disagree, (3) neither agree nor disagree, (4) agree to (5) strongly agree. In-house pretesting was adopted to assess the suitability of the instrument. Pilot testing was also carried out using 12 subjects, selected using the same procedures and protocols adopted for the larger sample. The feedback from the pilot testing confirmed that the questionnaire was appropriate in terms of relevance and construction.

2.3 Measures/statistical analysis of the questionnaire

The validity of the questionnaire was assessed using Factor Analysis. A principal component analysis was used to extract initial factors and an iterated principal factor analysis was performed using SPSS with an Orthogonal Varimax Rotation. In terms of the validity of the section relating to perceptions of service
delivery after the process of transformation, the five service quality dimensions (assurance, reliability, tangibles, empathy, responsiveness) were generated with respective eigenvalues being greater than unity (4.664, 3.056, 2.756, 2.601, 1.832). The items assessing perceptions of the transformation process were also reflected as having a very high level of internal consistency and reliability, with the Cronbach's Coefficient Alpha being 0.922.

2.4 Statistical analysis of the data

Descriptive statistics (means, standard deviations) and an inferential statistic (correlation, Mann-Whitney test, Kruskal-Wallis ANOVA) will be used to evaluate objectives and hypothesis of the study.

3 Results

3.1 Descriptive Statistics

The perceptions of health care employees regarding the sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance, empathy) was assessed by asking respondents to rate the various aspects of service quality using a 1 to 5 point Likert scale. The results were processed using descriptive statistics (Table 1). The greater the mean score value, the more positive the perceptions of service delivery after the process of transformation.

Table 1. Descriptive statistics: sub-dimensions of service quality

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Mean</th>
<th>95 % Confidence Interval</th>
<th>Variance</th>
<th>Std. Dev.</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Lower Bound</td>
<td>Upper Bound</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tangibles</td>
<td>3.247</td>
<td>3.103</td>
<td>3.390</td>
<td>0.746</td>
<td>0.864</td>
<td>1</td>
</tr>
<tr>
<td>Reliability</td>
<td>3.105</td>
<td>2.974</td>
<td>3.237</td>
<td>0.627</td>
<td>0.792</td>
<td>1</td>
</tr>
<tr>
<td>Responsiveness</td>
<td>3.310</td>
<td>3.183</td>
<td>3.438</td>
<td>0.592</td>
<td>0.769</td>
<td>1</td>
</tr>
<tr>
<td>Assurance</td>
<td>3.338</td>
<td>3.256</td>
<td>3.495</td>
<td>0.516</td>
<td>0.718</td>
<td>1</td>
</tr>
<tr>
<td>Empathy</td>
<td>3.385</td>
<td>3.269</td>
<td>3.501</td>
<td>0.488</td>
<td>0.698</td>
<td>1</td>
</tr>
</tbody>
</table>

From Table 1 it is evident that the respondents have varying views of the sub-dimensions of service quality after the process of transformation, which in descending level of mean score value is:

- Empathy (Mean = 3.385);
- Assurance (Mean = 3.338);
- Responsiveness (Mean = 3.310);
- Tangibles (Mean = 3.247);
- Reliability (Mean = 3.105).

From the results it is evident that employees believe that after the restructuring health care workers have improved levels of empathy, followed by assurance, responsiveness, tangibles and lastly, reliability. Whilst respondents have a most positive view of the impact of restructuring on service delivery, when compared again a maximum attainable score of 5 it is evident that there is room for improvement in each of the sub-dimensions of service quality. In order to assess where these improvements lie, frequency analyses were conducted.

In terms of empathy, respondents believed that as a result of the restructuring the hospital/clinic (64.6%) and hospital personnel (52.8%) is able to give patients individual attention and 57% felt that the hospital/clinic has the patient’s best interests at heart. Furthermore, whilst 49.2% of the respondents agreed that the restructuring has enabled personnel of the hospital/clinics to better understand the specific needs of patients, 38.7% were not convinced that the restructuring has led to such improvement. In addition, 42.9% of the respondents are uncertain whether the process of restructuring has made the operating hours of the hospital/clinics convenient to all its patients.

In terms of assurance, respondents believed that as a result of the restructuring process personnel has learnt to behave in ways that instills confidence in patients (51.1%), are consistently courteous to patients (56.1%) and have the knowledge to answer patient’s questions (71.8%). However, 51.7% of the respondents were not convinced that the process of restructuring has made patients feeling safer in their interactions with the hospital/clinic.

In terms of responsiveness, respondents agreed that after the restructuring the personnel of the hospital/clinic are able to tell patients exactly when services will be performed (67.6%) and are always willing to help patients (62.7%). Furthermore, whilst 35% of the respondents felt that as a result of the restructuring personnel in the hospital/clinic are never busy to respond to patients’ requests, 37.1% were not convinced and a further 37% disagreed. In addition, a significant percentage of the staff were not convinced that after the restructuring, personnel of the hospital give prompt service to patients (43.7%) and a further 22.5% disagreed that they do.

In terms of tangibles, respondents believed that as a result of the restructuring the physical facilities at the hospital/clinic are visually more appealing (68.3%), personnel in the hospital/clinic are neat in appearance (61.5%) and that materials associated with the service such as pamphlets or statements are...
visually appealing (64.8%). However, whilst 37.1% of the respondents indicated that after the restructuring the hospital/clinic has modern equipment, a significant 46.9% disagreed and a further 16.1% were uncertain.

In terms of reliability, respondents reflected that as a result of the restructuring when a patient has a problem the hospital/clinic shows a sincere interest in solving it (60.1%) and that the hospital/clinic insists on error-free records (64.6%). Furthermore, whilst 33.8% of the respondents agreed that the restructuring has ensured that when the hospital/clinic promises to do something by a certain date it does it, a significant percentage disagreed that this happens (38.7%) and a further 27.5% were uncertain. In addition, whilst 64.6% of the respondents indicated that the restructuring has enabled the hospital/clinic to provide its service at the time that it promises to do so, 31.5% disagreed and a further 28.7% were uncertain. Also, 38% of the respondents were uncertain that as a result of the restructuring the hospital/clinic gets things right the first time and 41.6% indicated that they do not get things right the first time.

3.2 Inferential Statistics

Inferential statistics were conducted to test the hypotheses of the study relating to perceptions of the sub-dimensions of service quality after the process of restructuring.

3.2.1 Relationship between sub-dimensions of service quality

Hypothesis 1. There exists significant intercorrelations amongst the sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance, empathy) respectively (Table 2).

Table 2. Intercorrelations: sub-dimensions of service quality

<table>
<thead>
<tr>
<th>Sub-dimension of Service Quality</th>
<th>Tangibles</th>
<th>Reliability</th>
<th>Responsiveness</th>
<th>Assurance</th>
<th>Empathy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangibles</td>
<td>r 1</td>
<td>p 0.477**</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reliability</td>
<td>r 0.281*</td>
<td>p 0.509*</td>
<td>0.469*</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Responsiveness</td>
<td>r 0.245*</td>
<td>p 0.642*</td>
<td>0.690*</td>
<td>0.000*</td>
<td></td>
</tr>
<tr>
<td>Assurance</td>
<td>r 0.117*</td>
<td>p 0.687*</td>
<td>0.851</td>
<td>0.038**</td>
<td></td>
</tr>
<tr>
<td>Empathy</td>
<td>r 0.000*</td>
<td>p 0.000*</td>
<td>0.000*</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*p < 0.01

Table 2 indicates that the sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance, empathy) significantly intercorrelate with each other at the 1% level of significance, except for tangibles and empathy which show no significant relationship. Therefore, hypothesis 1 may only be partially accepted at the 1% level of significance. In particular, strong, direct and significant relationships were noted between assurance and responsiveness and empathy respectively at the 1% level of significance.

3.2.2 Impact of biographical variables

The influence of the biographical variables (gender, job category, age, tenure, qualification) on health care employees’ perceptions of the sub-dimensions of service quality as a result of the process of restructuring were evaluated using tests of differences (Mann-Whitney test, Kruskal-Wallis Analysis of Variance) respectively.

Hypotheses 2. There is a significant difference in the perceptions of health care employees varying in biographical profiles (gender, job category, age, tenure, qualification) regarding the sub-dimensions of service quality as a result of the process of restructuring (tangibles, reliability, responsiveness, assurance, empathy) respectively (Table 3 to Table 6).
Table 3 indicates that there is a significant difference in the perceptions of male and female health care employees regarding empathy whereby females reflect higher levels of empathy as reflected in the mean scores (Mean = 3.432) than males (Mean = 3.185) at the 5% level of significance. No other significant differences were noted between males and females regarding the remaining sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance) respectively. Hence, hypothesis 2 may only be accepted in terms of gender and empathy at the 5% level of significance.

Table 4. Mann-Whitney test: sub-dimensions of service quality and job category

<table>
<thead>
<tr>
<th>Sub-dimension of Service Quality</th>
<th>Mann-Whitney U</th>
<th>Z</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangibles</td>
<td>1756.5</td>
<td>-1.378</td>
<td>0.138</td>
</tr>
<tr>
<td>Reliability</td>
<td>2022.0</td>
<td>-0.172</td>
<td>0.864</td>
</tr>
<tr>
<td>Responsiveness</td>
<td>1649.5</td>
<td>-1.685</td>
<td>0.062</td>
</tr>
<tr>
<td>Assurance</td>
<td>1202.5</td>
<td>-3.894</td>
<td>0.000*</td>
</tr>
<tr>
<td>Empathy</td>
<td>1353.0</td>
<td>-3.140</td>
<td>0.002*</td>
</tr>
</tbody>
</table>

No other significant differences were noted between males and females regarding the remaining sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance) respectively. Hence, hypothesis 2 may only be accepted in terms of gender and empathy at the 5% level of significance.

Table 4 indicates that there is a significant difference in the perceptions of health care employees varying in job category (clinical and non-clinical staff) regarding assurance and empathy whereby clinical staff reflected higher levels of assurance as reflected in the mean scores (Mean = 3.491) than non-clinical staff (Mean = 3.044) and the former also reflected higher levels of empathy (Mean = 3.480) than the latter (Mean = 3.143) at the 1% level of significance. No other significant differences were noted between clinical and non-clinical staff regarding the remaining sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance) respectively. Hence, hypothesis 2 may only be accepted in terms of job category and assurance and empathy respectively at the 1% level of significance.

Table 5. Kruskal-Wallis Anova: sub-dimensions of service quality and age and tenure

<table>
<thead>
<tr>
<th>Sub-dimension of Service Quality</th>
<th>Age</th>
<th></th>
<th></th>
<th></th>
<th>Tenure</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Kruskall-Wallis Statistic</td>
<td>Df</td>
<td>p</td>
<td></td>
<td>Kruskall-Wallis Statistic</td>
<td>Df</td>
<td>p</td>
</tr>
<tr>
<td>Tangibles</td>
<td>7.705</td>
<td>4</td>
<td>0.103</td>
<td>4.950</td>
<td>4</td>
<td>0.293</td>
<td></td>
</tr>
<tr>
<td>Reliability</td>
<td>5.129</td>
<td>4</td>
<td>0.274</td>
<td>4.901</td>
<td>4</td>
<td>0.298</td>
<td></td>
</tr>
<tr>
<td>Responsiveness</td>
<td>1.991</td>
<td>4</td>
<td>0.737</td>
<td>8.870</td>
<td>4</td>
<td>0.064</td>
<td></td>
</tr>
<tr>
<td>Assurance</td>
<td>1.917</td>
<td>4</td>
<td>0.751</td>
<td>4.029</td>
<td>4</td>
<td>0.402</td>
<td></td>
</tr>
<tr>
<td>Empathy</td>
<td>2.126</td>
<td>4</td>
<td>0.713</td>
<td>3.719</td>
<td>4</td>
<td>0.445</td>
<td></td>
</tr>
</tbody>
</table>

Table 5 indicates that there is no significant difference in the perceptions of health care employees varying in age and tenure regarding the sub-dimensions of service quality (tangibles, reliability, responsiveness, assurance) respectively. Hence, hypothesis 2 may be rejected in terms of the sub-dimensions of service quality and age and tenure respectively.

Table 6. Kruskal-Wallis Anova: sub-dimensions of service quality and qualification

<table>
<thead>
<tr>
<th>Sub-dimension of Service Quality</th>
<th>Kruskall-Wallis Statistic</th>
<th>Df</th>
<th>p</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangibles</td>
<td>2.008</td>
<td>4</td>
<td>0.734</td>
</tr>
<tr>
<td>Reliability</td>
<td>16.092</td>
<td>4</td>
<td>0.003*</td>
</tr>
<tr>
<td>Responsiveness</td>
<td>9.708</td>
<td>4</td>
<td>0.046**</td>
</tr>
<tr>
<td>Assurance</td>
<td>9.749</td>
<td>4</td>
<td>0.045**</td>
</tr>
<tr>
<td>Empathy</td>
<td>20.376</td>
<td>4</td>
<td>0.000*</td>
</tr>
</tbody>
</table>

* p < 0.01
** p < 0.05

Table 6 indicates that there is a significant difference in the perceptions of health care employees varying in qualification regarding reliability and empathy respectively at the 1% level of significance and responsiveness and assurance respectively at the 55 level of significance. Mean analyses indicate that the perceptions of health care employees regarding the sub-dimensions of service quality (reliability, empathy, responsiveness, empathy) after the process of restructuring became more positive as their
qualifications increased up until a Degree qualification and dropped for health care employees with a Masters degree. No significant differences were noted in the perceptions of health care employees varying in qualification regarding tangibles after the process of restructuring. Hence, hypothesis 2 may only be accepted in terms of qualification and reliability, empathy, responsiveness and empathy respectively at the 1% level of significance and not in terms of tangibles.

4 Discussion of results

4.1 The sub-dimensions of service quality after the restructuring

The results reflect that employees were fairly convinced that the process of transformation undertaken in the health care organization led to enhanced service quality in terms of improved empathy, assurance, responsiveness, tangibles and reliability (Mean scores ranged from 3.105 to 3.385 against a maximum attainable score of 5) thereby respectively indicating increased some room for further improvement. In terms of their perceptions of the restructuring in enhancing empathy, employees were not convinced that the restructuring has enabled personnel of the hospital/clinics to better understand the specific needs of patients nor made the operating hours of the hospital/clinics convenient to all its patients. In this regard, Nauert (2002) suggests adopting business strategies such as environmental assessments of market wants, needs and demands and Ramgem et al. (2011) emphasizes that an integrated delivery network will improve access to health services and respond better towards people’s health needs. Except for the current strategies used to improve health services such as flexible hours, efficiency measures and, information technology, Powers and Jack (2008) suggest that organizations can increase their flexibility by relying on multi-skilled employees like nurse practitioners and physician assistants. In terms of the service quality dimension of assurance, employees did not believe that the restructuring process made patients feel safer in their interactions with the hospital/clinic. This triggers the importance of South Africa’s first service delivery initiative of Bathopele which means people first and is based on eight principles of service delivery (Russell & Byuma, 2001). With regards to responsiveness, a significant percentage of the employees were not convinced that responding to patient’s requests improved after the restructuring. Oliveira-Cruz, Hanson, and Mills (2003) mention that one of the constraints of health service delivery is the shortage and distribution of qualified staff. Nauert (2002) suggests the business strategy of incorporating system linkages with key physicians and other providers and the strengthening of executive direction to enhance business performance (Nauert, 2002). In terms of tangibles, employees felt that the restructuring did not result in the provision of modern equipment. This is ironic as Clancy (2006) believes that equipment is a fundamental resource for health service delivery and Oliveira-Cruz, Hanson, and Mills (2003) identify the lack of equipment as a constraint of health care service delivery. In terms of the service quality dimension of reliability, a large percentage of employees felt that the restructuring did not improve reliability of service in that services were not still delivered according to set date and time and things are not done right the first time. This result confirms Loevinsohn and Harding’s (2005) notion that allocating more resources to health services does not necessarily address the problem of service delivery. This is particularly true, considering that the quality of health care service delivery depends on job satisfaction and empowerment of health workers (Leggat et al., 2010), participation in decision making and psychological support from supervisors (Mukherjee & Malhotra, 2006) as well as effective communication (McCallin, 2001; Robinson et al., 2010).

Furthermore, the five sub-dimensions of service quality as perceived by employees after the process of transformation correlate significantly with each other at the 1% level of significance except for tangibles and empathy which do not relate. The implication is that business strategies designed and adopted, during and after the restructuring process, to improve each sub-dimension of service quality individually has the potential to snowball and improve employee perceptions of health care service delivery as a whole. Conversely, failure to manage each of the sub-dimensions of service delivery after the transformation process can perpetuate negative perceptions of the restructuring and bring about a failed process in enhancing health care service delivery. The significant relationships amongst these five sub-dimensions of health care service delivery emphasizes the need for an unfragmented and integrated delivery network as proposed by Ramgem et al. (2011).

4.2 The impact of biographical variables

The results also indicate that perceptions of the service quality dimension of empathy after the restructuring process is significantly influenced by gender, job category and qualification. The qualification of employees also influenced their perceptions of reliability, responsiveness and assurance after the restructuring. No other biographical influences were noted. Whilst these biographical influences were noted, employees’ perceptions of these sub-dimensions of service delivery may also be influenced by staff attitude towards patients (McIntyre & Klugman, 2003).
5 Recommendations and conclusion

The results of the study reflect obvious recommendations which when implemented have the potential to result in enhanced service delivery and a more successful restructuring process (Table 7).

Table 7. Recommendations to enhance each of the sub-dimensions of service quality

<table>
<thead>
<tr>
<th>Sub-dimensions of service quality</th>
<th>Recommendation</th>
</tr>
</thead>
</table>
| Empathy                          | ● Understand the specific needs of patients.  
                                      ● Adopt business strategies such as environmental assessments of market wants, needs and demands  
                                      ● Make operating hours of the hospital/clinics convenient to all patients and take cognisance of those travelling distances.  
                                      ● Increase flexibility in service delivery by relying on multi-skilled employees like nurse practitioners and physician assistants. |
| Assurance                        | ● Make patients feel safer in their interactions with the hospital/clinics as medical setbacks can be a daunting experience.  
                                      ● Adopt and effective implement the eight principles of Bathopele for enhanced service quality and delivery. |
| Responsiveness                   | ● Respond to patients’ requests promptly.  
                                      ● Ensure that the hospital/clinics are sufficient and qualified staff.  
                                      ● Incorporate system linkages with key physicians and other service providers.  
                                      ● Ensure strengthened executive direction in order to enhance business performance. |
| Tangibles                        | ● Ensure the provision and effective utilisation of modern equipment.  
                                      ● Ensure that staff are trained to use the modern equipment and that they are not under-utilized. |
| Reliability                      | ● Deliver promised service according to set date and time.  
                                      ● Do things right the first time as this is imperative in health care.  
                                      ● Ensure that staff are satisfied, empowered, engage in decision making and receive psychological support from supervisors and effective communication and these motivate employees to perform optimally and enhance service quality. |
| Overall                          | ● Monitor employee attitudes to patients.  
                                      ● Ensure an unfragmented and integrated health care service delivery network |

Health care service delivery is a challenge in many countries and health care organizations are trying to overcome the obstacles to improved health services. Whilst identifying strategies to improve health services is vital, it is also imperative to ensure that the strategies are selected by taking cognisance of the cultural and environmental context in which they are to be implemented. The provision of quality health care service delivery means ensuring improved and equal access to health services, enlarged access to priority health interventions, reduction in costs to ensure affordability and responding effectively to people’s health needs. Accomplishing this not only requires business and financial strategies but also effective human resource management and communication strategies because keeping staff motivated is imperative in nurturing proper attitudes towards patients thereby enhancing health care service quality. Regular service delivery surveys will provide feedback on patients’ perceptions of service quality in relation to tangibles, reliability, responsiveness, assurance and empathy and provide insight into staff attitudes and behaviours. People must be provided with a well coordinated continuum of services in an integrated way in order to ensure effective service quality.

References


DEVELOPMENT IN WESTERN IDEOLOGY OF ENTREPRENEURIALISM AND THEIR (MIS)APPLICATIONS IN THE CONTEXT OF NON-WESTERN CULTURES

Helan Ramya Gamage*, Ananda Wickramasinghe**

Abstract

The focus of this article is a conceptual analysis of the western entrepreneurship paradigm and its practical implications, based on a desktop approach. In order to bring a holistic view of the western paradigm, the following questions were raised: What constitutes the western paradigm of entrepreneurship? How does this paradigm transfer to other cultures? Why is this paradigm criticized? The purpose of evaluating the western paradigm is to gain an understanding of western ideologies in entrepreneurship to consider a suitable methodology for an alternative approach in entrepreneurship research. The different disciplinary perspectives and the reductionist approach of the western paradigm resulted in limited returns to entrepreneurship programs since one disciplinary perspective can never handle all relevancies of entrepreneurial holism. It may be better to seek a context-sensitive alternative approach.

Keywords: Indigenous Entrepreneurship, Cultural Practices in Context, Critical Perspectives on Entrepreneurship Practice, an Alternative Approach in Entrepreneurship Research

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1 Introduction

The specific question of the appropriateness of a western philosophy to entrepreneurial activity in other cultures is analysed. It has generally been believed that knowledge from the developed western context can be introduced to and applied in developing countries. As a result the influence of the west on ideas and practices in non-western countries has been strong (Sinha 1999). Recent developments in cultural awareness within developing countries have belatedly led to questioning of the utility of western management concepts and practices transferred to Asia (Kao et al. 1999). Most contemporary scholars argue that the quest for economic and industrial development in developing countries through such traditional western ideologies creates challenges (Fink et al. 1983; Kao et al. 1999; Sexton 1987; Sinha 1999) and may also be inadequate (Hofstede 1994; Adler, 1997; Alawattage 1998; Nanayakkara 1999; Wickramasinghe & Hopper 2000). It has been asserted that little is known about the effectiveness of cross-border transfer of organizational knowledge involving dissimilar cultural contexts (Bhagat et al., 2002). It appears that the western entrepreneurship paradigm does not draw on the deep-rooted settings in society and culture of many developing countries. This paper critically and conceptually analyses the western entrepreneurship paradigm and its implications of applying in non-western cultures with some reflections from Asian context.

2 Entrepreneurial thought as history: The Western paradigm

Since the 16th century, industrialisation in the west has provided the seedbed for the development of modern economic theories. The early traditional craft system in the west constituted the historical entrepreneurial culture in western societies. It was legitimised by
society and characterised by local markets, a stable and predictable life cycle and a hierarchical social order (Paula 1996; Ross 1999). Industrialisation produced an environment which was quite different from the medieval handicraft system. This radical change of the economy in the west has been given priority in academic discourse. It has been modelled and described by the scientific paradigm of economics (Paula 1996). The field of entrepreneurship emerged in this process. Later western historians, psychologists, sociologists and anthropologists extended the modelling of entrepreneurship into different areas within the framework of socio-economic development.

In the western context, the word ‘entrepreneurship’ originated from the French verb *entreprendre* and can be traced back to the medieval handicraft system in Europe in the 1100s (Elkjaer 1991). In the Asian context, Perera (1990) argues entrepreneurial activity can be traced back to the merchant-entrepreneur which has existed in the Mohenjo-Daro, Harappan¹, Deccan, Sri Lankan, Arab, and Jewish civilisations. In England the terms ‘adventurer’ and ‘undertaker’ were originally used to denote an entrepreneur. Such terms as ‘projector’ and ‘contractor’ were used from the 14th century onwards (Williamson 1966). These terms referred to functions and qualities which were an exciting and unknown experience taken at one’s own risk (Greenfield & Strickon 1981).

According to Davenport and Prusak’s (1998) ‘Working Knowledge’, knowledge is a fluid mix of framed experience, important values, contextual information, and expert insight. Moreover, knowledge originates from unique experiences and organizational learning by key constituents, and often remains embedded, not only in written documents but also in routines, tasks, processes, practices, norms, and values. It is clear that western disclosures in entrepreneurship are essentially embedded in the western culture and are also shaped by the philosophical foundation of economic rationalism. In other words, the knowledge of entrepreneurship has been fashioned predominantly from a theoretical perspective based on economic functionalism, and rooted in the cultural contexts and socio-industrial experience of western societies.

Industrialisation in the 19th century led to a more definitive approach to the phenomenon of ‘entrepreneurship’. The technological and economic changes which began in industrialisation in England represented something new in human history ² (Dillard 1967). It is this mainstream culture of industrialisation which has most deeply affected the understanding of entrepreneurship. With changes over time in the west, entrepreneurship has involved several phases in which it has varied substantially with regard to type and presumably function (McGuire 1964). For analytical convenience, the evolution of entrepreneurship has been considered to proceed through economic perspectives, non-economic disciplines and contemporary entrepreneurship as set out below.

### 3 Explanation of economic perspectives

A number of economic perspectives have been developed over the history of economics in which different meanings have been given for the term ‘entrepreneurship’.

#### 3.1 The classical economic approaches and the neo-classical approach

The pioneers of entrepreneurship were the classical economists Richard Cantillon (2001), Adam Smith (1805), J.B.Say (1834), and J.S. Mill (1848). Their focus was on the normal flow of economic activities³ under conditions of rational individuals with ideal information in new, unknown states of economy. This market-exchange economy required psychological and material resources to organise large-scale, mass production effectively and rationally. In this institutional process entrepreneurship has been defined as a factor of production that carries risk and uncertainty in the process of organising other factors of production (Cole 1949).

A dynamic theoretical work on entrepreneurship emerged with the neo-classical American economist Joseph A. Schumpeter’s work ‘The Theory of Economic Development’ in 1936. In this era of industrialised-market-organised societies, Schumpeter aimed at more advanced equilibrium states, ‘carrying

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¹ ‘Entre’ stand for ‘between’ and ‘prendre’ being for ‘to take’ or ‘to undertake’ (Bolton et al. 2000).
² The Indus Valley / Mohenjo Daro civilisation dates back to 3500 BC and is considered one of the first signs of human civilisation.
³ In late medieval Europe there were two basically different methods of production. Initially, the traditional handicraft system produced products for the local market which was a secure, controlled and organised system. Moreover, there was no accumulation of capital. However, gradually from the 13th century onwards permissible free competition emerged in western society (Gay 1923 cited in Aitken 1965) and this developed further with the growth of international trade. Large-scale enterprises in industrialisation involved risk bearing, capital accumulation, and psychological and organising abilities to approach and enhance unknown international markets. From this the initial understanding of entrepreneurship emerged.
⁴Demand and supply are interfaces in the market mechanism and form an economic equilibrium. It has been identified as the invisible hand hypothesis Smith, A. (1805). An inquiry into the nature and causes of the wealth of nations. London, Harrison and Company.
new combinations\(^5\). He succinctly terms ‘innovation’ as entrepreneurship and the individual whose function is to carry innovation out is called an entrepreneur (Schumpeter 1965). The individual entrepreneur, as an instrument (carrying new combinations) in the economy is primarily a decision maker and is the key to the growth process. Therefore ‘there are no entrepreneurs without innovations and no capitalist returns and no capitalist propulsion without entrepreneurial achievement’ (Schumpeter cited in McGraw, 1991:380). Schumpeter’s concept of innovation includes the elements of risk-taking, superintendence and coordination which allow economic systems to avoid repetition and progress to more advanced states.

### 3.2 Post-Schumpeterian evolution

Post-Schumpeterian evolution proceeded with the Harvard tradition and the neo-Austrian school. The Harvard school believes entrepreneurship is a purposeful activity which initiates, maintains or develops profit-oriented business. In this process it interacts with the internal situation of the business and with the economic, political and social circumstances surrounding the business (Cole 1946). This Harvard School considers the human factor in the production system as well as sensitivity to environmental characteristics that affect decision-making.

The neo-Austrian school believes that the economy moves towards equilibrium to the extent that the entrepreneur correctly anticipates future conditions, and facilitates other individuals’ efforts to achieve their own objectives. Therefore, it is concerned with entrepreneurial alertness (High 1986). In the face of an asymmetrical distribution of information and knowledge of markets (entrepreneurial alertness), this leads to the realisation of an information arbitrage (Kirzner 1973). Related profitable opportunities which only the entrepreneur is able to identify and to realise are exploited. The neo-Austrian school considers disequilibria as a necessary condition for entrepreneurial successes, and not a result of it.

### 3.3 Non-economic disciplinary perspectives

Since the Second World War, Schumpeter’s emphasis on the actor (entrepreneur) has been utilised in various non-economic disciplines including history, psychology, sociology, management and organisational studies.

\(^5\)Schumpeter (1936: p132) noted that individuals attempted to ‘… reform or revolutionize the pattern of production by exploiting an invention … or untried technical possibility for producing a new commodity or producing an old one in a new way… This[es] require[s] aptitudes that are present in only a small fraction of the population …’.

### 3.3.1 Psychological approaches

The psychological approach to entrepreneurship emerged from the research of David McClelland (1953; 1961). In his ‘The Achieving Society’ he argues for a causal link between the psychological factor, a need for achievement (n-Ach) and economic growth. For McClelland (1961), and McClelland and Stewart (1982), the need for achievement is rooted in an interrelated set of child-rearing practices and characterized by a desire to do well, not so much for the sake of social recognition or prestige, but to attain an inner feeling of personal accomplishment (McClelland 1961). McClelland’s analysis of entrepreneurship is based on the conclusion reached by Weber (1930) on Protestant values and the spirit of capitalism. While Weber describes economic growth in terms of socio-religious values and the spirit of capitalism. While Weber describes economic growth in terms of socio-religious values, McClelland (1961) explains the psychological attributes of the individual entrepreneur.

McClelland (1961) identifies three potent needs motivating an individual. These are: a need for achievement, a need for power, and a need for affiliation. The need for power is manifest in the concern with the control of means of influencing a person (McClelland 1961). The need for affiliation regards establishing, maintaining or restoring an affective relationship with another person or, in a word, friendship (McClelland 1961). Finally, the need for achievement can be considered as the need for challenge and success, which motivates entrepreneurial activity.

McClelland and Stewart (1982) employed rigorous research procedures, using comparative analysis, to answer the question: why do some societies produce outstanding individuals (that is, entrepreneurs) while others do not? To this end he employed a cross-cultural approach which sought to develop objective criteria applicable to all societies. In this objectively rationalised process he was recognised largely for his ingenious method of measuring a need for achievement through a psychological projective technique called the ‘Thematic Apperception Test’\(^6\).

The individual with the greater desire for achievement has greater potential to be an entrepreneur. Therefore, n-Ach has persisted in mainstream entrepreneurship theory (Shaver & Scott

\(^6\)Ambiguous pictures are given to respondents who are requested to describe them, and their descriptions are measured for the content of N-Ach. One such test consists of a picture showing a man sitting at a table which has some papers on it, close to an open window, and nearby is a framed but blurred picture. If the respondent’s description centres on work, and is individualistic in content, he is given a positive score, while if it centres on the blurred picture, and brings out concern for his family, he is given negative score. The results of the positive and negative scores give him an N-Ach rating. TAT is a heavily used technique in the process of entrepreneurship development in Sri Lanka.
1991) and it has been included in most training and development in entrepreneurship\(^7\). It was believed that n-Ach could be inculcated through training in self-reliance, rewarding hard work and persistence in goal achievement and creating interest in excellence. All these focus on individual oriented development and a later extension of this psychological aspect of the entrepreneur, eminent personality trait theory,\(^8\) has emerged in the study of entrepreneurial achievement (Fraboni & Saltstone 1990).

3.3.2 Sociological approaches

Sociologists suggest that economic actors' decision-making and actions can be fully understood only by taking the social context into account since organizations and individuals are embedded in cognition, institutions, culture, and social structures (Zukin & DiMaggio 1990). Sociological approaches provide an understanding of how the societal context affects the prevalence and role of the entrepreneurial sector. Sociologists' explanations are mainly based on Karl Marx (1818-1883) and Max Weber (1804-1891). Models of class conflict, starting with Karl Marx, tend to emphasise somewhat different aspects of societal interactions (Marx 1970; Marx & Aveling 1896). Similarly, Weber (1930) emphasised the differences in the values associated with Protestant and Catholic religious teachings. He concludes the Protestant faith, prudent and sober, leads to the increased well-being of the individual. As a result, Protestants were more prevalent at the top of the economic structure. Accordingly, the sociological approach in entrepreneurship focuses on social contexts that affect individual behaviour.

A social system includes social actors (called individuals) and organised collectives such as business organizations, political parties, and government agencies. Thus entrepreneurship encompasses all the constituent subsystems and individual actors, who may be participating in a variety of systems. Among sociologists Jenks (1938), Cochran & Miller (1947), and Williamson (1966) stress the importance of the socio-cultural milieu in entrepreneurship development and suggest that socio-cultural history accounts for the entrepreneurial functions of a large number of individuals.

3.3.3 Management approaches

The roots of management theories lie mainly in Europe: with Adam Smith, John Stuart Mill, Leo Tolstoy, Max Weber, Henri Fayol, Sigmund Freud, Kurt Lewin and many others (Hofstede 1993). From a management perspective entrepreneurship is defined simply as business management (Rimmer 1999). There are four well-established schools of management thought\(^5\): the classical, behavioural, management science and situational approach.

However, the management approach excludes the need for the entrepreneur to be the founder of the business, but rather considers the entrepreneurial role within the managerial role of the chief executive officer. Therefore, vision and strategy are needed in steering the organization successfully, by capitalising on opportunities using inherent strengths and eliminating inherent weaknesses in the organization, and converting threats into opportunities. It is also believed that maintaining the efficiency and effectiveness of an entrepreneurial process leads to organisational performance. However, Greenfield and Strickon (1981) argue that western management practices may appear somewhat strange in different cultural situations. This means management functionalism is rational but unable to take cultural patterns into account.

\(^{1}\)In Sri Lanka, most training institutions of entrepreneurship have included this personality development component in their training packages and several games and personal assessments are being used to develop ‘the entrepreneurial personality’ within individuals.

\(^{5}\)Since the early 1800s, the classical view of management centres on how a business should be organized and the practices an effective manager should follow. As an example Fayol (1930) introduced his 14 principles of management while Weber (1930) worked for his bureaucracy model. Fredrick Taylor (1911) called the father of scientific management, introduced time and motion studies and standards for work (piece rates) with better ways to motivate workers. Since the early 1900s behaviourists focussed on the challenges of understanding and managing people in their work place. Their models come from psychology, sociology and related fields. As an example Elton Mayo’s Hawthorne Studies was concerned with the workers’ productivity and social factors affected behaviour and productivity, morale, status, and good working relationships. Since the late 1940s, management scientists in their decisional (operations) approach have asserted that management effectiveness lies in being able to solve complex problems. Accordingly the following scientific techniques are recommended in the process of managerial decision-making a). facts are gathered and employed carefully with the best possible decision-making process, b). managers are better able to carry out rational analysis of demand on organization and resources available to meet demands, c) Management Information System (MIS), Spreadsheet modelling, Break even and Profitability analysis and Cost benefit/cost effectiveness analyses. The Situational Approach includes all aspects of the previous including internal and external environments of organization.
4 Critics of Entrepreneurship understanding in different perspective

The different disciplinary perspectives and the reductionist approach of the western paradigm resulted in limited returns to entrepreneurship understanding. Each perspective has its own limitations since one disciplinary perspective can never handle all relevancies of entrepreneurial holism.

4.1 Critics of the economic understanding of entrepreneurship

The classical economists, in their invisible hand hypothesis, ascribe a functional role to the entrepreneur in the productive process. Accordingly, the entrepreneur is a risk-taker, decision-maker, organiser, coordinator, innovator, employer of factors of production, and arbitrager with the degree of success depending on fulfilling this function (Herbert & Link 1982). It is clear that this functional role of entrepreneurship and the independent personality of the entrepreneur have been determined within the conditions of industrialisation and industrialised capitalistic societies.

In general each of the economic understandings of entrepreneurship has its own criticism.

a) The classical economists narrowed the term ‘entrepreneur’ to its economic perspective only. Therefore the term ‘entrepreneur’ as ‘actor’ did not really materialize (Gupta 1987; Fontaine 1991) and emphasis was placed on the ‘act’ of entrepreneurship.

b) These are also problems with Schumpeter’s analysis10. Firstly, the emphasis on the individual entrepreneur, who is considered as an economic instrument, places the entrepreneur outside society and social interactions. Secondly, the entrepreneur as a solitary decision maker in an enterprise economy creates the sense of the social process as based on ‘individualism’. Thirdly, it is questionable that entrepreneurs will be able to try out what they are supposed to in ‘new combinations’. As a result, the desirability of entrepreneurial reality based only on individual (entrepreneur) choices and decisions is questionable.

Moreover, it can be argued that the philosophical understanding of ‘development’ is a common limitation for all these economic understandings of entrepreneurship. It is clear that ‘development’ has been conceptualised narrowly along with a particular perspective of economic rationalism. Analysis of ‘economic perspective’ reflected that economists have put effort into finding out how entrepreneurs contributed to the past growth of the economy and formulating models for the future growth of societies (towards new advanced economic equilibriums). Therefore, development theories formed in the context of industrialisation, support the economic scientific worldview (Casson 1982) and the non-human dimensions of industrialisation (Bygrave & Hofer 1991; Shrivastava 1994; Purser et al. 1995). Consequently, studies of entrepreneurship have tended to overlook the human, social and cultural aspects which include employee satisfaction and attitudes which may be reflected in labour turnover and labour unrest, income disparities which represent the dimensions of integration and inter-dependence, and the dimensions of ethical responsibility which can be approached with such indicators as illegal practices, corruption and environment pollution.

4.2 Critics of McClelland’ psychological orientation

According to McClelland (1955) a large incongruity between an entrepreneur’s aspirations and end results leads to ‘avoidance motives’ as far as personal achievement is concerned. Such individualistic rationalisation isolates the entrepreneur from the social context within which he/she operates. As a result, McClelland’s analysis of entrepreneurship on the individualistic psychological orientation has been empirically disproved in some other cultural contexts (Hornaday 1971; Tropman 1989; Perera 1990; Ghosh 1993; Baum et al. 2001) including Sri Lanka (Perera 1990; Budhadasa 1999; Gamage et al. 2003a) where individual entrepreneurial aspirations do not only emerge from the need for achievement.

McClelland’s Thematic Apperception Test (TAT) for the entrepreneur profile is also contested because although McClelland believes that a high need for achievement creates entrepreneurs, issues arising from further research show that this correlation is not clear within sport psychology (Woods 1998) and the correlation is inconsistent for technical entrepreneurs (Roberts 1991).

McClelland’s approach is based on the presumptions of the scientific nature of mental formation in childhood and is therefore questionable: Is it only this psychological formation of childhood that enables a person to be successful in a society which has a very distinct cultural background and values? According to Woods’ (1998) findings, around 75% of the contribution to human personality is genetic while the other 25% is due to environmental influences. However, Whybrow (1999) found the genetic contribution to personality to be only 40%11. Such understanding weakens this theory in the context of interpreting the entrepreneur solely as an ‘individual’ apart from societal influences.

Hagen (1962) challenges McClelland by directing attention to the level of the group, as

10Solo (1951) and Herbert and Link (1982) examine the Schumpeterian perspective and highlight its limitations.

11The findings of empirical research at the University of Minnesota on identical twins who were exposed to different environment expound genetic contribution and the environment as parameters of human behaviour.
opposed to the level of individual motivation. He focuses on disadvantaged minorities in complex national societies (usually developed societies) and argues ‘they have contributed disproportionately to the supply of entrepreneurs precipitating economic growth’ (Hagen 1962: 60). He asserts that the feeling of discrimination among disadvantaged groups has been compensated for in the only ways available to them. It is exemplified by the historical role of the Dissenters in England, the Protestants in France, and the Parsees in India. In each case the loss of group status has promoted individualism and self-reliance, which then favours innovation and entrepreneurial activity (Hagen 1962). Several other psychological approaches to understanding entrepreneurship have been suggested. Byham (1984) argues left-brain and right brain function is useful for decision making and selecting and directing the work force in an organization. Thus the basic guideline of industrial organization psychology for example, has been good selection, goal setting, communications and participativeness which facilitates the success of an organization. This has been extended by Baron (2000) who indicates that both cognitive and social factors influence the success of entrepreneurship. In this theory, cognitive factors help in developing distinctive thinking patterns, while social factors influence the effective interaction of entrepreneurs with others.

In conclusion, the emphasis is on the individual entrepreneur who has been taken out of the socio-cultural context. These psychological approaches have also tended to ignore socio-cultural interactions which would enable a holistic understanding of entrepreneurship.

4.3 Critics of the sociological approach of entrepreneurship

Sociological theories emphasize that it is critical to separate the development of entrepreneurial activity as an activity from other spheres of community life and the social history of a country. Accordingly, this approach has taken an open-system or environmental approach to entrepreneurship by which the impact of external factors such as socio-economic, political, educational, and legal, on entrepreneurial practices and effectiveness is emphasized (Gnyawali & Fogel 1994; Bygrave & Minniti 2000; Schwartz & Teach 2000). However, Reynolds (1991) notes this approach most often embraces a societal equilibrium model that leads to a smooth functioning or low-conflict society. This model brings a rational process of entrepreneurship. Consequently, Balakishnan et al., (1999) argue that although social variables have been used to explain entrepreneurial activity, most studies undertaken under this rubric fail to answer the question: what constitutes entrepreneurial behaviour? and/or ‘who is an entrepreneur?’ A question arises, whether even the sociological scholars have fully understood the deep-rooted cultural influences on the entrepreneur’s social actions.

5 Contemporary understanding of entrepreneurship

The historical analysis of entrepreneurship as a field of study illustrates that entrepreneurial activity has been widely recognized and encouraged by several other disciplines. Different disciplinary perspectives have led to more divergence than convergence in moving towards the goal of practical conceptualisation of entrepreneurship (Greenfield & Strickon 1981; Brazeal & Herbert 1999; Swedberg 2000; Kuratko & Hodgetts 2001).

Since the 1990s, the field has expanded into several incongruent domains such as corporate entrepreneurship, macro environmental linkages, international entrepreneurship and career alternatives (Brazeal & Herbert 1999). Although this wide range of disciplinary contributions expands the knowledge of entrepreneurship it has failed to develop a comprehensive or agreed understanding of entrepreneurship (Domar 1968; Smart & Conant 1994; Brazeal & Herbert 1999) or in a single, agreed upon way of entrepreneurship (Fraboni & Saltstone 1990). In fact the knowledge gathered about entrepreneurship is still relatively limited (Cunningham & Lischeron 1991; Brazeal & Herbert 1999).

6 Passing on the western paradigm to other cultures

Significant efforts have been expended in attempting to implant understanding of entrepreneurship from the west into developing economies. There are several views on why western knowledge is dominant in developing countries. Greenfield and Strickon (1981) argue that developing nations depend on the western ideologies because: a) they lack their own knowledge creation regarding development; and b) these countries are ambitious for rapid development, and

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13The actuality of different perspectives is like six blind men and the elephant (Ken Keyes 1975:45. Appendix 2). The six blind men each has different perspective of the elephant. One believes the elephant is like a piece of rope, another believes it’s like a brick wall etc. They rationalised their feeling objectively. None has a complete view; in fact they can never know the complete elephant in one instant of time (lack of holism).
assume western knowledge is advanced and developed. Leonard (1985) has examined this reliance on western models at the organisational level and asserts that organizations generally seek external ‘well-springs of knowledge’ that are vital for their development. In this process it is assumed western theories are the best and only way to success.

Hofstede (1980; 1994) emphasizes that the hypothesis of cultural transferability underpins much of the ‘aid’ provided by the developed world to underdeveloped poorer countries. Further more, Nanayakkara (1999a) asserts that the various types of technical and training assistance programmes and professionals that have been implanted from the western world to developing countries have been instrumental in the initiation of this dependency relationship. Gupta and Govindarajan (1991) stress that not only aid agencies but also multinational corporations are networks of transactions that are engaged in knowledge flows. Economic liberalisation in developing countries allows foreign investment by multinational corporations which results in this knowledge transfer.

However, Adler (1997) examines other reasons for the management knowledge system of developing countries being heavily influenced by the west. He explains three main reasons: a) most management schools are in the USA; b) the vast majority of management professors and researchers are trained in the USA; and c) the majority of management research still focuses on USA companies (Adler 1997:12). Generally, most developing countries depend on the west for professional training and higher education, as they believe that the western system and theories are the best or the only way to get better knowledge (Cheng et al. 2001).

With this understanding, it is clear that western knowledge is often accepted (without questioning) as suitable for entrepreneurial research studies, education, training and development in developing nations. The situation is best represented in the words of Davenport and Prusak (1998: 98) as: ‘spontaneous and unstructured transfers of knowledge routinely take place within and across organizational boundaries, whether the process is actively managed or not’. The socio cultural context which provided the foundation for the knowledge and the theoretical assumptions rooted in it are ignored and/or believed to be culturally universal. It is evident that transplanted ideologies may be meaningless without the support of an underlying and widespread pattern of culture and behaviour.

6.1 Influence of the western ideologies in Sri Lanka

The above discussed issues related to imparting the western paradigm to other cultures are relevant in Sri Lanka along with the effects of western colonisation by the Portuguese, Dutch and British. Several positive and negative criticisms based on the western invasions in Sri Lanka describe emerging influences from the west.

The British had the greatest impact on ‘Ceylon’. Ludowycyck (1966) states that whatever the Portuguese and Dutch did, the British improved upon. He attributed this accomplishment to the British grounding in liberalism, a belief in the emancipation of slaves, the absence of religious persecution, and conscious attempts to maintain good relations between the rulers and the ruled. The Roman Catholic religion and law, a western free education system, the plantation system, as well as trading and commercialisation of the economic system increasingly influenced the indigenous way of social life (Jayawardena 2000). De Silva (1953: 4) states that ‘the indigenous administrative system was converted into an engine of oppression and misgovernment for commercial profit and private gain’. That is, the capitalistic system was superimposed on Sri Lankan social formation with the development of plantation trading and associated organizations and management.

Hence, the imitation and replication of the west seems to have characterized work and work organizations in Sri Lanka by suppressing the region’s own patterns of traditional work and trading organization. Consequently, almost all Sri Lankans have been influenced by the education and orientations set down by western ideologies (Nanayakkara & Ramasinghe 1984).

6.1.1 Entrepreneurship training and education

The development of entrepreneurship as a distinct discipline at institutes of higher learning in Sri Lanka has been influenced in terms of objectives, design, content and methods, by the disciplinary development of entrepreneurial management education in the developed world (Nanayakkara 1999a). The ideology of entrepreneurship training and education in Sri Lanka has come from leading American universities such as Harvard, and prestigious British institutions. Similarly, the personnel involved in bilateral and multilateral assistance programs have also spread western ideology through their training programs. The World Bank (1984) argued that Sri Lankan business managers need more western management know-how such as Marketing, Personnel Management, Investment Analysis and similar subjects in the traditional business curriculum. It is therefore not surprising that during the last two decades from 1980, the two most dominant training assistance programs in entrepreneurship in Sri Lanka have been the American-based International Labour Organization Project and the German based CEFE\textsuperscript{13} program.

It is clear that western knowledge in Sri Lanka is influential. The entrepreneurship literature available,\textsuperscript{13}Competency based Economies through Formation of Enterprise.
either from overseas or produced locally, is almost exclusively western in origin and character (Nanayakkara, 1999a). It often ignores the complexities of acquisition, mobilization, and implementation of knowledge which have been discussed by several researchers such as Shenkar and Li (1999), Almeida et al. (1998) and Larsson et al. (1998). These authors have identified the significance of knowledge and issues concerning the cross-border transfer of organizational knowledge. Shenkar and Li (1999) and Leonard (1985) argue that it is important for the host to possess appropriate absorptive capacity to utilize such knowledge.

However, according to Nanayakkara (1999a), Sri Lankan policy makers have adopted almost all the patterns of management and organizations that prevail in the west because they have been overwhelmed by the level of industrialisation and economic prosperity in the west, and they are anxious to catch up. He further emphasises that this blind-faith in adopting western theories has to be made known to Sri Lankan decision-makers. Glade (1967) and Sexton (1987) also remind us that the study of entrepreneurship is a product of the evolutionary thought of the nineteenth century and that therefore, a theory of change must be developed. However, what is rather surprising is not so much the beginning of this dependency as its continuation over the past two decades (from 1980) in Sri Lanka.

7 Theoretical conflicts and cultural implications of the western entrepreneurial paradigm

This analysis encounters multi-disciplinary literature in different contexts.

7.1 Emerging theoretical conflicts

Business management in Asia is different (Hofstede 1993; Sinha 1995; Adler 1997; Nanayakkara 1999a; b). Organisational and management theories are culture specific; therefore, theoretical receptiveness and responsiveness are also culture bound. As an example, Adler (1997: 41), reports on McGregor’s (1966; 1984) theory X and theory Y in leadership in a case of a Canadian employee working under a Filipino boss. Here, the ‘theory X’ approach of the Filipino boss as perceived by the Canadian employee was, in fact, the ‘theory Y’ approach as perceived by the Filipino boss.

Heintz (2001) explains that Romanian managers adopt western management strategies (by belief in their value or by interest) that do not correspond to the cultural background of Romanian employees. Instead of creating a positive ‘culture of enterprise’, the application of western theories generates clashes of cultures and leads to business failures. Haley and Tan (1996) found theoretical divergence between Asian and western executives and strategic theorists in relation to strategic decision making. One of the major differences in Asian decision-making stems from the base information available to, and desired by Asian decision makers, which differs from the western ideologists.

Hofstede (1980) questions the universality of American management theories, in particular, motivation and leadership and organisational theories, using his findings of a survey of over 116,000 IBM employees from 40 independent countries. He argues that all motivational factors and leadership styles are western or culture-bound to the west. As a consequence, these theories do not offer universal explanations of motivation; rather, they reflect the value system of Americans. Moreover he argues that USA management theories have failed to provide consistently useful explanations outside the USA. He reported that in Germany and France, the original theme of ‘Management by objective’ (MBO) could not be adopted entirely as in USA companies (Hofstede 1980). Nanayakkara (1999a) also found that MBO as process seems to require certain individual qualities which are inherently absent in the Sri Lankan cultural context.

Roberts (1991) who used the Thematic Apperception Test technique for seventy-two technical entrepreneurs in United Kingdom found that while on average technical entrepreneurs had only a moderate N-Ach, 80% of entrepreneurs in the high-growth companies showed high N-Ach. Other important issues are apparent from his findings: while only 30% had responded to a challenge by becoming an entrepreneur; another 39% responded to a desire to be independent; and the rest to a desire to be wealthy. This represents socially and economically influential factors pushing entrepreneurs rather than n-Ach. From these understandings a question that arises is if western ideologies are not universally applicable even in other western countries, what are the impacts of western ideologies on developing economies which are economically, industrially, socially and culturally more diverse?

7.2 Significant cultural implications

The argument that western entrepreneurial theories and concepts are applicable to another culture has been subject to much critical comment. This indicates underlying differences due to cultural predispositions.

By looking at Figure 1, we can get some idea about the cultural difference between the west and Asia. Furthermore, Hofstede (1983), who studied

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"These range from Sigmund Freud’s 'sexual instinct' to McClelland’s (1961) need for achievement, as well as Maslow’s (1943) 'hierarchy of needs', Fredrick Herzberg’s (1966) ‘job enrichment’, Victor Vroom’s (1964) 'expectancy', and David McGregor’s, (1960) theory X and theory Y; and Likert’s leadership (1967) are also culture-bound to the west."
differences in people’s work related values in 50 countries, concludes that people of the United States are ‘highly individualistic’ and that they tend to ‘maintain power equality’ among themselves. In the case of Asia, however, it was found that the relevant value configuration of the people was quite opposite: low individualism and large power distance.

Perera (1990) asserts that if entrepreneurs in the west have power bases which are individualistic, and have needs for personal achievement, then they stand in sharp contrast to their counterparts in the east who have social power bases, and whose needs for achievement are collectivistic. Due to these cultural differences with the west, there is substantial doubt that Sri Lankan entrepreneurial practices will ever simply follow in the steps of the west.

Cultural challenges to western knowledge represent threats to ‘western consultants’. According to Maddison (1965), Seefeldt (1985) and Harari (1990) while it has long been recognised that ‘consultants’ crossing national boundaries in order to offer technical assistance often face cultural problems, there is a dearth of research detailing the complex issues involved in clashes of values. This has regularly resulted in the inability to read political dynamics and insensitivity to customers and mores. A broad range of literature in developing nations argues that effective cross-border transfer of knowledge will become increasingly critical as incongruity among social and cultural factors intensifies.

Figure 1. The cultural differences relative to the UK

Adopted from Kogut and Singh (1988), developed using Hofstede’s data

7.2.1 The Sri Lankan context

Influenced by this paradigm, various entrepreneurial activities that originally evolved in a different context have been undertaken by many Sri Lankan business organizations. How many of these ideologies actually take root and bear fruit in the Sri Lankan setting is not precisely known due to the lack of sophisticated research studies focussed on this issue. Research aimed at examining the entrepreneurship phenomena on the same western theoretical tracks and methodology (objective rationalism and hypothetico
deduction)\(^\text{16}\) appear to be incapable of explaining the deep-rooted socio-cultural, ethno-religion, and psychological factors affecting small enterprise growth in Sri Lanka (Samarasinghe 1996); A survey of Some Selected Organizations (Ekanayake 2000); Socio-economic and psychological factors affecting small enterprise growth in Sri Lanka (Samarasinghe 1996); A study of Small Business Performance: The tendency to stagnate (Wijedasa 1990); The influence of childhood experiences on Entrepreneurs’
political contextual setting, which triggers the problem of blind faith in western models by Sri Lankan policy makers and practitioners.

However, the experience of some concerned professionals, academics, entrepreneurs and researchers in Sri Lanka shows their disappointment of continuation of such knowledge. Academics in Sri Lanka, such as Gamage et.al.(2003a, 2003e), Perera (1990), Alawattage (1998), Nanayakkara (1999a), Ratnasiri (1999), and Wickramasinghe & Hopper (2000) reveal that western type management, education and training have not been able to make an appreciable contribution to organisational success in Sri Lanka. Thus, failures seem to outnumber successes (Ratnasiri 1999). These Sri Lankan researchers have identified that the reasons for these failures are based on social and cultural factors (Perera 1990; Alawattage 1998; Nanayakkara 1999a; Wickramasinghe & Hopper 2000, Gamage et.al.(2003a, 2003d, 2003e), ). Others criticize the assumption of objectivism in western ideologies (Alawattage 1998; Ratnasiri 1999; Wickramasinghe & Hopper 2000). With regard to training professionals in entrepreneurship in Sri Lanka the validity of training models based on western practices has also been questioned (Fernando 1993; Budhadasa 1999).

7.2.2 The Indian context

The inappropriateness of western ideologies in a developing country is also seen in India. Sinha and Sinha (1990) have identified numerous ways in which Indian and western managerial behaviours differ. For example, the traditional notion of ‘check with the boss’ in India is the crux of the majority of decision-making which naturally shifts the locus of control to the highest authorities in the organization which routinely form the hierarchical relationship in Indian organizations. Communication patterns are therefore affected by power-play patterns, which involve ‘affective reciprocity’ between superiors and their subordinates. This preference for a personalised relationship within organizations contrasts with the more contractual relationships in western theories and organizations. Moreover, in India a dilution of organisational norms has been affected by familism which in turn affects planning. The individualistic orientation of western ideologies is in contrast with the Indian collectivistic orientation which facilitates the motivation of personnel to be loyal and committed to work. Therefore Tripathi (1990) suggests the creation of a synergistic mix between traditional indigenous roots and modern techniques to increase the efficiency of Indian enterprises.

7.2.3 The context of Pacific Rim

Industrial cultures such as China, Japan and other countries of the Pacific Rim have also challenged western ideologies. Sinha et al. (1999) showed that the communication and trade network patterns of the British and Chinese are completely different. While the British communication style is more formal, the Chinese communication pattern is more relationship-oriented. Chinese trading networks are based not on contract but on trust and family ties. Moreover, Japan and most newly industrialised countries of the Pacific Rim have adopted entrepreneurial management styles, work attitudes and values rooted in Confucian social philosophy, familism, and institutional structures that are not by any means Euro-American (Sinha et al 1999). Comparing Japanese and American management styles Adler and Graham (1989) reveal that while their management exhibits 95% similarities, they differ in vitally important respects of society and culture. The reason is the underlying beliefs of Asian and European thinking affect ways of managing and doing business.

8Conclusion

The western approach to entrepreneurship, especially its evolution and limited returns to the application of western models of entrepreneurship. However, different national cultural characteristics mean that the possibility of adopting mainstream entrepreneurial ideas, concepts and theories usefully between nations is highly unlikely because the culture of every day life is complex and not easily ignored. Yet the assumptions of transferability of other cultural philosophies underpins much of the ‘aid’ provided by the developed western world. The methods employed to transform western ideologies into other cultural settings, including Sri Lanka, were ineffective as they were not developed to be flexible to contextual variations.

The different disciplinary perspectives and the reductionist approach of the western paradigm resulted in limited returns to entrepreneurship programs since one disciplinary perspective can never handle all relevancies of entrepreneurial holism. It appears that the western entrepreneurship paradigm does not draw on the deep-rooted settings in society and culture of many developing countries. As a result, indigenous entrepreneurial realities are not well understood. Rather than continuing to study entrepreneurship within this western framework and set of assumptions, it may be better to seek a context-sensitive alternative approach.
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OWNERSHIP STRUCTURE, POLITICAL CONNECTION AND FIRM PERFORMANCE: EVIDENCE FROM INDONESIA

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Abstract

This paper investigates whether ownership structure and high levels of political connection in Indonesian firm’s impacts on firm performance. Studying ownership structure in Indonesia is interesting for a number of reasons. Firstly, companies in Indonesia are owned by the families and corporate ownership structure is largely concentrated. Secondly, many companies in Indonesia have connections with politicians. Thirdly, little work has been done in Indonesia on the impact of foreign ownership on performance. Thus foreign ownership provides a unique setting for examining the monitoring role of foreign ownership as a substitute for corporate board monitoring. Using both accounting and market measures of firm performance we find that Indonesian firms with high political connections outperform Indonesian firms not politically aligned. Firms with significant foreign ownership performed better than domestic only owned firms. The results of the study support the findings that the governance of the largest government and foreign ownership firms not only acts to monitor management activities but also plays a representative role for monitoring shareholders.

Keywords: Firm Performance, Indonesia, Political Connection, Governance

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1 Introduction

Agency theory (Jensen and Meckling 1976) defines the agency relationship where the principal (or owner) delegates tasks to an agent (or manager). The theory highlights costs associated with the principal-agent relationship which include the opportunistic behaviour or self-interest of the agent taking priority over the principal’s interest. Mallin (2004) highlighted a number of dimensions to this including the agent misusing their power for financial or other advantage, and the agent not taking appropriate risks in pursuance of the principal’s interests – often because managers are more risk-averse than the companies they lead. Another cost arises due to the principal and agent having access to different levels of information; the agent (manager) usually being in control of superior and more detailed information than that of the owner (information asymmetry). This requires the owner to institute expensive monitoring of the managers actions to redress the knowledge imbalance. Agency theory maintains that management (agents) will act opportunistically to increase their personal wealth at the expense of the owners (principal) of an organization. To achieve this, managers rely upon the dispersed nature of ownership and their access to superior information (“information asymmetry”).

The majority of past research within this area focused almost exclusively on Anglo-American firms, where the predominant agency conflict is that between professional managers and their widely dispersed shareholders. This relationship is far less pronounced in Indonesia where many firms are closely held by a small group of shareholders, often with strong family ties or are politically closely aligned. This gives rise to a different agency theory conflict, that between controlling shareholders and minority shareholders. The private benefits of majority control of companies by their management are then balanced against those of minority shareholders and may ultimately lead to overall reductions in company values. In Indonesia we posit that ownership is concentrated and that the agency problem is not a manager-shareholder conflict but a conflict between the controlling owners and minority shareholders. It is also clear from earlier work, Fisman (2001) that for a very large part of the Indonesian economies political connection is a significant variable.

In general we investigate whether ownership structure and high levels of political connection in Indonesian firm’s impacts on firm performance. Using both accounting and market measures of firm performance we find that Indonesian firms with high political connections outperform Indonesian firms not politically aligned. Firms that have the largest (block) shareholders and companies with significant foreign ownership performed better than domestic only owned firms. The results of the study support the findings that the governance of the largest government and foreign owned firms not only acts to monitor management activities but also plays a representative role for monitoring shareholders.

The remainder of the paper is organized as follows. In section 2 a review of the relevant literature
is provided. Research methodology including sample selection, variable measurement and model specification is given. The results of this study are discussed in section 4 followed by a brief conclusion in section 5.

2 Previous literature on ownership concentration

The agency theory literature considers ownership concentration as an important mechanism which helps to mitigate incentive problems arising from separation of ownership and control. The early studies on separation of ownership and control addressed the question whether owner controlled firms outperform management controlled firm. The bulk of these studies had used percentage holdings of voting shares as a benchmark to segregate firms into owner controlled (OC) and management controlled (MC) and found mixed results. Recent studies have tended to move away from this arbitrary OC and MC dichotomy and have instead examined the effects of inside and outside ownership concentration on firm performance. However, unlike the early studies, recent studies have relied on contemporary theories of the firm (e.g., positive agency theory) to develop testable propositions. This section provides a review of the recent studies relevant to the purpose of our study. These studies are reviewed because like our study they also investigate the role of ownership concentration in controlling agency conflicts.

The notion that ownership structure affects firm performance emanates from Berle and Means (1932) and forms the basis of the theory of agency. Jensen and Meckling (1976) formally developed a model in which they show that value of the firm depends on the distribution of share-ownership between owner-manager (inside shareholder) and outside shareholder. Following Jensen and Meckling, several theoretical and empirical studies (e.g., Demsetz and Lehn 1985; Morck, Shleifer, Vishny 1988; Wruck 1989; and McConnell and Servaes 1990) have provided evidence on the relation between firm performance and ownership structure. These studies are reviewed below.

Demsetz and Lehn (1985) investigate two issues surrounding the separation of ownership and control. First, they examine the economic factors which are associated with ownership concentration. Second, they test the effect of ownership concentration on firm performance. The motivation for their study is to explore empirically the factors that influence the structure of ownership. Using a sample of 500 firms they find that firm size, instability of profit rate, and whether the firm is a regulated utility or financial institution and whether the firm is in mass media or sports industry to be statistically significant in explaining differences in concentration of ownership. Additionally, they use recursive regression to test the effect of ownership concentration on firm performance. Contrary to the prediction of Berle-Means (1932), they find no significant correlation between firm performance and ownership structure. Methodologically there are at least two problems with their study. First, Demsetz and Lehn test the effect of ownership concentration on corporate performance but ignore influences of board composition and compensation plans on firm value. Second, they do not control for IOS and as a result, their model may be misspecified.

Morck, Shleifer, and Vishny (1988) address the issue whether firm performance increases with management ownership. Based on a sample of 371 firms they find that corporate performance (as proxied by Tobin's q) increases as board ownership rises but the relationship between the two is not linear. That is, firm performance increases as board ownership reaches the 0% to 5% range of managerial ownership, falls as board ownership rises to the 5% to 25% range, and then increases for ownership level beyond the 25% range. While Morck et al's study innovative, providing a test of the relationship between firm performance and management ownership, it ignores the joint effect of management and non-management ownership on firm value. Furthermore, like most prior studies (e.g., Demsetz and Lehn 1985), Morck et al. have tested the relationship between ownership structure and firm performance on a cross-sectional basis making it difficult to ascertain whether their findings are stable over time.

In an interesting extension of Morck et al's (1988) study, Wruck (1989) considers, whether change in ownership concentration associated with a private sale of equity securities is correlated with change in firm value (as proxied by abnormal return of equity securities). To address this, Wruck accesses data consisting of 128 private sales of equities for NYSE and AMEX firms. Wruck then conducts two sets of analyses. The first set focuses on a cross-sectional analysis, using ownership level and change in ownership (as measured by the difference in concentration of ownership before and after the sale of securities) as independent variables and changes in firm value (measured by the abnormal return arising from the changes in market's expectation of the net present value of the firm) as dependent variable. Wruck finds a significant increase in the firm's value with the increase of ownership concentration.

The second set is for a comparison of her results with those of Morck et al. (1988). Wruck's investigation yields results similar to those of Morck et al. except for 0-5% range of ownership, where no statistically significant relationship is found between the change of ownership and firm performance.
Notwithstanding these findings, Wruck’s results are confounded by the problem with sample selection. Her sample consists largely of small firms with an average market value of $234 million compared to average market value of $910 million of all CRSP firms. Consequently, her study may not be generalisable to the entire firm population.

McConnell and Servaes (1990) examine the relationship between corporate performance and the structure of equity ownership. They extend prior study by Morck et al. (1988) in two ways. First, they classify the ownership structure into four categories such as corporate insiders, individual atomistic shareholders, block shareholders, and institutional investors. Second, they use a time-series rather than cross-sectional design to test the relationship between ownership concentration and firm performance (as measured by Tobin’s q). McConnell and Servaes find a statistically significant curvilinear relation between corporate performance and proportion of shares held by insiders. Tobin’s q first increases and then decreases as inside ownership exceeds approximately 40% to 50%. They also find a positive relation between Tobin’s q and the proportion of shares owned by institutional investors. While their results are consistent with their hypotheses, the explanatory power of their test is relatively low. This may be due to the misspecification of the independent variables. For instance, McConnell and Servaes, assume an additive relationship among the ownership variables but fail to consider the interaction effect between inside and outside ownership and how they affect the firm’s performance.

2.1 Ownership structure and political connection in Indonesian context

Studying ownership structure in Indonesia is interesting for several reasons. First, the ownership structure of Indonesian firms is markedly different than the comparatively well-studied US, UK, and Chinese environments. Ownership concentration tends to be extremely high with shareholders holding at least 20 percent of equity on average accounting for about 80 percent of share ownership in a given firm. Moreover, in 2001 approximately 80 percent of firms listed on the IDX had a majority of equity held by one holder or a tightly knit group (Fan and Wang 2002). From an economic standpoint one could argue that the highly concentrated nature of many Indonesian firms may have positive implications for firm performance. According to Mobarak and Purbasari (2006), the potential for institutional shareholder including foreign shareholder activism has increased dramatically in Indonesia in the post Suhaarto era: “Foreign institutions increasingly have close contact with the management of listed companies. A growing number of the major listed companies have equity management programmes which develop and foster strong relationships with analysts and foreign investors.” This could imply an increased role for monitoring by foreign shareholders, assuming foreign ownership concentration is an effective substitute for corporate board monitoring.

Other studies reported that many Indonesian firms are politically connected (Gul, 2006). This situation began from the Suhaarto government’s corruption, nepotism and family intervention to the country’s economic and business affairs. The Suhaarto government had supported these firms by channeling contracts to them and by making investment capital available to them at preferential interest rates. The political connection, with management inclined to maintain this relationship, may increase the risk to outside investors resulting from a higher degree of expropriation by insiders.

The greater perceived risks inherent in politically connected firms are considered to arise due to increased agency costs in these firms. Agency costs are traditionally concerned with the potential divergence of interests between management and shareholders caused by each of these groups being interested in their own utility. Politically connected firms have this agency cost between management and shareholders, and additionally have the self-interest of the political party/entity to which they are affiliated and the subsequent divergence of interests to contend with. Thus, this study should provide insights into the impact of political connection in Indonesia on the relatedness of board composition and firm performance.

In a Malaysian context, Gul (2006) provides empirical support that auditors perceive greater risk inherent in politically connected firms leading to their performing greater audit effort that in turn leads those firms being charged higher fees. He suggests that “this is so because these firms have a higher probability of their business failing, and because they are more likely to misstate their financial health in their financial statements so as to avoid debt covenant violations”.

Thus, our study provides insights into the impact of political connection in Indonesia on the relatedness of ownership structure and firm performance.

3 Research methodology

3.1 Sample selection process

The data used for this study is primarily collected from ORBIS database and firm’s annual reports that are downloaded from Indonesia Stock Exchange.
(IDX). The IDX Monthly Statistics is also used to obtain the other information when they are not available in the ORBIS database and firm’s annual reports. The initial sample consists of 1,125 firm-year observations covering the period 2006 to 2009. Consistent with prior research we eliminate financial firm (this includes bank, insurance, unit trusts and finance firms) sector. Firms in this sector are subject to different regulatory requirements and characteristic operations that could unduly affect the variable measures of this study. We lose 346 observations because we are unable to download those annual reports on IDX. After screening for financial firms and firms with missing information, this study utilises the data from the remaining 535 observations, in which, each observation provides different level of financial report completeness. Table I provides details of information availability of each performance and other variable measure from 535 observations. It shows that the number of firm’s performance measures availability from the entire observations ranges between 407 and 475 (see Table 1 for the details).

**Table 1. Sample selection process**

<table>
<thead>
<tr>
<th>Panel A: Original sample</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total numbers of firm-year observations</td>
<td>1,125</td>
</tr>
<tr>
<td>Less: Number of financial firm-year (bank, insurance, unit trusts and finance firms)</td>
<td>(244)</td>
</tr>
<tr>
<td>Less: Number of firm-years annual reports that cannot be collected</td>
<td>(346)</td>
</tr>
<tr>
<td>Original sample - number of non-financial firm-year observations</td>
<td>535</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B: Final sample for analysing Market Capitalisation</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Original sample - number of non-financial firm-year observations</td>
<td>535</td>
</tr>
<tr>
<td>Number of firm-year observations with do not have market capitalisation information and other proxy measures</td>
<td>(128)</td>
</tr>
<tr>
<td><strong>Final sample used</strong></td>
<td>407</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel C: Final sample for analysing Earnings Per Share</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Original sample - number of non-financial firm-year observations</td>
<td>535</td>
</tr>
<tr>
<td>Number of firm-year observations with insufficient information to construct earnings per share and other proxy measures</td>
<td>(116)</td>
</tr>
<tr>
<td><strong>Final sample used</strong></td>
<td>419</td>
</tr>
</tbody>
</table>

3.2 Variables measurement

This study uses accounting and market measures of firm’s performance respectively as dependent variables. Our market performance proxy is market capitalisation (hereafter, MarCap) which is the aggregate number of shares multiplied by regular market closing price. The accounting measure that is employed in this study has been widely used in previous research (e.g., Lambert and Larcker 1987; Omran, Bolbol, and Fatheldin 2008) is Earnings Per Share (EPS). We measure EPS as the firm’s earnings after extraordinary items and discontinued operations divided by weighted-average number of issued shares.

We focus on the impact of various forms of ownership structure (the largest, internal, government, and foreign shareholders) and political connection on firm performance. Ownership structures are defined as the percentage of shares owned by the largest, board and management, government, or foreign shareholders respectively. We define a firm is connected with politician if it meets one of the criteria: (1) the firm is state-owned, or (2) the firm is owned by the Suharto family or directly affiliated with Suharto family business groups (Fisman 2001; Leuz and Oberholzer-Gee 2006), or (3) the firm’s top officers (board of commissioners or board of directors) are a member of parliament. To control for compounding influences of cross-sectional factors, this study includes auditor type, size, corporate governance, and industry as control variables in the regression analysis. The perceived quality of the auditor is also considered to be a possible determinant of the firm financial performance (e.g., Frankel, Johnson, and Nelson 2002; Gul, Chen, and Tsui 2003). Prior research usually distinguishes between non-Big 4 and Big 4 audit firms arguing the latter to be of a higher quality than the former (Heninger 2001; Mayhew and Wilkins 2003). This study includes Big 4 as a control for perceived auditor quality. Indicator variable with firm i scored one (1) if the firm’s auditor in fiscal year t is a Big 4 accounting firm; otherwise scored zero (0). A

19 This information is reported in the Roadmap of Indonesian Business Groups 1998 that is developed by the Castle Group, a leading economic consulting firm in Jakarta (Fisman 2001).
study concerning a nexus between firms’ characteristics and their financial performance conducted by Baek, Kang, and Park (2004) find that the firm size is the important factor influencing its financial performance. Therefore, this study includes $Size$ as another control variable in the regression model. $Size$ is calculated as the natural logarithm of the total sales. Following past literature (e.g., Beasley 1996; Peasnell, Pope, and Young 2000; Klein 2002; Filatotchev, Lien, and Piesse 2005) who document that suggest that the presence of the non-executive independent boards and audit committee improves companies’ performance. Finally, to ensure results are not driven by the domination of a specific industry sector, this study includes industry manufacturing (Industry) variable to control for potential industry clustering effects (Baek et al. 2004). The industry sector is sub-divided into manufacturing and non-manufacturing firms. Proxy measures for the dependent, independent and control variables are defined in Table 1 as follows.

### Table 2. Variable definition and description

<table>
<thead>
<tr>
<th>Variable Description</th>
<th>Variable Title</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dependent Variable</strong></td>
<td></td>
</tr>
<tr>
<td>Natural logarithm of the aggregate number of shares multiplied by regular market closing price</td>
<td>$MarCap$</td>
</tr>
<tr>
<td>Earnings after extraordinary items and discontinued operations divided by weighted-average number of issued shares</td>
<td>$EPS$</td>
</tr>
<tr>
<td><strong>Control Variables</strong></td>
<td></td>
</tr>
<tr>
<td>Natural logarithm of the total sales</td>
<td>$Size$</td>
</tr>
<tr>
<td>Indicator variable with firm $i$ scored one (1) if its auditor is a Big-4 firm; otherwise scored zero (0).</td>
<td>$Big4$</td>
</tr>
<tr>
<td>Percentage of the board of commissioner that is independent</td>
<td>$IndBOC$</td>
</tr>
<tr>
<td>Percentage of the audit committee members that is independent</td>
<td>$IndAudCom$</td>
</tr>
<tr>
<td>Indicator variable with firm $i$ scored one (1) if from the agriculture; mining; basic industry and chemicals; miscellaneous industry; consumer goods; property, real estate and building construction industries; otherwise scored zero (0).</td>
<td>$Industry$</td>
</tr>
<tr>
<td><strong>Independent Variables</strong></td>
<td></td>
</tr>
<tr>
<td>Percentage of the largest outside blockholders</td>
<td>$Top1$</td>
</tr>
<tr>
<td>Percentage of shares owned by board of commissioner and board of director</td>
<td>$domestic$</td>
</tr>
<tr>
<td>Percentage of government shareholders</td>
<td>$Gov$</td>
</tr>
<tr>
<td>Percentage of foreign shareholders</td>
<td>$Foreign$</td>
</tr>
<tr>
<td>A firm is connected with politician if it meets one of the criteria: (1) the firm is state-owned, or (2) the firm is owned by the Suharto family or directly affiliated with Suharto family business groups (Fisman 2001; Mobarak and Purbasari 2006), or (3) the firm’s top officers (board of commissioners or board of directors) are a member of parliament</td>
<td>$Politic$</td>
</tr>
</tbody>
</table>

### 3.3 Model specification

This study uses OLS multiple regressions as the main statistical technique to test the hypotheses. The main regression models are defined in the following equations:

$$Performance_i = \alpha_0 + \gamma_1 Ownership_i + \gamma_2 Politic_i + \gamma_3 Ownership*Politic_i + \alpha_4 Size_i + \alpha_5 Big4_i + \alpha_6 IndBOC_i + \alpha_7 IndAudCom_i + \alpha_8 Industry_i + \epsilon_i$$

### 4 Results

#### 4.1 Descriptive statistics

Table 3 provides the descriptive statistics of the independent and control variables. Panel A shows the descriptive statistics for continuous variables in the regression model, while Panel B exhibits details in the categorical variables.
Table 3. Descriptive Statistics

<table>
<thead>
<tr>
<th>Panel A - Continuous Variables</th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>Std Dev</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Dependent Variables:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MarCap (million IDR)</td>
<td>446</td>
<td>6,289,777.58</td>
<td>670,500.00</td>
<td>19,181,698.03</td>
<td>3,923,14</td>
<td>204,623,979.21</td>
</tr>
<tr>
<td>EPS</td>
<td>460</td>
<td>119.31</td>
<td>26.13</td>
<td>289.06</td>
<td>-860.23</td>
<td>1,253.17</td>
</tr>
<tr>
<td><strong>Independent Variables:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Top-1</td>
<td>535</td>
<td>50.14</td>
<td>52.00</td>
<td>20.81</td>
<td>7.42</td>
<td>99.74</td>
</tr>
<tr>
<td>Gov</td>
<td>535</td>
<td>3.26</td>
<td>0.00</td>
<td>13.33</td>
<td>0.00</td>
<td>68.42</td>
</tr>
<tr>
<td>Internal</td>
<td>535</td>
<td>1.70</td>
<td>0.00</td>
<td>5.44</td>
<td>0.00</td>
<td>54.00</td>
</tr>
<tr>
<td>Foreign</td>
<td>506</td>
<td>22.14</td>
<td>9.68</td>
<td>27.65</td>
<td>0.00</td>
<td>99.80</td>
</tr>
<tr>
<td><strong>Control Variables:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IndBOC</td>
<td>508</td>
<td>39.62</td>
<td>40.00</td>
<td>11.76</td>
<td>0.00</td>
<td>1.00</td>
</tr>
<tr>
<td>IndAudCom</td>
<td>485</td>
<td>30.44</td>
<td>33.33</td>
<td>15.80</td>
<td>0.00</td>
<td>1.00</td>
</tr>
<tr>
<td>Size (million IDR)</td>
<td>535</td>
<td>3,268,605.18</td>
<td>829,360.91</td>
<td>6,957,527.08</td>
<td>31.37</td>
<td>60,689,784.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Panel B – Categorical Variables</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non Big-4</td>
<td>246</td>
<td>48.81</td>
</tr>
<tr>
<td>Big-4</td>
<td>258</td>
<td>51.19</td>
</tr>
<tr>
<td>Non Politic</td>
<td>303</td>
<td>56.95</td>
</tr>
<tr>
<td>Politic</td>
<td>229</td>
<td>43.05</td>
</tr>
<tr>
<td>Non Manufacturing</td>
<td>305</td>
<td>57.01</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>230</td>
<td>42.99</td>
</tr>
</tbody>
</table>

Legend: See Table 1 for full definitions and descriptions for the dependent, independent and control variables

Panel A shows that the average level of market capitalisation of the sample firms is IDR6,289,778 million with a range between IDR3,923 to IDR204,623,979 million. In addition, sample firms record a mean (median) of 119.30 (26.13) for EPS respectively. In term of ownership structure, on average, more than a half (50.14%) companies in the sample are controlled by the largest stockholders. On average, 3.26% of the firm shareholders are control by the government. Additionally, both management and board of commissioner hold, on average, 1.70% of the company equities. Finally, around 22.14% of the company equities belong to foreign investors.

In regard to the control variables, on average, 39.62% of the board of commissioner and 30.44% of the audit committee members are independent. In addition, the average total sales of the sample firms have a mean of IDR3,268,605 million ranging from IDR31 to IDR60,689,784 million. Panel B of Table 3 indicates that more than a half (51.19%) of the sample firms use the service of Big 4 audit firms. Around 43% of the sample firms are politically connected. Finally, firms classified as manufacturing industry make up 43% of the firms included in the sample.

Table 4 presents the Pearson correlations between the test variables. The correlation results do not provide comprehensive support for the study’s hypotheses. Top-1 and Gov are positively and significantly correlated with the two performance measures (MarCap and EPS). Table 4 also documents significant and negative correlation between Foreign and EPS at p<0.05. Internal ownership is highly negative and significant correlated with MarCap. Finally, Table 4 indicates there is no significant effect of the Politic on all measurements of performance.

Findings also show a significant positive and negative correlation amongst the measurements of independent variable. As the correlation value is below the critical limits of 0.80 (Hair, Anderson, Tatham, and Black 1995; Greene 1999; Cooper and Schindler 2003) it is suggested that a multicollinearity problem between independent variables is not a serious concern. In respect to correlations between independent and control variables, and amongst control variables themselves, the highest correlations are between Size and IndAudCom, with a coefficient of -0.352. This value is, again, below the critical limit of 0.80. Variance inflation factors calculated for all regressions reported in Table 5 for all independent and control variables provide further indications that multicollinearity is not a problem in the model estimations (Hair et al. 1995; Greene 1999; Cooper and Schindler 2003).

As a further check for multicollinearity, this study performs the model estimations reported in Tables 5 by first excluding Size and then IndAudCom. The independent exclusion of each respective control variable does not significantly alter the findings reported in the main result.
Table 4. Pearson correlation matrix

<table>
<thead>
<tr>
<th></th>
<th>MarCap</th>
<th>EPS</th>
<th>Top-1</th>
<th>Gov</th>
<th>Internal</th>
<th>Foreign</th>
<th>Politic</th>
<th>IndBOC</th>
<th>IndAudCom</th>
<th>Sice</th>
<th>Big 4</th>
<th>Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>MarCap</td>
<td>1</td>
<td>.403</td>
<td>.144</td>
<td>.330</td>
<td>-.232</td>
<td>.067</td>
<td>.058</td>
<td>.048</td>
<td>.480</td>
<td>.395</td>
<td>.485</td>
<td>.225</td>
</tr>
<tr>
<td>EPS</td>
<td>.403</td>
<td>1</td>
<td>.286</td>
<td>.195</td>
<td>-.087</td>
<td>.148</td>
<td>-.022</td>
<td>-.020</td>
<td>.255</td>
<td>.296</td>
<td>.106</td>
<td>.244</td>
</tr>
<tr>
<td>Top-1</td>
<td>.144</td>
<td>.286</td>
<td>1</td>
<td>.102</td>
<td>-.125</td>
<td>.120</td>
<td>-.158</td>
<td>-.024</td>
<td>.091</td>
<td>.211</td>
<td>.031</td>
<td>.066</td>
</tr>
<tr>
<td>Gov</td>
<td>.330</td>
<td>.195</td>
<td>.102</td>
<td>1</td>
<td>-.048</td>
<td>-.120</td>
<td>-.005</td>
<td>-.031</td>
<td>.265</td>
<td>.111</td>
<td>.280</td>
<td>.156</td>
</tr>
<tr>
<td>Internal</td>
<td>-.232</td>
<td>-.087</td>
<td>-.125</td>
<td>.048</td>
<td>1</td>
<td>-.146</td>
<td>-.067</td>
<td>-.189</td>
<td>-.104</td>
<td>-.179</td>
<td>-.055</td>
<td>-.078</td>
</tr>
<tr>
<td>Foreign</td>
<td>.067</td>
<td>.148</td>
<td>.120</td>
<td>-.120</td>
<td>-.146</td>
<td>1</td>
<td>-.064</td>
<td>.032</td>
<td>-.057</td>
<td>.158</td>
<td>-.119</td>
<td>.074</td>
</tr>
<tr>
<td>Politic</td>
<td>.058</td>
<td>-.022</td>
<td>-.158</td>
<td>-.005</td>
<td>-.067</td>
<td>-.064</td>
<td>1</td>
<td>.101</td>
<td>.076</td>
<td>-.073</td>
<td>.088</td>
<td>-.024</td>
</tr>
<tr>
<td>IndBOC</td>
<td>.048</td>
<td>-.020</td>
<td>-.024</td>
<td>-.031</td>
<td>-.189</td>
<td>.032</td>
<td>.101</td>
<td>1</td>
<td>.049</td>
<td>-.005</td>
<td>-.032</td>
<td>-.022</td>
</tr>
<tr>
<td>IndAudCom</td>
<td>.480</td>
<td>.255</td>
<td>.091</td>
<td>.265</td>
<td>-.104</td>
<td>-.057</td>
<td>.076</td>
<td>.049</td>
<td>1</td>
<td>.352</td>
<td>.267</td>
<td>.082</td>
</tr>
<tr>
<td>Sice</td>
<td>.395</td>
<td>.296</td>
<td>.211</td>
<td>.111</td>
<td>-.179</td>
<td>.158</td>
<td>-.073</td>
<td>-.005</td>
<td>.352</td>
<td>1</td>
<td>.102</td>
<td>.210</td>
</tr>
<tr>
<td>Big 4</td>
<td>.485</td>
<td>.106</td>
<td>.031</td>
<td>.280</td>
<td>-.055</td>
<td>-.119</td>
<td>.088</td>
<td>-.032</td>
<td>.267</td>
<td>.102</td>
<td>1</td>
<td>.249</td>
</tr>
<tr>
<td>Industry</td>
<td>.225</td>
<td>.244</td>
<td>.066</td>
<td>.156</td>
<td>-.078</td>
<td>.074</td>
<td>-.024</td>
<td>-.022</td>
<td>.082</td>
<td>.210</td>
<td>.249</td>
<td>1</td>
</tr>
</tbody>
</table>

Legend: ** and * indicate significance at p<0.01 and p<0.05, respectively (based on two-tailed tests). See Table 1 for full definitions and descriptions for the dependent, independent and control variables.

4.2 Multivariate analysis

Table 5 tabulates panel least squares results for the sample firms. Panel A presents the results of regression using the market capitalisation as a market-based performance measure, while Panel B using the earning per-share (EPS) as an accounting-based performance measure. The main panel least squares results are reported in Model 1 of Panels A and B. We further explore political-connected firms and firm performance for alternative ownership structures that are present in these firms. The results are reported in Model 2 of both Panels A and B.

Regression model estimates reported in Table 5, Panels A and B, are all statistically significant (F-statistic p<0.01). The model in Model 1, Panel B (23.60%) explains the most variance in the dependent variable and that for Model 2, Panel A (52.90%) the least. As shown in Model 1, Panel A, The coefficients on Top-1, Gov and Foreign are positive and statistically significant at p<0.01. This results support the notion that the largest, government and foreign investors’ roles are not only to monitor management activities but also to play a representative role for minority shareholders in maintaining their interest. However, we find the coefficient for Internal to be negative and significant at p<0.05 level (see Model 1 of Panel A). This suggests that board of commissioner and management shareholders appear to lower the level of monitoring and harm firm performance.

Our result is consistent with Klien (2002) who find a positive association between CEO shareholdings and the magnitude of earnings management. In a similar vein, Santiago-Castro and Brown (2009) suggest that CEO ownership increases the potential for minority shareholder expropriation. In addition, the coefficient for Politic is positive and significant (at p<0.01 level) related to firm performance; thus, this study compliments the work of Leuz and Oberholzer-Gee (2006) and Fisman (2001) who document that in Indonesia a considerable percentage of well-connected firms’ value comes from political relationships. Our result also provides support for the argument forwarded by Faccio (2006). Using a globally sample of 47 countries, Faccio (2006) finds that closed political ties have significant increase in corporate value. Finally, as reported in Model 2 of Panel A, the coefficients for the interaction in term of political connectedness with the presence of the largest and foreign investors (Top-1*Politic and Foreign*Polit) are negative and positive and significant (at p<0.01) respectively. These indicate that foreign shareholdings are more likely to have better performance especially in political firms than non-political firms. Conversely, the presence of the largest investors might reduce firm performance in firms with closed political connections compared to those non-politically connected firms.

Model 1 of Panel B presents the coefficients for Top-1, Gov, and Foreign are positive and significant (p<0.01, p<0.05, and p<0.05 respectively) suggesting that the largest, government, and foreign ownerships are more likely to decrease agency costs and increase firms’ accounting-based performance (measured by EPS). Moreover, the coefficients for the interaction of political connectedness with the presence of the largest and foreign investors (Top-1*Politic and Foreign*Polit) are positive and significant at p<0.01 (see Model 2 of Panel B). Again, these indicate that political ties add to firm performance than those non-political ties when the largest and foreign investors are present.
Table 5. Multiple regression result

<table>
<thead>
<tr>
<th>Variable</th>
<th>Market Capitalisation (MarCap)</th>
<th>Earnings per Share (EPS)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Model 1</td>
<td>Beta</td>
</tr>
<tr>
<td>(Constant)</td>
<td>8.896</td>
<td>7.647</td>
</tr>
</tbody>
</table>

**Independent Variables:**

- **Top-1**
  - Model 1: 0.016, t-stat: 3.400*
  - Model 2: 0.029, t-stat: 4.442*

- **Gov**
  - Model 1: 0.020, t-stat: -0.098, 2.135, 2.280**
  - Model 2: -0.039, t-stat: -1.522, -10.378, -0.319

- **Foreign**
  - Model 1: 0.009, t-stat: 2.373*, -0.084, 1.038, 2.162**
  - Model 2: 3.532, t-stat: -20.353, -273.892, -2.271**

- **Top-1*Politc**
  - Model 1: -0.026, t-stat: 2.831, 1.913**
  - Model 2: 12.610, 0.387

- **Gov*Politc**
  - Model 1: 0.122, t-stat: 0.590, 12.610, 0.387
  - Model 2: 12.610, 0.387

- **Internal*Politc**
  - Model 1: -0.030, t-stat: 5.348, 1.089
  - Model 2: 12.610, 0.387

- **Foreign*Politc**
  - Model 1: 0.019, t-stat: 3.123*, 1.913**
  - Model 2: 12.610, 0.387

**Control Variables:**

- **IndBOC**
  - Model 1: 1.790, t-stat: 2.524*, 1.630, 2.336**, 142.818, 1.313, 186.747, 1.147
  - Model 2: 142.818, 1.313, 186.747, 1.147

- **IndAudCom**
  - Model 1: 0.546, t-stat: 1.089, 0.821, 1.668***, 1.957, 7.144*, 0.239, 1.668***
  - Model 2: 1.957, 7.144*, 0.239, 1.668***

- **Size**
  - Model 1: 0.249, t-stat: 7.409*, 0.239, 2.144*, 19.547, 3.766*, 16.516, 2.091**
  - Model 2: 19.547, 3.766*, 16.516, 2.091**

- **Big 4**
  - Model 1: 1.076, t-stat: 5.893*, 1.062, 5.844*, 89.167, 3.202*, 123.274, 2.948*
  - Model 2: 89.167, 3.202*, 123.274, 2.948*

- **Industry**
  - Model 1: 0.476, t-stat: 2.774*, 0.517, 3.070*, 1125.26, 4.829*, 181.840, 4.679*
  - Model 2: 1125.26, 4.829*, 181.840, 4.679*

**Model Summary**

- R-Squared: 0.517, 0.547
- Adj. R-Squared: 0.517, 0.547
- F-Statistic: 38.392*, 29.461*, 12.733*, 9.334*
- Sample Size: 407, 407

Legend: *, **, and *** indicate significance at p<0.01, p<0.05 and p<0.10 respectively (based on two-tailed tests). See Table 1 for full definitions and descriptions for the dependent, independent and control variables.

Our further analyses reveal that foreign ownerships have significantly higher (at p<0.01 level) financial leverage (measured by total debt to total equity) than those domestic investors (see Table 6 below).

Table 6. Descriptive statistics – Foreign versus Domestic ownership

<table>
<thead>
<tr>
<th>Ownership</th>
<th>N</th>
<th>Mean</th>
<th>SD</th>
<th>t-value</th>
<th>Sig</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic Ownership</td>
<td>211</td>
<td>68.56</td>
<td>122.86</td>
<td>-2.653</td>
<td>0.008</td>
</tr>
<tr>
<td>Foreign Ownership</td>
<td>285</td>
<td>104.53</td>
<td>178.87</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Of those 285 foreign ownership firms, around 42.11% (120 firms) are politically connected. Indonesian politically connected firms often receive privileges of access to domestic debt financing (Leuz and Oberholzer-Gee 2006). For example, in 1990s the Golden Key (a chemical and manufacturing firm) received an unsecured loan of $430 million from Bank Pembangunan Indonesia (an Indonesian state-owned bank). Court proceedings finally revealed that the youngest son of President Suharto was involved in the approval process for that loan (McBeth 1994).

Similarly, the Barito Pacific group, one of the largest Indonesian conglomerates which had very close ties to President Suharto, received large loans from state banks. It is widely cited that well political relations are the reason behind the state banks’ generosity (Borsuk 1993).

5 Conclusion

Berle and Means (1932) commented that where managers hold little equity in the firm and
shareholders are too dispersed to enforce value maximisation, corporate assets may be deployed to benefit managers rather than shareholders. Such managerial benefits can include shirking and perquisite taking, but also encompass pursuit of non-value maximising objectives such as empire building. According to Jensen and Meckling (1976), the costs of deviation from value maximisation decline as management ownership rises. As their stake rises, managers pay a larger share of these costs and are less likely to squander corporate wealth. According to this convergence of interest hypothesis, market value increases with management ownership. Numerous studies have identified a positive relationship between executive compensation and firm performance. An analouged area that is often overlooked is the relationship between firm performance and political connection. In many respects political connection can proxy for inside ownership as both will impact on the level of board monitoring and the impact of corporate political connection is a significant part of the Indonesian economy.

Governance practices and regulations applied to a company’s board of directors are viewed as key differences between developed and developing countries. As noted by Denis and McConnel (2003), “the first generation of international corporate governance research examines governance mechanisms – particularly ownership and board structure – for individual countries in depth and establishes that there are important differences in governance systems across economies” (p.30). Our study found that the largest government and foreign ownerships are positive and significant associated with firm’s performance as measured by market capitalisation. Internal shareholding is negative and significant relationship with market capitalisation. In addition, political connected firms are positive and significant associated with MarCap and EPS when foreign investors are present.

References

EMPLOYEE THEFT IN THE SOUTH AFRICAN RETAIL INDUSTRY: KILLING THE GOOSE THAT LAYS THE GOLDEN EGG?

M.C. Cant*, E.C. Nell**

Abstract

Employee theft has once again come to the fore as a result of the economic crises prevailing world wide. It is a known fact that as economic hardships increase people are looking at other ways and means to supplement their declining income. One such method is unethical behaviour in the form of employee theft. Retail shrinkage as a result of theft by employees and consumers is a serious problem worldwide and has a direct effect on commerce and industry. Not only does it result in a loss of profit but the retailer is also faced with additional costs such as legal expenses, loss of productivity, expensive security measures, product replacements, increased insurance, loss of trained staff and the expense of retraining new staff in the case of conviction of dishonest employees. The cost of employee theft is enormous and it has a definite and detrimental impact on business activities. Industry estimates place shrinkage at between 5 and 7 percent of turnover, with most companies budgeting for at least 3 to 5 percent. The main purpose of the study was to examine the reasons why employees participate in this type of dishonest behaviour and the methods that they use in such instances. The research followed a quantitative approach where a survey questionnaire was used as the data collection method. As few if any person will admit to stealing, projection techniques were used to obtain the information. It was found that employees are aware of a variety of methods by which employees steal. The impression was gained that employees are not aware of the impact and effect losses of this nature have on the future success of a company. Dishonesty creates its own vicious circle. If management is perceived as treating employees unfairly in order to make even larger profits employees become defiant and react in such a dishonest manner. Employees then regard stealing as paying management back for this. This study highlights the areas where corrective action is required and indicates the need for a strict security policy and a beneficial corporate environment to be created by management.

Keywords: Retail Industry, Employee Dishonesty, Theft, Shrinkage, Shoplifting

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1 Introduction

Retail shrinkage is not simply an affliction of modern times. It is in fact a very ancient form of crime to which reference is made as far back as 1597 in England (Curtis, 1960:91, Segrave, K. 2001). Today, 500 years later, it has been reported that one of the major results of the financial crisis in the world is the increase in employee theft in the workplace which have contributed to the fact that the retail sector is one of the worst affected industries suffering from a rise in employee theft in the workplace over the past two years (Investigate: 2012: 1). It is also agreed that retail shrinkage caused by employee and customer theft is a serious economic problem that affects both commerce and industry. Research conducted by the Australian Retailers Association have indicated that shoplifting is the most common crime that impacts on retailers, their profit, customers, staff and day-to-day trading practises (Crime Prevention, 2012: 2). According to Murphy (2009) at least 50 percent of inventory losses for retailers can be attributed to employee theft. A study conducted by Arthur Young Associates (Mason & Mayer, 1993: 233) indicated that retailers now attribute more of their losses to employee theft than to shoplifting by customers. Specifically, they believe the breakdown to be as shown in table 1 below and it is expected that these figures will be very similar today.
The magnitude of employee theft is enormous and when looking at the problem of dishonest employees, it is advisable to keep in mind that internal theft is costly in various ways (Hess, 2009). Some hidden or additional costs associated with employee theft include the following:

- the loss of one or more trained employees due to the fact that they were fired or convicted;
- the possible "contamination" or influencing of other employees leading to new losses;
- the cost involved in training replacement employees;
- the cost of destroyed or stolen records;
- the unfavourable publicity and damage to the outlet's image; and
- the lowered morale when suspicion is directed at honest and valued employees.

It would be almost impossible for any retailer to devise security measures to monitor the dishonest activities of all retail employees throughout a working day, especially in complex multi-product, multi-location, multi-price, and multi-national corporate entities (Ferrell & Hirt, 2002: 37-50). In order to be able to reduce or minimise theft of this nature a retailer must focus on securing some sort of buy in or a commitment from its employees. It will also be important to create an environment that is conducive to honesty and loyalty. The need for research into prevailing attitudes underlying employee dishonesty is therefore clear. Only when the retailer knows what the reason for dishonesty and negative attitudes are can he attempt to find ways to improve the situation. In this study recommendations are made to this effect.

### 2 Research objectives

The main aim of the study was to explore the reasons and methods for employee theft in the South African retail industry and to formulate appropriate actions to combat this behaviour.

To achieve the main (primary) objective, the following secondary objectives are proposed:

- To explore the reasons for employee theft, and
- To identify the more common methods by which employees steal.

### 3 Research methodology

In order for the researchers to explore the reasons and methods for employee theft in the South African retail industry, a quantitative approach was followed and the

#### Table 1. Breakdown of shrinkage

<table>
<thead>
<tr>
<th>Category</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee theft</td>
<td>43</td>
</tr>
<tr>
<td>Shoplifting (external)</td>
<td>30</td>
</tr>
<tr>
<td>Poor paperwork and control</td>
<td>23</td>
</tr>
<tr>
<td>Vendor theft</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
</tr>
</tbody>
</table>

required data needed was collected by means of a survey questionnaire. Secondary as well as primary data were used to obtain the required information in order to analyse the reasons and methods for employee theft. To address the problem adequately, the research methodology was based on the primary data collection from employees in a particular chain store. The population for the research survey consisted of the employees of a major retail chain store in the Gauteng province in South Africa. In total five stores were identified based on the high levels of shrinkage taking place in them and all the employees of these outlets were included in the survey. There were a total of 185 employees in these stores and all were included in the survey. Due to the sensitive nature of the subject under investigation the interviews were conducted in a group fashion. This was done by bringing all the employees of a particular store together in the training room and by means of a power point slide show, the respondents were requested to complete the questionnaires handed to them.

The questionnaire comprised of a set of two 4-point Likert-scale questions that were used to determine the main constructs of this study. These two Likert-scale questions were found to be highly reliable with a Cronbach’s Alpha of 0.7. The first section of the questionnaire examined the employment history of the employees, followed by the different reasons why employees steal. Section two investigated the methods by which the employees feel their colleagues partake in dishonest practices and the last section of the questionnaire comprises of the demographics that describe the profile (characteristics) of the respondents.

4 Employee theft

All major chain stores are in agreement that the largest slice of retail shrinkage in South Africa is directly related to employee theft. A major retailer put employee theft at 72 percent of total shrinkage while Murphy (2009) puts the average figure of employee theft at more than 50 percent. To worsen this problem is the fact that employee theft is far more insidious and complex than shoplifting. Large retail outlets employ hundreds of personnel with access to merchandise, and under a wide variety of conditions which heighten the potential for dishonest behaviour (Crime Prevention, 2012: 2). Employee theft comes in many shapes and forms, and may take the form of “borrowing” money from a cash register; taking merchandise, supplies, or tools home in handbags and lunch boxes; or more-complicated manipulations of organisational assets (more recently by computer) for personal benefit.

4.1 The causes or reasons for employee theft

Arriving at some consensus as to the causes of employee theft has been an allusive goal for many researchers. Fitzmaurice and Radolf (1961:4), Bullard and Resnik (1983:53) and Sennwald and Christman (2008) indicated four conditions that give rise to employee theft, namely

wrong hiring, temptation, desire and opportunity. These conditions although still applicable today, are a rather one-sided and limited view of the problem. According to these authors, employee theft is influenced by four major opportunities. These are:

• Easy access to company cash and property.
• An inherent lack of integrity.
• Pressure caused by personal problems increases the propensity to steal.
• The organisational climate can be conducive to dishonesty.

When there is little opportunity to steal, even the employee with the lowest level of integrity will find it difficult to do so. Nevertheless, while opportunities can be minimised they cannot be eliminated. In a study conducted by Hollinger & Clark (1983), need was found to be unrelated to employee theft. The study, however, indicated that employee integrity was closely related to theft in the workplace. Those who steal appear to have the attitude that stealing is not unethical, or that it can be justified in some cases.

Personal pressure such as economic pressures or performance pressures may lead to a honest employees to become dishonest as he or she need to make the grade or survive. Merriam (1977:386) and Pedneault (2010) have identified similar causes or reasons for employee theft and these include amongst others economic, individual, personal and organisational influences. Each of these causes is briefly discussed below.

Other causes of employee theft that have not been mentioned may exist, but these are the most commonly articulated causes for dishonest behaviour. It should be noted however that these differing causes are probably not mutually exclusive and normally a combination of these factors will be present leading up to dishonest behaviour.

4.2 The methods of Employee theft

The methods used by employees to steal are wide and diverse and not easy to identify or deal with. Employees are also very creative in their methods used to steal. Irrespective of the methods devised to curb theft those who want to be dishonest will be so and employers must be wary thereof. Therefore, any security policy should be constantly evaluated and revised as often as necessary (Reference for Business, 2012).

According to Bamfield (November-December, 1988:23) and Cant (1991: 189), there are perhaps 130 different basic methods by which customers, employees and suppliers' representatives can steal from retailers, and there are at least 47 different ways of stealing at the checkout point, including sweet hearting and under ringing. Retail theft thus embraces a variety of problems and this means that there can be no quick technological fix - or single big idea - which will discourage employees from dishonest practices. While it would be impossible to identify all possible methods of internal theft, the following are some of the more common methods used.
4.2.1 Theft of cash

Sales is the area where cash theft mostly occur, but dishonest employees in the bookkeeping and credit departments can also do a great deal of damage due to their access to larger amounts of money.

The most vulnerable area for cash theft is, as one might expect, the cash register. A common method of theft here is by simply not ringing up a transaction or sale and pocketing the money. This happens most frequently in retail type establishments which have a rapid turnover of customers, such as restaurants or bars, where the employee can keep the register open after an initial sale. A similar type of activity is the "no sale" transaction. Here the employee rings a no sale on the cash register and fails to give the customer a sales receipt. "Underring" is a method, like the "no sale" transaction, whereby the employee does not give the customer a receipt and pockets the difference.

4.2.2 Theft of merchandise

As with the stealing of cash, merchandise theft methods may range from complex operations involving several employees to the simple taking home of small items in pockets or purses. The merchandise may include items that are offered for sale by the business or tools and other items used by the business. Similarly, the motives may be the resale of the items for cash or alternatively for the personal use of the employee. In any case, the results of merchandise theft may be devastating to the business.

4.2.3 Dishonest practices

Purchasing agents add an additional dimension to the problem of internal theft. Purpa (2008) notes that perhaps nine out of ten purchasing agents take gifts or kickbacks from suppliers. He further points out that some manufacturers include a two to three percent mark-up in their costs to make provision for these items. While this does not appear to be the same as direct theft, the employer still loses money in the transaction.

In the receiving department there can be false counts of shipments in order to cover shortages. These can result from thefts or from conspiracy with vendors who are charging for goods they never delivered. Another variation on receiving fraud is to arrange the records and paperwork in such a way that the same invoice is paid twice.

It is clear from the above discussion that various methods are used by employees to steal, and it is not really possible to eradicate these types of problems. The best that can be hoped for is to reduce the incidents and opportunities. The implications for the business are quite obvious. The ultimate result is higher prices due to added security, tamper proof packaging, surveillance systems, and so on.

5 Research findings

The results of this survey are based on the 185 completed questionnaires received from a census survey of all the employees in the five selected retail outlets. The chain store is the universe from which the sample is drawn. The sample is large enough to be representative of the universe and there is no reason why the conclusions and recommendations drawn from the study, should not also be applicable to the retail sector as a whole. As mentioned previously the selected retail stores are the largest and most "troublesome" branches of the chain store. If top management succeeds in limiting employee theft in these stores, it follows that the same measures in other retail stores would probably also be successful. The following research findings were observed in the study.

5.1 Employment history

In this section the employment records of the respondents in the sample are examined. Figure 1 below indicated the previous employment experience of the respondents and it is observed that the majority (42,2%) of respondents have worked in a supermarket before, while a further 9,7 percent indicated that they have been employed in a retail store before. This implies that 51,9 percent of the employees have previous experience in a retailing environment and have probably been exposed to the opportunities for dishonesty. In total 36 employees indicated that this was their first job.

Figure 1. Employment experience

<table>
<thead>
<tr>
<th>Supermarket</th>
<th>Other Retail Store</th>
<th>Other</th>
<th>None</th>
</tr>
</thead>
<tbody>
<tr>
<td>42,2%</td>
<td>28,6%</td>
<td>19,5%</td>
<td>9,7%</td>
</tr>
</tbody>
</table>
From figure 2 below it is evident that the majority of respondents (42.7%) have been employed by the chain store for between 3 and 5 years, while 38.9 percent have been employed for more than 6 years. Regarding the position held, it is evident that a high number of employees are employed as packers (38.4%), as well as a fairly large number employed as cashiers (19.5%). Compare to the fewer, more senior positions of stock controller and supervisor (18.3%), it is clear that the task of the latter employees in controlling losses are not an easy one, as they need to control a large workforce. Other positions held represent 23.8 percent of employees and include jobs such as cleaners, casuals and messengers.

Figure 2. Years employed and position held at the Chain store

5.2 Attitude to and awareness of dishonest behaviour

This section deals with respondents’ attitude to and awareness of all forms of dishonesty. Figure 3 below represents the opinion of respondents regarding the question whether or not taking an item in a store, without paying for it, is ever justified. It was found that an overwhelming majority of respondents (88.6%) are of the opinion that it is never justified for an employee to take an item without paying for it. However it is interesting to note that 11.4 percent of the respondents are of the opinion that it is justified for employees to steal, thereby demonstrating an underlying negative attitude towards honesty.

Figure 3. Justification for taking an item without paying for it

Table 2 below indicates the responses of the respondents regarding the awareness of any dishonest practices in the store as well as the methods used to steal from the store. From the table it is clear that employees are to a greater or lesser extent aware of all the dishonest practices as mentioned in the table.
Table 2. Awareness of dishonest practices

<table>
<thead>
<tr>
<th>Practice</th>
<th>Yes n</th>
<th>Yes %</th>
<th>No n</th>
<th>No %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Underringing of the cash register</td>
<td>57</td>
<td>30,8</td>
<td>128</td>
<td>69,2</td>
</tr>
<tr>
<td>Failing to ring up sales</td>
<td>57</td>
<td>30,8</td>
<td>128</td>
<td>69,2</td>
</tr>
<tr>
<td>Overcharging of customers</td>
<td>69</td>
<td>37,3</td>
<td>116</td>
<td>62,7</td>
</tr>
<tr>
<td>Cashing of bad cheques for friends</td>
<td>42</td>
<td>22,7</td>
<td>143</td>
<td>77,3</td>
</tr>
<tr>
<td>Fictitious refunds</td>
<td>55</td>
<td>29,7</td>
<td>130</td>
<td>70,3</td>
</tr>
<tr>
<td>Taking cheques payable to cash</td>
<td>46</td>
<td>24,9</td>
<td>139</td>
<td>75,1</td>
</tr>
<tr>
<td>Trading of unpaid for merchandise with friends</td>
<td>38</td>
<td>20,5</td>
<td>147</td>
<td>79,5</td>
</tr>
<tr>
<td>Hiding goods in stairways, public lockers, etc.</td>
<td>46</td>
<td>24,9</td>
<td>139</td>
<td>75,1</td>
</tr>
<tr>
<td>Taking goods from the warehouse with cooperation of warehouse employees</td>
<td>38</td>
<td>20,5</td>
<td>147</td>
<td>79,5</td>
</tr>
<tr>
<td>Giving employee discount to friends</td>
<td>43</td>
<td>23,2</td>
<td>142</td>
<td>76,8</td>
</tr>
<tr>
<td>Putting on clothes and wearing them home</td>
<td>49</td>
<td>26,5</td>
<td>136</td>
<td>73,5</td>
</tr>
<tr>
<td>Intentionally soiling garments for damaging merchandise so employees can buy them at reduced prices</td>
<td>34</td>
<td>18,4</td>
<td>151</td>
<td>81,6</td>
</tr>
<tr>
<td>Smuggling out goods in trash and refuse containers</td>
<td>50</td>
<td>27</td>
<td>135</td>
<td>73,</td>
</tr>
<tr>
<td>Giving a cut-price to friends</td>
<td>41</td>
<td>22,2</td>
<td>144</td>
<td>77,8</td>
</tr>
<tr>
<td>Taking packages from the delivery trucks</td>
<td>40</td>
<td>21,6</td>
<td>145</td>
<td>78,4</td>
</tr>
<tr>
<td>Hiding of small items in a regular employee package</td>
<td>41</td>
<td>22,2</td>
<td>144</td>
<td>77,8</td>
</tr>
<tr>
<td>Switching of price tags</td>
<td>62</td>
<td>33,5</td>
<td>123</td>
<td>66,5</td>
</tr>
</tbody>
</table>

Taking the answers at face value, the table indicates that the following practices of employee dishonesty are the most popular forms of dishonesty and are taking place in the chain store quite often:

- Overcharging of customers – 37.3 percent;
- Switching of price tags – 33.5 percent;
- Underringing of the cash register – 30.8 percent;
- Failure to ring up sales – 30.8 percent;
- Fictitious refunds – 29.7 percent.

5.3 Reasons for employee theft

Various reasons as to why employees steal have been discussed above. These reasons can be grouped in specific categories. Table 3 shows the reasons why employees steal. In order to understand the answers they were grouped according to “fully agree” and “agree” on the one side and “don’t agree” and “totally disagree” on the other side.

Table 3. Reasons why employees steal

<table>
<thead>
<tr>
<th>Reason</th>
<th>Fully Agree n</th>
<th>Agree n</th>
<th>Don’t Agree n</th>
<th>Totally Disagree n</th>
</tr>
</thead>
<tbody>
<tr>
<td>They are under paid</td>
<td>76</td>
<td>39</td>
<td>29</td>
<td>41</td>
</tr>
<tr>
<td>See it as part of their pay packet</td>
<td>42</td>
<td>35</td>
<td>50</td>
<td>58</td>
</tr>
<tr>
<td>The company would not feel it</td>
<td>34</td>
<td>23</td>
<td>59</td>
<td>69</td>
</tr>
<tr>
<td>Because it is easy</td>
<td>28</td>
<td>31</td>
<td>61</td>
<td>65</td>
</tr>
<tr>
<td>There is no strict security</td>
<td>37</td>
<td>43</td>
<td>45</td>
<td>60</td>
</tr>
<tr>
<td>They like to do it</td>
<td>31</td>
<td>38</td>
<td>64</td>
<td>52</td>
</tr>
<tr>
<td>They see it as a challenge</td>
<td>33</td>
<td>44</td>
<td>57</td>
<td>51</td>
</tr>
<tr>
<td>They know they can get away with it</td>
<td>36</td>
<td>29</td>
<td>61</td>
<td>59</td>
</tr>
<tr>
<td>Need to do it to keep up with their living standard</td>
<td>45</td>
<td>40</td>
<td>43</td>
<td>57</td>
</tr>
<tr>
<td>To pay gambling debts</td>
<td>36</td>
<td>23</td>
<td>57</td>
<td>69</td>
</tr>
<tr>
<td>They are influenced by their friends</td>
<td>34</td>
<td>30</td>
<td>44</td>
<td>77</td>
</tr>
</tbody>
</table>
From the table it is evident that according to the respondents, the most important reason why employees steal is because they are underpaid (62.2%). The current economic climate is a contributing factor to this, and it can be accepted that this is a major reason why employees steal. The second important reason why employees steal is because they need to keep up with their living standards (45.9%). This fact goes hand in hand with worsening economic climate and the reluctance of people to adapt their living standards accordingly. It is clear from the two main reasons why employees steal that the economic climate has a definite influence on theft by employees. The third important reason why employees steal is because there is no strict security (43.2%) and they have indicated that they will not be caught if they stole something. These findings pose serious questions regarding the effectiveness of current methods used to curtail losses of this nature. The fourth important reason why employees steal (41.6%) is because they see it as part of their pay package. This implies that employees regard it as their right to take some items for themselves at the expense of the company. The fifth reason as indicated in the table is that employees regard theft as a challenge (41.6%) and therefore they steal. If the situation in which they find themselves is therefore challenging, they may opt for stealing. This probably means that there are opportunities for them to steal.

The remaining reasons offered by respondents seem to indicate that employees steal because it is either fun or easy or the fact that the company owes them something. It would seem as if they feel it is their right to react in this way.

5.4 Methods used by employees to be dishonest

Various methods are used by employees to be dishonest. By asking employees to indicate the methods used by other employees to be dishonest, it was hoped that an idea would be obtained as to which methods are used. Below in table 4, the frequency of employee responses are indicated on a scale question. The responses “mostly used” and “often used” are added together as this would provide a more realistic picture of the methods used to be dishonest.

<table>
<thead>
<tr>
<th>Methods</th>
<th>Mostly Used</th>
<th>Often Used</th>
<th>Seldom Used</th>
<th>Never Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tag switching</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>55</td>
<td>29.7</td>
<td>19.5</td>
<td>13.5</td>
</tr>
<tr>
<td>Underringing</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>35</td>
<td>18.9</td>
<td>45</td>
<td>41.6%</td>
</tr>
<tr>
<td>Switching the contents of products</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>32</td>
<td>17.3</td>
<td>20</td>
<td>16.8</td>
</tr>
<tr>
<td>No-sale ringing</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>42</td>
<td>22.7</td>
<td>31</td>
<td>16.2</td>
</tr>
<tr>
<td>Overcharging of customers</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>31</td>
<td>16.8</td>
<td>30</td>
<td>16.2</td>
</tr>
<tr>
<td>Giving the wrong change</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>32</td>
<td>16.8</td>
<td>30</td>
<td>16.2</td>
</tr>
<tr>
<td>Hiding goods and taking it later</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>30</td>
<td>16.2</td>
<td>22</td>
<td>16.2</td>
</tr>
<tr>
<td>Taking goods from the warehouse with assistance from them</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>30</td>
<td>16.2</td>
<td>19</td>
<td>16.2</td>
</tr>
<tr>
<td>Giving employee discount to friends</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>20</td>
<td>10.8</td>
<td>17</td>
<td>16.2</td>
</tr>
<tr>
<td>Putting on clothes and wearing them home</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>25</td>
<td>13.6</td>
<td>18</td>
<td>16.2</td>
</tr>
<tr>
<td>Soiling of garments to buy it at lower prices</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>23</td>
<td>12.4</td>
<td>21</td>
<td>16.2</td>
</tr>
<tr>
<td>Hiding of small items in employee package</td>
<td>n</td>
<td>%</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>32</td>
<td>17.3</td>
<td>26</td>
<td>16.2</td>
</tr>
</tbody>
</table>

The more important methods used by employees to steal have been discussed above. An encouraging sign from the table is the relatively high percentages in the “never used” column (average ±50%). Even so, this means that one half of the employees still have knowledge of the 13 methods mentioned in the table. Form the table it would seem that the methods mostly and often used by employees to be dishonest are tag switching (49.2%) and Underringing (34.2%). The five methods mostly used by employees to be dishonest are presented in figure 4 below.
In table 2, “employees’ awareness of dishonest practices” was determined. Some of the responses in table 2 are more or less in line with the responses in table 4, where 33.5 percent of employees indicated that they are aware of tag switching taking place, 30.8 percent are aware of Underringing and 30.8 percent awareness of “no sale” ringing.

The percentages in the “no” column of table 2 also correspond largely with the percentages in the “Never Used” column of table 4. In table 2, 81.6 percent of employees indicated that this method is never used. Similarly, 79.5 percent of employees are not aware of employees taking goods from the warehouse with the co-operation of warehouse employees, as opposed to 60.5 percent who indicated that this method is never used. Giving employee discounts to friends are probably not widely used as 76.8 percent indicated that this method is never used. Giving employee discounts to friends are probably not widely used as 76.8 percent indicated that this method is never used. The fact that these percentages are closely matched supports the validity of the results.

The listed five methods all warrant urgent attention as they all relate to employees working on cash registers who can collaborate with employees and/or friends. This presents a serious threat to any business if employees in positions of trust abuse this trust.

The methods used to steal are not all easily traceable and to a large extent management has to rely on the honesty of employees. Dishonesty involving customers can have a very negative effect on the image of the company if customers realise they are being overcharged, or given the wrong change. This may lead to customers not patronising the store, or even “spreading the word” by means of word of mouth.

5.5 Demographic profile of the respondents

Lastly, the respondents were asked to indicate their demographic information for the purpose of the study. Questions such as the respondent’s gender, age, marital status and number of children were asked. The following information were gathered from the respondents and used to establish the demographic background of respondents who participated in the study.

Below in figure 5 it is evident that there is more of less an even distribution of males (53.5%) and females (46.5%) employed at the retail outlets.

In figure 6, it can be seen that there is a concentration of respondents (29.2%) in the 26-30 years age group, followed by the 31-35 years age group (22.2%) and the >40 years age group (18.3%). Youngsters in the under 20 years age group (1.1%) and 20-25 years of age group (12.4%) comprise a relatively small proportion of the respondents.

From figure 7 below it is clear that the majority of the respondents (55.7%) are married. A substantial number of respondents are single (35.1%), while divorced or widowed respondents comprise only 9.2 percent of the sample.
From figure 8 below, it is clear that the overwhelming majority of respondents (28.6%) have only one child. A fairly large proportion of respondents (37.9%) have three or more children. The implication of this is that, generally, the larger the family the harder pressed they are to make ends meet. It is known that age and family size have an influence on the incidence of theft — especially in times of economic hardship. From the responses it would seem that no difference is apparent between the different groups and therefore no distinction is made in the subsequent analysis.
6 Recommendations

It would seem from the discussion of the main findings that the reason for employees to be dishonest in the workplace is due to the fact that they feel they are underpaid, that they need to keep up with their living standards, there are no strict security, they see it as part of their pay package and they regard theft as a challenge. It can therefore be recommended that the management of the chain store should implement better and more advanced security systems and a written policy should also be enforced. A real need exists for a properly constructed security policy, but in order for such a policy to be acceptable, it is essential that everybody in the company work together. It is recommended that such a policy should cover all relevant topic areas and should strictly be adhered to.

They should also improve on communication between the employees and management with the aim to also improve on the relationship between them in order to make the employees feel comfortable to talk to management regarding personal matters such as illness, underpayment, other employees that are practicing dishonest behaviours and as well as to make the employees feel that the management are supporting them. The support of employees can, however, only be achieved if management is instrumental in creating a climate of mutual trust. Employees must feel free to approach management with problems and they must feel that management really cares about them. This implies that the right culture must be cultivated in the company, one in which managers are seen as the heroes, that is, people to look up to and follow. The examples set by management are therefore essential if the right climate is to be established. Without this, no loss prevention programme will be effective. The basic pre-requisite for creating a beneficial climate is for management to set the example.

In order to create a climate of mutual trust and respect, management needs to address those areas which contribute to distrust and negative attitudes. One such area which needs to be improved is working conditions. The majority of employees indicated that they are underpaid. While a large portion indicated that the reason as to why they steal is because it is easy, and because there is no strict security. By improving working conditions and making employees aware of how their working conditions compare with those of other similar companies, the perception that management does not care can be rectified. Furthermore, the ease with which stealing can be accomplished needs to be removed by means of stricter security and the establishment of a participation security force, where employees are actively involved in loss prevention programmes. The problem of employee theft will never be totally eradicated, but there are preventative measures by which losses of this nature can be limited.

7 Conclusions

Theft from retail stores is a very ancient form of crime. As far back as 1735 it appears that shoplifting became so common and so detrimental to the retailers in London that an application was made to the government for assistance in apprehending the offenders. Today, hundreds of years later, retailers still experience the same problem. Little is known about the extent of shoplifting, employee theft and the methods used to steal from retailers. This study was undertaken to help close the information gap and to provide a clearer insight in this phenomenon. The primary objective for this study was therefore to explore the reasons and methods for employee theft in the South African retail industry. Both the primary and secondary objectives set for this study was achieved. The survey determined the reasons why employees steal and it also determined the most common methods by which employees steal. The impression gained from this survey is that there are a variety of methods by which employees steal, perhaps even some unknown to management and
that it would not be easy to eliminate them. Both management and employees offer reasons as to why employees are dishonest. Some of the reasons being underpaid, keeping up with living standards and there aren’t strict security. The establishment of a more honest climate can only be achieved if the reasons for these actions are known. Furthermore, the survey showed that the methods used to steal vary and are not all easy to detect. Some methods have serious consequences, not only for employees, but also for customers. Further research can be conducted in order to determine if the employees are motivated in the work place and if effective communication between employees and management takes place.

References

CONSUMERS’ EXPENDITURE PATTERNS AND SHOPPING PREFERENCES IN UNDERDEVELOPED URBAN AREAS: THE CRITICAL CASE OF TSHWANE

Michael Colin Cant*, Catherine Mpolokeng Sephapo**

Abstract

This paper investigates the household expenditure patterns and shopping preferences of consumers residing in underdeveloped black urban areas in the Tshwane area. Black households are already by far the largest group in the middle-income (LSM 5-8) market, where their numbers continue to grow steadily (Chase, Legoete & van Wamelen, 2010:2). Past research provides oddments of general spending patterns in South Africa among the population at large; however, this study focuses specifically on the area of Tshwane. Although the sample size was not representative of the entire population, the results provide a picture of what and how black consumers residing in this area spend their household income. A quantitative approach was used for this study where a survey questionnaire was used as a method for collecting data. The results showed that although the income of the sample population was not high, basic needs were fulfilled and the concept of keeping costs low did not come at the expense of the quality of goods and services.

Keywords: Household Expenditure Patterns, Informal Black Urban Areas, Consumers, Tshwane Area, Preferences, Shopping Patterns

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1 Introduction

The recession that South Africa has been going through in recent years has made the country’s consumers adapt and change their behaviour so that they can survive (SA Trader, 2012). To do this, consumers have had to modify their emotional and functional needs to suit their oscillation in their disposal incomes. This means that people who do not have a set income each month cannot spend the same money on set items each month. This translates to everything from food to clothes and entertainment (SA Trader, 2012). There are numerous reasons why black consumption patterns warrant separate attention. A focus on black consumption provides insight into the emerging black middle class, a phenomenon drawing much interest from analysts and commentators (Nieftagodien & Van der Berg, 2007:3).

Gauteng is the smallest province in South Africa but the most densely populated. Its population is estimated to be 7 870 000, which includes people from surrounding areas such as Evaton, Sebokeng, sharpville, Tshwane and Soweto among others (SA Townships, 2012).

The study focuses on the household expenditure patterns of consumers residing in black urban areas of Tshwane as well as shopping preferences because limited research has been done in this area. For the purpose of this study, the term ‘Black urban area’ will refer to underdeveloped urban residential areas in which non-white inhabitants live. These residents include black, coloureds and Indian working class individuals (Give Hope, 2009). The city of Tshwane’s Black urban areas include Atteridgeville, Eersterus, Laudium, Mamelodi, Marabastad, Saulsville and Soshanguwe (SA Townships, 2012). There is a higher concentration of people residing in these areas however; there are also limited shopping centres within their immediate surroundings where they could shop. It has been a recent development where ‘malls’ are being erected in black urban areas such as the ‘Maponya Mall’ in Soweto. Which leads to the question as to how and where do black consumers spend their household income? The aims and objectives of the research study will follow in the subsequent section. The theoretical framework used to conceptualise consumer shopping preferences in this study will then be discussed. The research methodology used to conduct this study will then be discussed followed by an analysis of previous research studies. The research findings, concluding remarks and recommendations will end the study.

2 Aim and objectives of the research

The aim of this study was to establish expenditure patterns of consumers residing in Black urban areas of Tshwane in South Africa. Additional objectives were formulated to attain the aim of the paper. They comprise of the following:

- To investigate what consumers residing in black urban areas spend their household income on.
To establish whether consumers residing in black urban areas of Tshwane have retail stores within their townships.

To determine whether consumers residing in black urban areas of Tshwane have generic clothing stores within their townships.

To determine where consumers residing in black urban areas of Tshwane prefer to shop.

To ascertain the frequency in which consumers shop at generic clothing outlets.

To ascertain the frequency in which consumers residing in black urban areas of Tshwane shop at retail outlets within their townships.

To establish the reasons why consumers shop at generic outlets.

To explore the reasons why consumers shop at shopping malls.

3.1 Theoretical framework

Shopping behaviour of consumers differ from one consumer to another. These individuals are all influenced by various factors therefore impacting on their behaviour. This impact could either be negative or positive. Sheth (1983) in Rajamma and Neeley (2005) suggest that consumers’ shopping preference for a shopping outlet will be determined by their shopping motives as well as the shopping options they have available to them. These motives have been conceptualised to be of two types, (a) functional needs and non-functional needs (Rajamma&Neeley, 2005:65). It is argued that functional needs are related to outlet attributes whereas non-functional needs are anchored to outlet association (Rajamma&Neeley, 2005:65). Another factor under consideration is the shopping options consumers have available to them. This is set to have some impact on the shopping preference of consumers. In this paper, the conceptualisation of the process underlying consumers’ preferences for shopping at different locations is based on the role of shopping location and consumer characteristics. This conceptual model is modified from that used by Levin, Levin and Weller (2005).

Figure 9. Conceptual framework


Vital in this conceptualisation is that shopping locations are evaluated in terms of the extent to which key attributes are perceived to be delivered better from the location (CBD, in the townships or suburbs). We therefore refer to these as attribute values and their perceived importance for that particular shopping location is referred to as the attribute weights. The overall utility for the different shopping locations is the product of attribute value by attribute weight, summed ever attributes (Levin, Levin & Weller, 2005: 281). For the purpose of this study, the term utility refers to the state of usefulness.
of the different shopping locations, highlighting the benefits that each location provide to consumers.

3.2 Household consumption expenditure in Tshwane

The term “consumption expenditure” is used to distinguish between expenditure on goods and services that are intended for immediate use and disbursements which are intended to provide resources for the future such as investments and other forms of savings (StatsSA, 2006:15). Total spending is made on consumer goods and services and this spending is therefore determined by the level of household income (Preserve articles, 2011). Household income is defined as the total income from all the people living in a particular household (Business Dictionary, 2012). It refers not only to the salaries and benefits received but also to the receipts from any personal business and investments (Business Dictionary, 2012).

Most South Africans are dependent on incomes from salaries (StatsSA, 2010). Nationally, salaries (62.4%) and grants (44.9%) were received by the highest percentages of households (StatsSA, 2010). Provincially, Western Cape (74.7%) and Gauteng (74.2%) had the highest percentage of households who earned an income from salaries (StatsSA, 2010). Grants were more prevalent than salaries as a source of income in Limpopo (58.2%), Eastern Cape (56.2%), Northern Cape (52.2%) and Free State (51.5%) (StatsSA, 2010). About a third of households in the Eastern Cape (37.6%) and Limpopo (33.1%) selected social grants as their households’ main source of income (StatsSA, 2010).

A survey conducted by the South African Institute of Race Relations showed that for 2008, white South Africans earned considerably more income than other races (Mail & Guardian, 2009). According to the survey, the average per capita income in South Africa for the 2008 period was R32 599, while per capita income for white people was R135 707 (Mail & Guardian, 2009). Income per capita refers to a measure of the amount of money that is being earned per person in a certain area (Investopedia, 2012). Income per capita can apply to the average per-person income for a city, region or country and is used as a means of evaluating the living conditions and quality of life in different areas (Investopedia, 2012). Indians had the second highest per capita income at R56 173, with coloured South Africans at R23 569 and black South Africans with the lowest per capita income at R 19 496 (Mail & Guardian, 2009).

Given the wide differences in income between the population groups (Black African, coloured, Indian/Asian and white) in South Africa, and the impact of income on spending patterns, the finding of large differences in expenditure patterns between the population groups is to be expected (StatsSA, 2006). Table 1 provides the distribution of household consumption expenditure by population group. This excludes imputed rent, mortgage and other unclassified expenses.

Table 5. Distribution of household consumption expenditure by population group

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Food and non-alcoholic beverages</td>
<td>35.9</td>
<td>19.8</td>
<td>34.6</td>
</tr>
<tr>
<td>Alcoholic beverages and tobacco</td>
<td>2.6</td>
<td>2.4</td>
<td>2.6</td>
</tr>
<tr>
<td>Clothing and footwear</td>
<td>9.9</td>
<td>4.6</td>
<td>7.3</td>
</tr>
<tr>
<td>Housing, water, electricity, gas and other fuels</td>
<td>10.1</td>
<td>14.8</td>
<td>11.9</td>
</tr>
<tr>
<td>Furnishings, household equipment and maintenance of the house</td>
<td>13.2</td>
<td>8.9</td>
<td>7.7</td>
</tr>
<tr>
<td>Health</td>
<td>0.7</td>
<td>1.9</td>
<td>1.2</td>
</tr>
<tr>
<td>Transport</td>
<td>9.8</td>
<td>17.6</td>
<td>10.8</td>
</tr>
<tr>
<td>Communication</td>
<td>2.1</td>
<td>5.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Recreation and culture</td>
<td>2.4</td>
<td>4.8</td>
<td>3.0</td>
</tr>
<tr>
<td>Education</td>
<td>1.7</td>
<td>1.9</td>
<td>2.8</td>
</tr>
<tr>
<td>Restaurants and hotels</td>
<td>1.6</td>
<td>2.9</td>
<td>3.3</td>
</tr>
<tr>
<td>Miscellaneous goods and services</td>
<td>9.9</td>
<td>15.2</td>
<td>12.6</td>
</tr>
<tr>
<td>Total consumption expenditure</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>


According to Statistics SA’s Income and expenditure of households report (2006), black African consumers in South Africa spent 23.2 percent of their income on food and non-alcoholic beverages, 19 percent
on transport, 13.8 percent on miscellaneous goods and services and 11.3 percent on housing, water and electricity, gas and other fuels. This means that 67.3 percent of their income was spent on fulfilling basic needs. Remarkable findings from this study were that Black households spent 8% of their income on clothing and footwear, whereas the equivalent was spent on furnishings, household equipment and maintenance of their houses.

According to the Bureau of Market Research (2011), the results of the household income and expenditure patterns showed that there were nearly 14 million households in South Africa in 2010. From their findings, the emerging middle class (with an income of R100 000 – R300 000) had the biggest share of household income and expenditure in 2010. The group’s annual income for the year was estimated at over R477 billion with a reported expenditure of R476 billion. The realised middle class (with an income of R300 000 – R500 000) represent the second highest category, both in terms of income and expenditure in 2010. The total household income and expenditure for this group was estimated at R297 and R291 billion respectively (Bureau of market research, 2011).

These studies is an indication of how much money South Africans spend within their households, however limited research is done on consumer expenditure in the area of Tshwane. Thus this study aims to investigate expenditure patterns of consumers residing in black urban area in the Tshwane area.

### 3.3 Shopping patterns and preferences of consumers living in black urban areas of Tshwane

The term ‘Shopping patterns’ refers to the typical manner in which consumers purchase goods or services in terms of amount, frequency and timing (Business Dictionary, 2012). The concept of consumer preferences stems from the idea that customers prefer one product or one service over another and research into this area of consumer behaviour has brought understanding to some of the major issues with standard customer satisfaction - the most important issue being that high customer satisfaction does not assure continued customer preferences (International Communications Research, 2011). This is important for this study as shopping patterns of black individuals living in black urban areas of Tshwane may differ as they may not have unrestricted access to malls and shopping within their immediate surroundings.

The study by Wiese (2004) aimed to investigate consumer preferences of students at the Tshwane University of Technology, Witbank campus. The majority of the respondents were Black and the results concluded that 65 percent of students preferred to shop at shopping centres. Fifty six percent of these students indicated that they usually shopped in town (CBD), 46 percent shopped close to where they stay and 50 percent of students admitted to shopping where it saves them time. Although students preferred to shop at shopping centres, a large proportion of them shopped at places where it was convenient and saved them time. Since limited similar research has been done in the Tshwane area, this study is imperative in understanding the reasons why Tshwane consumers living in black urban areas prefer to shop where they do. In addition, this might help in identifying new development opportunities for these black urban areas.

The research conducted by Tustin (2008), provided great insight on consumer shopping patterns of black individuals residing in the Soweto urban area of Gauteng. Gautengs’ black urban areas include Evaton, Sharpville, Soweto, and Tshwane but are not limited to these areas (SA Townships, 2012). Although limited research is available on the Tshwane area, Soweto provides a good illustration and motivation of existence of a need within the black urban area.

The opening of four major shopping mall or centres (Protea Gardens, Baramall, Jabulani and Maponya Mall) in Soweto since 2005 has changed the entire shopping landscape and shopping experience of residents in these urban areas. With further development still to be done in this area, past shopping behaviour trends of Sowetans to shop outside Soweto are bound to change (Tustin, 2008). According to Tustin (2008), more than nine out of every ten Sowetans buy from local Soweto retailers whereas twenty percent of household goods and services are purchased from businesses located outside Soweto. Only 10.4 percent and 7.2 percent of consumers’ purchases are from home-based and vendors/hawkers/street front shops respectively.

Various reasons may be identified in understanding the motive consumers’ have for shopping in specific geographic locations. . The study conducted by Wiese (2004) provided one reason, namely; convenience. According to the review of all other sized shopping centres in Gauteng by Business Day (2012), these shopping centres are located in the wealthier suburbs and not necessarily where the largest demand or concentrations of people are located.

Furthermore, this inequality is worse in Johannesburg where large shopping centres are located much closer to one another than those in Tshwane (Business Day, 2012). On average, each shopping centre is 8 minutes travel time away from its nearest competitor while their uncontested catchment areas have a radius of only 4 minutes travel time (Business Day, 2012). If consumers have to travel longer distances to shopping centres to acquire goods they need, this increases their travel expenses per month (excluding daily travel expense to and from work). Therefore people’s preferences can somewhat be influenced by factors such as convenience or simply the products they seek at these shopping centres or malls.

### 4 Methodology

A quantitative approach was used for this study where a survey questionnaire was used as a method for collecting data. This approach was used to investigate expenditure...
patterns of consumers residing in black urban areas of Tshwane. This approach was deemed appropriate by the researchers since the aim of the study was to determine shopping patterns of black consumers residing in black urban areas; and this can be done through an analysis of frequency data. The population sample consisted of 38 Black individuals residing in black urban areas of Tshwane. Both males and females were approached and thus included in the target population. They varied in age, from 19 years of age to 56 years of age. The sampling method used in this study was the convenience sampling method. The data collection instrument consisted of dichotomous, multiple choice, single response as well as multiple choice, multiple response choice questions. Dichotomous questions are questions that can be answered ‘yes’ or ‘no’ (Batchelder & Narens, 1977:115). There are two types of dichotomous questions that may be considered: objective questions and subjective questions. Subjective questions; those that are formulated by the researcher and answered by members of the population; were used in this study (Batchelder & Narens, 1977:115). These were deemed appropriate since patterns of consumers were investigated and two or more alternative answers could be provided (Cooper & Schindler, 2011:330).

The questionnaire covered various facets of consumer spending patterns but those significant to the study are discussed. Respondents were given a list of three types of generic outlets and asked to indicate which of these outlets they had immediate access to. Each respondent could only indicate one option. After establishing these outlets, it was imperative that the researcher instigate how often consumers did their shopping there. Respondents were given the following options: sometimes, always and never. At the crux of the study, were questions investigating the shopping preference of consumers. From a list provided, respondents had to indicate which of the listed locations they preferred to shop from and provide reasons for the preferred location.

The Income and expenditure of household study conducted by Statistics South Africa for the 2005/2006 period was used to compare the differences in consumer spending.

5 Research findings

The previous section provided a review of literature on consumers residing in black urban areas of Tshwane. This section reports on the key findings from the research conducted. Completed questionnaires were received from 38 respondents (n=38) who lived within the black urban areas of Tshwane.

5.1 Household consumption expenditure in black urban areas of Tshwane

Figure 10. Average monthly expenditure
The respondents were provided with lists of items and asked to indicate how much they spent on each item per month. Consumers residing in black urban areas of Tshwane spend on average 31.31% of their average income on food and groceries. This accounts for the largest expense within their households. Rent was the second largest expense with consumers spending 25.69% of their income on rent. Consumers spent on average 7.94% of their income on clothing and footwear. On average, 64.73% of the total household income is spent on fulfilling basic need.

The respondents who completed the questionnaires indicated that they spent on average 3.81% of their income on entertainment and 5.39% on eating out. This was as 1.26% more than what was spent on clothing and footwear. This was particularly interesting since one can deduce that regardless on the LSM group individuals fall under or how much their household income is, it is important to have a well rounded balanced life. Consumers residing in black urban areas of Tshwane still insured that they lived such a life within their financial means. In addition, it was attention-grabbing to find that these individuals spent on average 1.59% of their disposable income on alcoholic beverages. This accounts for 0.39% more than what is spent on books and newspapers. One can only speculate as to why consumers residing in black urban areas of Tshwane do not invest in daily newspapers or books. The level of education of these individuals could be a possible reason or simply that these individuals differ in their interests to those who keep up with world news. An important difference which is noteworthy is that in total, respondents spent 4.1% of their income on communication costs. These included mobile and public telephone costs. This is 0.22% less than what respondents spend on toiletries and cosmetics. From these figures, one can form perceptions about the priorities of the respondents; that they believe that communication is equally important as their physical appearance.

5.2 Shopping patterns and preferences of consumers living in black urban areas of Tshwane

The respondents were given a list of retail stores common to South African consumers. These retail stores included brands such as but not limited to Edgars, Foschini, Markhams, Woolworths, Mr Price and Truworths. Sixty eight percent of those who completed the question indicated that they did not have these retail stores at their disposal within their immediate surroundings (within the black urban area they lived in) and thirty two percent indicated that they did in fact have these stores within their immediate surroundings where they could shop. Alternatively, respondents were asked if they had other generic clothing stores within the black urban area which they lived in. Figure 3 illustrates the number of respondents who indicated that they had generic clothing stores within the black urban area.

Figure 3. Access to generic clothing stores within black urban area

![Figure 3. Access to generic clothing stores within black urban area](image)

Sixty two percent of the respondents who successfully completed this question indicated that they has China shops within their residential area, thirty percent of respondents has access to Flea markets and eight percent had access to street vendors. From the respondents that indicated that they did in fact have retail stores and generic clothing stores within the area they lived in, respondents were asked to indicate the frequency in which they shopped at these stores respectively. Figure 4 provides a synopsis of the findings.
Since 32% of the respondents said they had retail stores within the black urban area they lived in, analyses of the frequency of shopping can only be done on these respondents. It was interesting to see that only 46% of those who had access to these stores occasionally shopped at them and that 39% said they did not shop at these stores at all. This could be due to a number of reasons, which will be investigated latter section. Of those that had indicated that they had generic clothing stores within the black urban area they reside, only 8% indicated that they repeatedly shopped there, whereas 77% indicated that they occasionally made use of these stores. Interesting that 15% said they never shopped at these generic stores. These results are supported Figure 5, which illustrates respondents’ answers when asked where they preferred malls or shopping complexes to be situated.

Figure 5. Shopping location preference

Majority (53%) of the respondents preferred to shop in the CBD, 37% indicated that they preferred to shop in the suburbs and only 10% said they preferred to shop in the township. There might be a number of reasons why consumers preferred to shop in the CBD and the suburbs. Figure 6 illustrates the reasons given by the respondents.

Respondents indicated that main reason they preferred to shop at malls was because the products offered were of good quality. Surprisingly enough, only 11% of the respondents went to shopping malls for recreational purposes (to watch movies etc.). Twenty seven percent of the respondents from the population found products offered at shopping malls were affordable therefore it was for that reason they shopped there. Twenty two of the respondents indicated that they shopped at malls because malls were closest to them than other generic stores.
Reasons given by respondents for shopping at generic outlets varied compared to the reasons given for shopping at malls. Six percent of the respondents admitted that the items offered at generic stores were of inferior quality but was the only thing that they could afford. Affordability was popular among the respondents, 61% of them indicated that this was the reason they bought products items at generic clothing stores. The relative distance of these stores showed 16% of the respondents acknowledging this as a reason for shopping at generic stores.

5.3 Demographic data of respondents having answered the questionnaire

The demographic data on consumers’ household expenditure patterns within the black urban areas of Tshwane covered the gender, age range and the racial group of the respondents. As per our discussion earlier, the term ‘Black urban area’ referred to underdeveloped urban residential areas in which non-white inhabitants live. These residents include black, coloureds and Indian individuals. Figure 7 represents the racial group distribution of consumers who completed the questionnaire.

Of the respondents who participated in the research study, 66% were black, 21% were coloured and 8% were Indian. However, regardless of the perception given by the definition provided earlier, that black urban areas of Tshwane was restricted to black, coloured and Indian consumers; 5% of consumers who partook in the study were in fact white. The gender distribution among the respondents was equally distributed; 50% of the respondents who answered the questionnaire were male and equally so, 50% were female.
Figure 8 depicts the age distribution of the consumers who took part in the research study. Thirty nine percent of the respondents were between the ages of 26 and 35 years; twenty six percent were between 36 and 45 years and twenty four percent were between the ages of 19 and 25 years. The age group 46 and 55 represented only eight percent on the total respondents and only three percent were older than 56 years.

6 Discussion

The Income and expenditure study conducted by Statistics South Africa indicated that black households spent on average 8% of their income on clothing and footwear. This was a very high fraction of their income compared to what white households spent (3.2%). From this, the assumption could have been made that the results of this study would also reflect that consumers residing in underdeveloped urban areas of Tshwane spent a large percentage of their income on clothing and footwear. However, looking at the overview of expenditure, one can assume that these household do not have a large budget from which expenses are paid out. On average, 7.94% of the household income is spent on clothing and footwear. An additional 4.32% and 2.63% is spent on toiletries and cosmetics as well as on hairdressers and beauticians respectively. It is clear that these consumers take much pride in their physical appearances, hence providing us with an idea of the type of their characteristics. People who look presentable tend to be more confident and therefore sterner about their decisions. These are important characteristics since these may influence ones perception of what is valuable and what you feel is important.

The utility of shopping location was determined by the reasons respondents provided for shopping at the various locations. Under the given definition of ‘utility of shopping location’; affordability, quality and convenience attributes that persuaded respondents’ of the utility of shopping locations. These variables contributed significantly to the development of consumers’ shopping preferences.

Critically looking at the situation, it is worthy of not to highlight that although consumers had ample generic outlets available to them within their immediate surroundings, they still preferred to shop in the CBD. However, this brought to light queries about the understanding consumers have of their real motives for shopping at shopping centres. 22 % of consumers indicated that they shopped at malls because it was closest to them; however, in many of the cases, individuals have to travel to reach these malls whereas generic outlets are fairly within reach.

Perhaps other motive for shopping at malls was to encounter an assortment of choice in products. This reason for assortment was not provided by respondents hence the acknowledgement of the possibility of this reason having an impact on results.

6.1 Practical Implications

The research findings showed some deviation to the expected results. Consumers said convenience was an important reason for shopping at malls, however, malls in the Tshwane region are relatively far and consumers need to travel to reach them. This was a clear indication that shopping preference was in a sense influenced by more than utility. Some factors consumers may not be consciously aware of therefore marketers need to anticipate these and bring them to the consumers’ attention.

7 Limitations

The limitations applicable to this study need to be acknowledged and taken into consideration before any recommendations are provided. Firstly the sampling size that was used was very small (n= 38), therefore the
expenditure patterns determined cannot be generalised to represent the entire Black urban area community. They can only provide a picture of what and how the sample spent their household consumption income. Secondly, although the respondents received complete anonymity, it is possible that respondents didn’t feel comfortable admitting to shopping at generic outlets therefore claiming to shop at well known retail stores to portray a positive image of themselves.

8 Recommendations

This study investigated various purchasing patterns of black consumers residing in black urban areas. The following are proposed recommendations that can be considered for further research:

- What can be concluded is that the wealthier suburbs of Tshwane are probably “over shopped” but not so for the whole of Tshwane. However, there is a real opportunity to locate large shopping centres in the township areas. Those wanting to take advantage of this opportunity can therefore conduct research.

- In addition, the study found that consumers residing in black urban areas of Tshwane had access to retail stores within their residential area; however, 39% of them never shop there. Further research can be conducted to understand the underlying issues consumers have with these stores that are good alternatives with good quality items.

- Consumers living in these areas could learn their preferences to shop at closer malls than travelling long distances to shops at malls located at suburbs. Further research can be conducted to determine the factors that can facilitate the process by which black consumers adapt their behaviour and develop preferences to shop at malls located within their immediate surroundings.

9 Conclusion

The primary objective of this paper was to investigate the household expenditure patterns and shopping patterns of consumers residing in underdeveloped urban areas of Tshwane. The data collected therefore reflects the consumption expenditure patterns of consumers residing in these areas. Although the sample size was not representative of the entire population, it provides a clear view of consumer spending patterns as well as shopping preferences. The results showed that a large amount of the households’ income is spent on fulfilling basic needs such as food, clothing and shelter. However, in trying to lower costs, the quality of goods and services is not compromised. Respondents preferred to shop at malls and well establish retail stores such as Edgars instead of at generic outlets.

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FAMILY BUSINESS EXIT AND PRIVATE EQUITY INVESTMENT DECISIONS: GOVERNANCE IMPLICATIONS FOR VALUE CREATION

Paolo Di Toma*, Stefano Montanari**

Abstract

This paper was motivated by the increasing interest in the current debate for the entrepreneurial process in family firms. Little research to date has investigated the family business exit and this topic is mainly considered as a failure for entrepreneurial families. However, when uncertainties arise concerning generational succession, the family business exit may enable ownership transitions facilitating survival and long term value creation strategies. Among the exit options, a private equity buyout may balance the family’s wealth protection and the firm’s future growth. However, which family specific characteristics and strategic needs may affect the exit option still remains a neglected topic. Based on recent research addressing entrepreneurship in family firms and corporate governance literature, this paper develops a case study for investigating the bridging role of private equity buyout for going through strategic transitions in family firms. Findings suggest that a private equity buyout is a governance mechanism which may sustain an entrepreneurial transition by realigning family interests and goals. It may also allow the family commitment for improving organizational capabilities required by an entrepreneurial transition.

Keywords: Family Business Exit, Private Equity, Entrepreneurial Process, Corporate Governance, Familiness

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1 Introduction

Continuity and enterprise are crucial dimensions affecting the dynamics of family firms, but some of them may lack the required resources and capabilities to manage generational succession (Cabrera-Suarez, De Saá-Pérez and Garcia-Almeida, 2001; Howorth, Westhead and Wright, 2004; Scholes, Wright, Westhead and Bruining, 2010; Sirmon and Hitt, 2003). Furthermore, many family firms face uncertainties when going through strategic transitions because their current skills, resources and capabilities which enabled their survival may become inadequate to the new strategic needs (Zahra and Filatotchev, 2004). When lacking suitable solutions to incumbent challenges, the family business exit may become the necessary option to ensure the firm’s survival and growth (Sharma, Chrisman and Chua, 2003; Sharma and Irving, 2005). Previous studies pointed out the exit as a relevant component of the entrepreneurial process and how it may result in an entrepreneurial renewal (De Tienne, 2010; Wennberg, Wiklund, DeTienne, and Cardon, 2010), but it still remains a neglected topic in family business research. Hence recent literature recognized the need to extend knowledge on what factors impact the effectiveness of the exit as a strategic transition in family firms (Nordqvist and Melin, 2010).

Among the range of alternative options leading to the family business exit, a private equity buyout may be selected by the family owners to protect their wealth invested in the firm whilst ensuring the firm’s continuity (Howorth, Westhead and Wright, 2004). Private equity buyouts have been mainly considered as an efficiency mechanism to restructure organizational processes, to downsize workforce and to reduce unit costs (Harris, Siegel and Wright, 2005; Wright, Hoskisson and Busenitz, 2000). However, scarce attention has been devoted to how private equity transactions may enable value creation by fostering entrepreneurial growth opportunities and gaining competitive advantage (Wright, Hoskisson, Busenitz and Dial, 2001; Meuleman, Amess, Wright and Scholes, 2009). Previous studies, mainly rooted in the agency theory, emphasize the monitoring role of private equity firms. The incentive realignment
perspective states that the reunification of ownership and control in the post buy-out firm will increase efficiency and performance (Wright, Amess, Weir and Girna, 2009). However, little research has addressed how private equity firms may enable entrepreneurial strategies by providing the resources and capabilities required to overcome strategic transitions. Buyouts usually involve radical changes in the corporate governance of firms and such variations may represent a crucial premise to allow value creation strategies whilst new corporate governance practices may facilitate or obstruct dealing with strategic challenges (Wood and Wright, 2009).

Building on corporate governance literature and recent research addressing linkages between entrepreneurship and family business, this paper focuses on contingencies affecting the family business exit by a private equity buyout through a case study. Ownership and governance issues will be considered with the aim of investigating the effectiveness of post buyout governance practices and their interplay for enabling the family firm’s strategic development and ownership transition. We also address how unique family characteristics shape differing combinations of resource diversity and accountability and how they impact on value creation strategies, even exploring potential complementarities or substitution effects among the established corporate governance practices resulting from private equity transactions.

This paper extends previous knowledge by providing new evidence on the topic of entrepreneurial exit in the context of a family firm. Furthermore, it contributes to understanding how the bridging role of a private equity buyback may enable entrepreneurial strategies and long term value creation. Finally, it advances previous research on how corporate governance practices may facilitate or obstruct the pursuit of entrepreneurial strategies in a family firm.

The study is organized as follows: The next section will shortly introduce the study’s main theoretical constructs and some missing links in explaining family business exit and the governance role of private equity buyout. Subsequently, the study’s research design, data collection and data analysis will be described. In the following sections, after a description of the case study, a specific statement will be delineated on the basis of the case analysis, linking it to the results provided by previous studies. Finally, in the discussion section, the broader implications of the study will be outlined.

2 Theoretical background

2.1 Definitions and focal firm

Even though in family business research differing definitions have been suggested, in this paper according to Chua and colleagues (1999) we define a family firm as controlled by families and that has a vision of family influence beyond the founding generation.

We investigated corporate governance in terms of its effectiveness. It addresses the degree of goal attainment by key constituents of the firm and according to the context of the firm’s organizational environment (Aguilera, Filatotchev, Gospel and Jackson, 2008:476).

Corporate governance effectiveness depends on a number of differing dimensions and, among them, strategy and resource roles together with promoting managerial entrepreneurship (Filatotchev, Toms and Wright, 2006; Filatotchev, 2007; Aguilera, Filatotchev, Gospel and Jackson, 2008).

Finally, this study focuses on a family firm moving from the entrepreneurial to the managerial stage. Having survived the start up stage it then dealt with additional strategic challenges requiring new, but differing resources and capabilities for sustaining its further growth. Firms like this have been addressed as entrepreneurial threshold companies (Gedajlovic, Lubatkin and Schulze, 2004; Zahra and Filatotchev, 2004). The firm we studied is also consistent with the adolescence phase of its entrepreneurial process as defined in Cardon and colleagues (2005). This stage is characterized by growth, but the firm also begins to establish a formalized organizational structure as well as rules and procedures (DeTienne, 2010).

2.2 The exit as an entrepreneurial stage in the context of the family firm

Entrepreneurship and family business research have traditionally been considered as distinct but overlapping domains of interest a and scanty attention has been devoted to the role of family firms in the entrepreneurial process (Chirico and Nordqvist 2010; Dyer and Handler 1994; Kellermanns, Eddleston, Barnett and Pearson 2008; Nordqvist and Melin 2010; Rogoff and Heck, 2003).

Even though some common topics are well recognized, family business research has been characterized by a prevailing focus on continuity, ownership and leadership succession within the boundaries of the holding family (Le Breton-Miller, Miller and Steier, 2004; Zahra and Sharma, 2004). In contrast, entrepreneurship literature main effort has been directed towards new enterprises, thus considering new ventures, innovation, and renewal (Sharma and Chrisman, 1999). Thus, family business research has neglected the role of families in promoting strategic change, as well as entrepreneurship research has overlooked how the entrepreneurial role is exerted in the specific organizational and cultural context of family firms (Aldrich and Cliff, 2003; Habbershon and Pistrui, 2002). Therefore, according to recent literature (Nordqvist and Melin, 2010; Zahra and Sharma, 2004), a new theoretical perspective is needed for
including and explaining how families contribute to value creation in a trans-generational view.

Exit has been traditionally equated with the failure of firms or of individual entrepreneurs both in the fields of entrepreneurship and family business. (Nordqvist and Melin, 2010; Wennberg, Wiklund, DeTienne and Cardon, 2010). Recent research points out the exit as a stage of the entrepreneurial process, thus not as the end of entrepreneurial but as a beginning for new venture opportunities (DeTienne, 2010; Salvato, Chirico and Sharma, 2010; Ucbasaran, Wright and Westhead, 2003). Moreover, despite a prevailing emphasis on equating the exit to failure or success, little research has investigated the exit strategy and its link with the exit decision (Wennberg, Wiklund, DeTienne, 2010).

Addressing the link between entrepreneurship and family business leads to consider the latter as an organizational context where unique characteristics may affect entrepreneurial processes (Nordqvist and Melin, 2010). In this view, the exit may be interpreted as a stage along the entrepreneurial path, but little research to date has investigated how it may be influenced by family’s certain characteristics (DeTienne, 2010; Habbershon and Williams, 1999; Niedermeyer, Jaskiewicz and Klein, 2010; Salvato, Chirico and Sharma, 2010; Sirmon and Hitt, 2003; Zellweger, 2007).

2.3 The value creation dimension of corporate governance and private equity buyout

The corporate governance research has been mainly rooted in the agency theory with the aim of protecting the firm’s value by reducing inefficiencies arising from conflicting interests (Filatotchev, 2007). However, going through strategic transitions, the value creation dimension of corporate governance may also become relevant, but the agency theory has shortcoming when considering entrepreneurial firms pursuing growth which may require changes in their resource base (Filatotchev, Toms and Wright, 2006; Zahra and Filatotchev, 2004). Competitive advantages are built upon the possession of valuable, rare, imperfectly imitable and non replaceable resources idiosyncratic to the firm (Barney, 1991) and well known drivers may be new products or new processes creating performance differences among firms (Danneels, 2002). Furthermore, in addition to the firm’s resource base, organizational and strategic processes are also relevant to promote the manipulation of resources into value creating strategies (Chirico and Nordqvist, 2010). Individuals holding power positions, such as senior managers or board members, can play a role in the development of capabilities by undertaking specific initiatives and establishing organizational routines. Governance issues in family firms may become potentially more complex than in non family firms, because of the intertwined systems of ownership, management and family (Westhead, Cowling and Howorth, 2001). The organizational value creating attributes are embedded in the firms’ system of corporate governance and relies upon differing incentives, authority structures and norms of accountability (Carney, 2005). The involvement of family members in ownership and/or in management may influence the firm’s strategic decision making, conditioning topics such as the goals pursued, time horizons, or the development of organizational capabilities (Sirmon and Hitt, 2003; Le Breton-Miller and Miller, 2006; Uhlaner, Wright and Huse 2007). Investigating how family members exert their power and responsibilities influencing strategic transitions may provide useful explanation on the topic of value creation over time in a family firm (Bruininge, Nordquist and Wiklund, 2007; Chirico and Nordqvist, 2010; Gedajlovic, Lubatkin and Schulze, 2004; Scholes, Wright, Westhead and Bruining, 2010).

Previous studies address private equity buyouts as a governance mechanism for rapidly and radically restructuring organizations worldwide (Wright, Amess, Weir and Girma, 2009:353). Private equity buyout may represent a suitable solution for family firms when they lack resources and capabilities required for going through strategic transition or when they are faced with succession uncertainties (Dawson, 2010; Howorth, Westhead, and Wright, 2004). Distinguishing characteristics of private equity buyouts rely upon a recognized bundle of mechanisms shaping the governance structure and represented by an active monitoring function exerted by the private equity firm, high leverage and close ownership under management control (Wright, Amess, Weir and Girma, 2009). Private equity investment decisions are characterized by uncertainty and time constraints, but they aim at increasing the targeted value of the firm over a 5-10 year period. Private equity buyouts have been frequently presented as improving efficiency in resource allocation processes (Cumming, Siegel and Wright, 2007; Scholes, Wright, Westhead and Bruining, 2010; Wood and Wright, 2009). For example, they may improve performance by cutting agency costs stemming from non economic goals affecting family firm performance, such as creating jobs for the members of the owner-family (Chrisman, Chua and Litz, 2004; Sharma, Chrisman and Chua, 1997). Otherwise, they may lead to strategic growth by providing required resources for upside the firm entrepreneurial opportunities (Meuleman, Amess, Wright and Scholes, 2009; Wright, Hoskisson, and Busenitz, 2001; Wright, Hoskisson, Busenitz and Dial, 2000; Wood and Wright, 2009). However, little research to date has investigated how private equity buyout may sustain value creation strategies in entrepreneurial firms by ensuring the development of internal resources such as managerial and organizational capabilities.
3 Methods

3.1 Empirical setting

This paper develops an inductive inquiry (Glaser and Strauss 1967) carried out through an in-depth longitudinal analysis of a revelatory case (Yin, 1994). As we were interested in understanding the exit as a phase of the entrepreneurial process of a family firm both at family and a firm level, as well as its correlated governance implications, Tieffe seemed a suitable case to investigate. In selecting research sites, the goal is to identify available cases that are likely to replicate or extend theory, rather than randomize (Eisenhardt, 1989), and that are promising in providing rich empirical data on the investigated phenomenon, based on a plurality of data sources (Yin, 1994). This company is a small Italian family firm which manufacturers hydraulic hose fittings and adapters. Since its establishment this company was held by a dominant coalition of families (Chua, Chrisman and Sharma, 1999). Although it went through recursive governance changes, the entrepreneurial role was clearly identified in one of the founding owners. With the announcement of his intention to retire, Tieffe faced trans-generational uncertainties which influenced the family business exit (Nordqvist and Melin, 2010). Hence the private equity buyout acted as a governance mechanism (Wright, Amess, Weir and Girma, 2009) which resulted in a strategic transition of the firm and a realignment of the family’s interests and goals. Our analysis examines contingencies affecting the exit decision and how it was carried out by the private equity buyout. After a brief description of the methods employed for data collection and data analysis, we discuss our empirical evidence.

3.2 Data Collection

Data were collected through personal interviews and secondary sources over a period of six months in 2010-2011. Aiming to investigate the research topics in depth, we conducted our case study relying on interviews with several people aimed at representing differing perspectives (Myers, 2009). Interviews were the primary source of data and we relied on informants chosen on the basis of their role within the governance and organizational structure and of their involvement in the transition process. At first we identified the key informants as individuals having the most information about our specific topics of interest. Furthermore, interviews were extended to all individuals known to have significant information because of their knowledge and involvement in the transition process under analysis (Myers, 2009).

Semi-structured interviews were conducted separately with individuals representing owners, board members, and managers. We also interviewed private equity and Tieffe consultants because of their involvement in the private equity buyout or because of their longstanding knowledge both of the family and the firm.

We interviewed informants from the entrepreneurial family included active members from the first and the second generation, aiming at deepening their own view regarding the family business exit and the following transition process to yield a more accurate analysis (Yin, 1994). Interviews were conducted during several formal and informal meetings having an average length of two hours and half. The interviews were audio-recorded and transcribed after each meeting. After each interview we had a discussion based on the impressions and written notes taken during the interview, and then noted our observations to crystallize the ideas (Bryman and Bell, 2007).

In order to achieve internal reliability of the study, interviews were listened to by two members of the research team with the purpose of checking for consistent interpretation (Bryman and Bell, 2007). Furthermore, after the interviews written notes were shared and matched by the researcher to check data and identify diverging interpretation. Ambiguous information or interpretation was clarified by asking confirmation of the respondents by telephone.

Interviews were organized in two parts. Initially, open-ended questions were asked without specifying the constructs of interest in the research project to the interviewee, so as to avoid influencing their answers. We let the respondents tell their story on the firm’s entrepreneurial process and on its corporate governance along its evolutionary path (i.e. overview of the family business’ history, crucial events and steps referring to the firm’s strategic behaviour and changes, general information about the corporate governance practices and their variations over time, the involvement of family members).

We focused the case study on the transition involving the family business exit and the private equity buyout which occurred in 2008, but we acquired further data regarding the previous history of the firm for a better interpretation and contextualization of events and roles of the individuals involved holding key positions. Data on previous events were a relevant source for understanding the family and organizational specificities, allowing a multiple level analysis.

During this part of the interviews, we asked in depth questions to obtain more details on the topics discussed and to triangulate the data acquired (Yin, 1994). In the second part of the interviews, structured questions were asked in order to investigate the role played over time by specific family and business characteristics as well as corporate governance practices (i.e. entrepreneurial role, board composition, information regarding family members’ characteristics, involvement, goals and motivations influencing the entrepreneurial exit and the private equity buyout decision), their mutual interplay and
potential complementarities or substitution effects. The aim was to investigate the outcome of the established governance arrangements as a whole and the following degree of effectiveness in supporting the firm’s strategic needs throughout the entrepreneurial exit process.

Secondary data were collected by multiple sources. (Table 1 provides a list of the main secondary sources employed in this study). Secondary sources allowed us to build longitudinal accounts of the intervening variations in the corporate governance structure, allowing us to identify critical events, potential links and contribute to build up a description of the organization and of its history (Bryman and Bell, 2007). It also enabled us to analyze formal agreements regarding, for example, incentives, expected performance rates, and corporate governance arrangements involving the private equity transaction. This information helped us to better understand the role of the private equity and its relationship with the entrepreneurial family. Furthermore, we used a range of sources of data to provide a rich and robust foundation for theory development.

**Table 1. Main secondary data sources**

- Financial reports (10 years)
- Official Business Register of the Italian Chambers of Commerce (from 1976 to date)
- Company website as of January, 2011
- Commercial catalogues
- Internal reports
- Buyout agreement
- Company documents and partners agreements
- Financial Press and newspapers articles.

### 3.3 Data Analysis

Data analysis was guided by theoretical concepts regarding the entrepreneurial process in family firms and the value creation dimension of corporate governance and we employed an iterative cycle of analytic induction and deduction (Eisenhardt, 1989). A multiple researchers approach allows triangulation, with the aim of analyzing data from different perspectives (Myers, 2009). Therefore, we triangulated data among respondents, who were required to tell their stories so as to obtain information from their individual point of view. Then we triangulated data acquired from interviews with data from secondary sources, such as published and unpublished documents. We stored the collected data in a data base specifically designed for the task of structuring and clarifying information and then we repeatedly iterated between data and theoretical constructs (Bryman & Bell, 2007). In a first phase, we addressed each construct separately and then we tried to explore emerging relationships among the identified constructs. We carefully read interview transcripts, observations and secondary data to identify and refine patterns. During the data analysis we generated memos and then matched them to refine theoretical understanding (Yin, 1994). The emerging theoretical constructs developed by the memos were compared to the evidence for evaluating their fit with data in an iterative process (Yin, 1994; Eisenhardt, 1989), often generating new and more finely detailed memos which became the basis for the presentation of the research findings. Some findings were consistent with the initial theoretical framework, but further insights also emerged and suggested refinements in the theoretical guide. This way allowed coding the new observation into themes and widening our theoretical framework. We early realized the relevance of the link between the family’s and the firm’s dynamics affecting the exit decision. Hence, by deepening the analysis we identified antecedents of the family business exit and how corporate governance variations by the private equity transaction impacted the entrepreneurial family exit while providing incentives to their commitment in the firm’s growth. Hence data analysis was undertaken by an iterative interplay between empirical and theoretical observations which led to our theoretical constructs (Locke, 2001). Figure 1 shows our data structure.

Correspondence between our theoretical insights and empirical observations were verified by follow up meeting with key informants. They also enhanced the internal and external validity of our theoretical findings. Then we presented our findings to academic colleagues to ensure the validity of our analysis and theory building during several informal and formal meetings.
4 Findings

In this section we report our research findings by explaining our empirical observations and the theoretical insights originated (Eisenhardt and Graebner 2007).

4.1 Case description

Tieffe was established in 1976 as Tecnoflex, thanks to the entrepreneurial successful experience of Antonio Vaghi, its first CEO. Unlike most Italian companies, Tecnoflex stock wasn’t entirely held by its founder, who only owned a minority share.

Tecnoflex was originally set up as a productive branch of Flexitubo, a company from the hydraulic sector established in Modena, a town in Northern Italy. Antonio Vaghi, previously a sales representative in Flexitubo, was put in charge of managing the new company and was therefore assigned a 20% of its stock share.

4.2 Industry overview

Hose fittings belong to the main sector of hydraulics, whose Modena district is one of the most important in the world. Hose fittings are metallic ends of flexible hoses conveying driving force into hydraulic circuits. Given the high oil pressure inside the pipes, hose fittings’ main features must be resistance, steadiness of their connection with the pipe, along with low costs and fast installation. This is the reason why a close cooperation between flexible hoses and hose fittings producers is crucial in order to develop and implement new solutions suitable for both parts.

This specific connection shapes the strategic features of the sector, divided into three types of players: pipes producers, hose fittings producers and assemblers. Each one of these businesses has different
features: pipes producers are economies of scale highly sensitive, because of the considerable investments for production and research, and have nowadays mainly been absorbed by a few multinational companies from the rubber and tires sector; hose fittings manufacturers, on the other hand, have much lower entry levels on the market, therefore the existence of small to medium businesses, like Tieffe. In this field, innovation and technologies are the nodal point, in fact, after products development in partnership with pipes producers, their economic life is quite long and these joint ventures might last years. Finally, assemblers are those buying both pipes and hose fittings to assemble and sell them to end consumers: this business’ technology is easily acquirable, entry levels are therefore low, and crucial features here are commercial ones, along with services.

This significant interdependence resulted into a progressive concentration of the companies from this sector into vertically integrated ones, able to perform internally all the three productive steps. Experts, nonetheless, consider this an inevitable and inescapable process, whose timing, though, is not undifferentiated: while all US producers are, in fact, vertically integrated, in Europe sectorial producers are fewer but stronger.

4.3 Company overview

The firm’s evolutionary path can be parted into four main phases.

During the first phase (1976 – 1994) Antonio Vaghi from salesman became entrepreneur of the Piacenza facility gaining, rapidly, more and more managerial autonomy. The legitimization and authoritative ness achieved by Vaghi in the hose fittings industry was such that Mr Gennaro Calanchi, the youngest of the company’s members, decided to come to an end the twenty years long partnership in Flexotubo with Mr Luciano Ferrarini in order to work with Vaghi in the hose fittings manufacturing.

The second phase (1994-1999) starts from the breakup with Flexotubo up to the appointment of Giovanni Vaghi, Antonio’s brother, as director in Tieffe. In this period Antonio Vaghi was running the company as an independent entrepreneur, also by an agreement stating that all strategic decisions should require accordance among the owners despite their differing shares. Antonio Vaghi, despite the significant growth in sales, did not have the skills necessary to give the company an equally significant improvement in terms of organization. His entrepreneurial style, in fact, revolved around his technical role and daily presence in the company and his strategies were basically focused on innovation and production. Antonio Vaghi soon acknowledged that his involvement in the day to day running of the business, along with low delegation, caused his physical presence to be essential even for the most ordinary issues. This not only was slowing the company’s development, but was also forcing him to neglect his most important activity for the company: the new products development.

The third phase (1999-2005) is characterized by an organizational improvement. This phase began when Giovanni Vaghi was appointed as director, up to the conveyance of the majority of shares to the private equity Cape fund. The company, thanks to Giovanni’s managerial experience and personal skills, as well as to his family ties with the entrepreneur, was reorganized in a more structured way. Giovanni defined a specialized organizational structure implementing a real information system with the aim of a constantly check of the company’s performances. Thanks to a steady process of legitimization, also endorsed by Mr Calanchi, was possible to Giovanni Vaghi to take over the major part of Antonio’s daily activities. In this way Antonio was allowed to convey his time and efforts into other strategic practices like R&D. The introduction of structured planning and control systems, coupled with the stable involvement of the board of directors, allowed for a better rationalization of investments and an overall improvement of company performance. In this period a new dilemma was arising: the generational transition. Many was the reasons leading to consider the owners’ sons not suitable for the role of successors in Tieffe. Mr Calanchi’s son, Elis, showed a scarce interest for Tieffe, preferring, instead, his role in OM, another firm owned by his family and sited in Jesi, operating in the hose fitting industry, where, since from 1999, he was involved in a managerial position. Lara Vaghi, Antonio’s daughter, nowadays accountant in Tieffe, lacked technical expertise and was rather unwilling to run for her father’s position thinking to have not to her father’s charismatic personality.

The fourth phase (2005-nowadays) is characterised by the fund entrance in the company’s ownership. Starting from 2005 the private equity transaction began to be considered as a viable solution for the succession issue. A previous experience with a foreign partner company (Czech Republic), proved it could be a flexible and suitable way for the finalizing of the company’s de-personalization. The operation would allow the monetization of part of the owners’ assets and the later passage of the company to an industrial partner. deal with the Cape fund was signed in 2008 for the conveyance to it of 60% of company stock shares.

The fourth phase is still in progress. The next step will carry to Antonio Vaghi’s withdrawal from the firm’s management and the consequent taking over by his brother Giovanni. This project require the creation of an engineering team necessary to take over gradually the research and development activity now centered on Antonio’s role. A stock option plan has already been outlined by the new management in order to successfully finalize the succession process.
The new organization counts on the definitive exit of the Calanchi family who has already started from 2007 its progressive disengagement. In 2007 OM in Jesi was unbundled by Tieffe and then acquired by Calanchi’s family. Nowadays the Vaghi family thereby remains the sole representative from the founding ownership and holds the operative delegacies, with Antonio Vaghi as Chairman and Giovanni Vaghi as CEO. Instead the private equity firm holds the majority in the board of directors by three representative, without delegacies and with mainly controlling and advisory tasks. Moreover, one of the member of the board is in charge of constantly monitoring the manage offering his support to the CEO in financial issues. This organization reflects the will of Calanchi’s family to carry their share to 16,5% allowing to Giovanni Vaghi to increase his share to 7%, a sort of award for the successful operations and for his new managerial and entrepreneurial role.

4.4 Antecedents of entrepreneurial exit: a multilevel perspective leading to the private equity option

4.4.1 Corporate governance and the need of improving the firm’s organizational capabilities

Tieffe is a small family firm which, since its start up as entrepreneurial venture and up to the private equity buyback, was owned by a dominant coalition of families. Among the founding owners, Mr Antonio Vaghi, holding 20% of the shares, was delegated to running the business, while the remaining owners, namely Mr Calanchi and Mr Ferrarini, provided financial capital and served as Directors keeping a monitoring role. Acting as the entrepreneur, Antonio Vaghi independently took charge of the development of both manufacturing and selling activities. His undisputed entrepreneurial leadership went through the recurring ownership and governance changes affecting Tieffe along years. It also led to a strong identification between Tieffe and Antonio Vaghi, both among the internal and external stakeholders, such as customers, suppliers, the banking system and so on. However, Antonio Vaghi never gained the majority of the shares and he only reached 50% of the shares when one of the founding member sold his shares in 1994. Table 2 provides a list of governance changes the firm went through since its establishment.

The entrepreneur’s efforts for expanding the company were driven by a strong focus on developing innovative and high quality products. For many years and up to the appointment of his brother to the Board in 1999, he never paid dividends, but constantly devoted all the available resources to the firm’s activities and to investments. He extensively invested in new equipment for improving automation in the manufacturing processes and for increasing the quality and performance of the products. In fluid power hose fittings manufacturing, a critical concern relates to avoiding the hose’s detachment due to the high pressure of the fluid. Even though this product is apparently simple and of small value, it’s quality and performance are crucial when employed, because hose fittings ensure the transfer of driving power by high pressure fluids. Furthermore, a detachment may become highly dangerous for employees working nearby, given the fluid’s high pressure. By innovating machinery and automated processes, Tieffe expanded over the years and it is currently recognized as one of the major manufacturers of hydraulic hose fittings and adapters in Europe. However, as a consequence of his frequently relinquishing dividends for investing in the modernization of the firm, the family’s wealth was highly concentrated in the value of the firm.

A further crucial requirement for gaining competitive advantage is product design and Antonio Vaghi developed personal skills and expertise leading to distinguished high performance products. Over the years, he personally designed a range of successful products, gaining a distinctive reputation. For example, a particular nut which took the name of the company and which ensures superior technical characteristics and performance is well known within this industry. Furthermore, hose manufacturers are unable to rapidly switch to a rival supplier of hose fittings because years of research and development are required to ensure perfect adaptation and good functioning. The entrepreneur’s personal capability and reputation were, therefore, a well recognized driver of the Tieffe’s growth in the long term.

Collected data show that a main factor in Tieffe’s evolutionary path was its organizational adaptation to growth. Antonio Vaghi’s background lacked managerial experience and he concentrated power. Therefore, Tieffe’s growth was accompanied by emerging organizational inefficiencies which affected performance. Aiming at improving the firm’s managerial skills and expertise he appointed a number of external managers who were, however, subsequently fired because results were inadequate. In 1998 he made a proposal to his brother Giovanni Vaghi to retire from his current employment so as to take charge of the Tieffe’s organizational restructuring. Giovanni Vaghi was a manager with long standing experience in a multinational company. He had worked 22 years in IBM Italy, where he had reached a high level position. Therefore his professional background was a significant resource for addressing organizational improvements and for introducing managerial techniques and expertise. Furthermore, by the appointment of Giovanni Vaghi as a Director, Antonio Vaghi was able to reduce his involvement in managerial tasks so as to increase his efforts in R&D activities in the development of new products.

We found evidence that the appointment of Giovanni Vaghi led to a substantial change in the firm’s growth trajectory. By the entrepreneur's empowerment, Giovanni Vaghi carried out substantial
organizational restructuring. He brought his managerial experience into Tieffe and addressed changes in the organizational structure and processes. For example, he substituted employees in positions of responsibility and promoted professionalization of young internal employees through training activities and power delegation. Moreover, Giovanni Vaghi developed informative systems, improved performance measurement systems and introduced planning and control systems as shared managerial tools and techniques for running the business. His goal was not merely to improve organizational efficiency, but also to reduce the firm’s dependence on Antonio Vaghi’s involvement and leadership by the improvement of the firm’s organizational capabilities. Changes were progressively carried out over the next few years, and performance improvements followed. However, organizational changes didn’t involve the development of new products because it was personally supervised by Antonio Vaghi. Therefore, we found evidence of the beginning of a strategic transition from an entrepreneur-centred firm towards a managerial one by the appointment of a family member serving as a Director. Changes in the firm’s resource base complemented the board variation which provided new competences and task specialization among Directors. Changes were sometime disruptive, but because of their affective relationships Antonio and Giovanni Vaghi carried out the organizational adaptation without conflict.

When Antonio Vaghi in 2005 matured his intention to retire, Tieffe faced succession uncertainties, because it was still dependent on the entrepreneur’s core competence on product design. Tieffe’s survival required new organizational capabilities ensuring the development of distinctive products, but neither family members, nor employees were able to provide such a resource. Therefore, we found evidence that the need of changes in the firm’s organizational capabilities, linked to the lack of this crucial competence inside the family influenced the family business exit decision when faced with the problem of generational succession.

### Table 2. Governance variations

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Ownership composition</th>
<th>Board Composition</th>
<th>Entrepreneur role</th>
</tr>
</thead>
<tbody>
<tr>
<td>ante 1976</td>
<td>Flextubo foundation</td>
<td>Ferrarini Luciano 50% Calanchi Gennaro 50%</td>
<td>Ferrarini Luciano (Chairman of the board) Calanchi Gennaro (CEO)</td>
<td>Antonio Vaghi sales representative</td>
</tr>
<tr>
<td>1976</td>
<td>Tecnoflex foundation with head office in Piacenza</td>
<td>Vaghi 25% Flextubo 75%</td>
<td>Ferrarini Luciano (Chairman of the board) Vaghi Antonio (Executive Director) Lazzari Angelo (Executive Director) Savoia Desiderio (Executive Director)</td>
<td>entrepreneurship beginning</td>
</tr>
<tr>
<td>1991</td>
<td>Merger Tecnoflex-Flextubo</td>
<td>Ferrarini Luciano 40% Calanchi Gennaro 40% Vaghi Antonio 9% Villa Tamara 3% (Vaghi’s wife) Lazzari Angelo 2% (manager) Tosi Sergio 2% (manager) Savoia Desiderio 2% (manager) Betta Giovanni 2% (manager)</td>
<td>Ferrarini Luciano (Chairman of the board) Vaghi Antonio (Executive Director) Lazzari Angelo (Executive Director) Tosi Sergio (Director) Savoia Desiderio (Executive Director) Calanchi Gennaro (Executive Director) Ferrarini Alberto (Director)</td>
<td>CEO of Flextubo and plant manager of the production department of Piacenza</td>
</tr>
</tbody>
</table>
### Table 2. Governance variations (continuation)

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Ownership composition</th>
<th>Board Composition</th>
<th>Entrepreneur role</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td><strong>Tieffe S.r.l. foundation conferring with the production departments in Cura Carpignano and Piacenza</strong></td>
<td><strong>Flextubo 100%</strong></td>
<td><strong>Calanchi Gennaro (Chairman of the board)</strong>&lt;br&gt;<strong>Vaghi Antonio (CEO)</strong>&lt;br&gt;<strong>Lazzari Angelo (Executive Director)</strong></td>
<td><strong>CEO of Tieffe</strong></td>
</tr>
<tr>
<td>1994</td>
<td><strong>Flextubo - Tieffe division</strong></td>
<td><strong>Vaghi Antonio 15%</strong>&lt;br&gt;<strong>Villa Tamara 5% (Vaghi's wife)</strong>&lt;br&gt;<strong>Calanchi 80%</strong>&lt;br&gt;<strong>Vaghi and Calanchi agree to manage the company as to have equal amount of share</strong></td>
<td><strong>Calanchi Gennaro (Chairman of the board)</strong>&lt;br&gt;<strong>Vaghi Antonio (CEO)</strong>&lt;br&gt;<strong>Lazzari Angelo (Director)</strong>&lt;br&gt;<strong>Calanchi Elis (Executive Director)</strong></td>
<td><strong>Disagreement between Ferrarini and Calanchi. Vaghi and Calanchi acquire the production division (Tieffe).</strong></td>
</tr>
<tr>
<td>1995</td>
<td><strong>Giovanni Vaghi becomes director of Tieffe</strong></td>
<td><strong>unchanged</strong></td>
<td><strong>Calanchi Gennaro (Chairman of the board)</strong>&lt;br&gt;<strong>Vaghi Antonio (CEO)</strong>&lt;br&gt;<strong>Calanchi Elis (Executive director)</strong>&lt;br&gt;<strong>Lazzari Angelo (Director)</strong>&lt;br&gt;<strong>Giovanni Vaghi (Director)</strong>&lt;br&gt;<strong>Negri Luigi (Director)</strong>&lt;br&gt;<strong>Riccardi Luigi (Director)</strong></td>
<td><strong>Antonio Vaghi asks his brother to join the Board of Directors to bring management experience</strong></td>
</tr>
<tr>
<td>1999</td>
<td><strong>Giovanni Vaghi becomes CEO of Tieffe and he begins to work in the company</strong></td>
<td><strong>Calanchi Gennaro 72%</strong>&lt;br&gt;<strong>Calanchi Elis 4% (Calanchi's son)</strong>&lt;br&gt;<strong>Calanchi Elena 4% (Calanchi's dauther)</strong>&lt;br&gt;<strong>Vaghi Antonio 20%</strong></td>
<td><strong>Calanchi Gennaro (Chairman of the board)</strong>&lt;br&gt;<strong>Vaghi Antonio (CEO)</strong>&lt;br&gt;<strong>Calanchi Elis (Executive Director)</strong>&lt;br&gt;<strong>Vaghi Giovanni (Executive Director)</strong>&lt;br&gt;<strong>Negri Luigi (Director)</strong>&lt;br&gt;<strong>Riccardi Luigi (Director)</strong></td>
<td><strong>Giovanni Vaghi works full-time in the company: he becomes executive director and plays the role of CFO</strong></td>
</tr>
<tr>
<td>1999</td>
<td><strong>Elis Calanchi becomes CEO of OM Oleodinamica S.r.l. a subsidiary company with head office in Jesi (AN)</strong></td>
<td><strong>unchanged</strong></td>
<td><strong>unchanged</strong></td>
<td><strong>Traduzione da italiano verso inglese</strong></td>
</tr>
</tbody>
</table>
### Table 2. Governance variations (continuation)

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
<th>Ownership composition</th>
<th>Board Composition</th>
<th>Entrepreneur role</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>Antonio Vaghi increases his share at 50% through a real estate spin-off</td>
<td>Calanchi Gennaro 42% Calanchi Elis 4% (Calanchi’s son) Calanchi Elena 4% (Calanchi’s daughter) Vaghi Antonio 50%</td>
<td>unchanged</td>
<td>The oldest son of Calanchi takes over the management of OM.</td>
</tr>
<tr>
<td>2005</td>
<td>Antonio Vaghi sells 2% of share to his brother Giovanni</td>
<td>Calanchi Gennaro 42% Calanchi Elis 4% (Calanchi’s son) Calanchi Elena 4% (Calanchi’s daughter) Vaghi Antonio 48% Vaghi Giovanni 2% (Vaghi’s brother)</td>
<td>Calanchi Gennaio (Chairman of the board) Vaghi Antonio (CEO) Calanchi Elis (Executive Director) Giovanni Vaghi (Executive Director) Riccardi Luigi (Director)</td>
<td>The Vaghi’s brother becomes to shareholder of Tieffe</td>
</tr>
<tr>
<td>2007</td>
<td>Tieffe sells its share in OM Oleodinamica to Calanchi’s family</td>
<td>unchanged</td>
<td>unchanged</td>
<td>OM exits from the group and becomes a company of Calanchi’s family</td>
</tr>
<tr>
<td>2008</td>
<td>Private Equity Fund acquires 60% of share of Tieffe through a LBO</td>
<td>Perroni Maurizio 3.6% (manager-Private Equity Firm) Cape Natixis 53.71% Cape due team 2.69% Calanchi Gennaro 16.5% Vaghi Antonio 14.5% Vaghi Giovanni 7% (Vaghi’s brother) Vaghi Lara 2% (Vaghi’s Daughter)</td>
<td>Vaghi Antonio (Chairman of the board) Giovanni Vaghi (CEO) Perroni Maurizio (Director) Cimino Simone (Director) Bortot Marco (Director)</td>
<td>The Calanchi’s family leaves the board of directors, Antonio Vaghi becomes Chairman of the board and Giovanni Vaghi becomes CEO</td>
</tr>
</tbody>
</table>

#### 4.4.2 Misalignment of goals, incentives, and time horizons among family members and the private equity buyout decision

Even though family members agreed on going through entrepreneurial exit, data from interviews showed substantial differences in their goals, incentives and time horizons which influenced the decision to carry out the private equity buyout option.

The founder’s intention to retire, which was the starting point of the entrepreneurial exit, was motivated by personal stress throughout his professional life. Being nearly sixty years old, he had started thinking of his future outside Tieffe, but was interested in protecting his family’s wealth by taking advantage of the increase in the firm’s value. Because of the governance structure since the firm’s establishment and the number of variations it went through over the years, he felt himself as the entrepreneur more than the owner and therefore the selling of the shares was an option he had always considered.

Industry uncertainties were also supporting his intention of selling the company, because of the tendency of mergers leading to vertically integrated manufacturers producing assembled hoses and hose fittings. Tieffe had been able to establish itself due to the distinctive quality and performance of its products, but the future necessity of joining an industrial partner could not be excluded. As an example, in 2001 a major hose manufacturer started negotiating the takeover of Tieffe, but the Vaghi family did not trust the strategic perspectives, and therefore the deal fell through.

Antonio Vaghi’s daughter, namely Lara, was working in Tieffe, but she was not confident in her succession because she lacked both the technical and commercial background. She was currently involved in administrative tasks and, at the time when the exit decision matured, did not seem interested in taking a high responsibility position. Hence Antonio Vaghi preferred to offer her capital not invested in the firm.

Even though his incentives were consistent with selling his shares, Antonio Vaghi was strongly interested in Tieffe’s survival in the long term. He
wanted to address the ownership transition by selecting an appropriate industrial partner to shape the new ownership structure. Hence, he was available to take a consultancy role for developing a new range of products ensuring the firm’s survival and growth in the future. Therefore, a private equity buyout may represent the appropriate governance mechanism allowing a transition stage requiring a mid term time horizon, despite his departure.

In contrast, Giovanni Vaghi, holding 2% of the shares, was less interested in taking advantage of the firm’s value, but rather in aiming at increasing his power and responsibilities within the firm. He was fifty two years old and so he was not thinking of retiring. He was at the height of his professional life and he had left his previous managerial career to become an entrepreneur. Furthermore, he was the leader of the firm’s ongoing organizational transformation, but he required time for reaching his goals. Hence a leadership succession from Antonio Vaghi to Giovanni Vaghi was not considered satisfying because the latter lacked a technical background and the organizational transition was still uncompleted. Moreover, he also found carrying out a private equity buyout consistent with his interests and goals because it could lead to a first step in the governance transition ensuring his rise both in the ownership structure and inside the board. He also could take advantage of the time required for completing his task.

Members of the Calanchi’s family were not interested in leadership succession. Both the founding partner and a son of his were involved in managing their own distinct firm and were mainly interested in the value of their shares. Furthermore, the goals and interests misalignment among the owners didn’t result in conflicts. Hence they evaluated the range of alternative exit options aimed at finding a balanced solution and agreed to carry out the private equity buyout as the most suitable one.

Therefore collected data show that misalignment involving family members’ goals, interest and incentives emphasized succession uncertainties and led to the family business exit. However, it also influenced the choice among the alternative exit options. The private equity buyout acted as a governance mechanism enabling the bridge to a new ownership and governance structure which currently is not settled, but that will be shaped by the influence of the entrepreneurial family. Moreover, the transition may give the opportunity for realigning the family members incentives and goal sharing because the private equity firm required their commitment and their involvement in governance and managerial positions.

4.5 Going through generational transition: corporate governance practices affecting the exit effectiveness

4.5.1 Organizational skills and overcoming of dependence on the entrepreneur’

Developing organizational skills had been Antonio Vaghi’s objective since the mid 90s, even before his brother entering the business. He had tried many times hiring a general manager, though never having found the right man for the job. He acknowledged, in fact, that without an organizational structure and delegacies, he couldn’t properly improve the company, all his time and energies being devoted to daily management. The new role of his brother, in 1999, giving the company a structure and implementing management control, progressively improved the situation, though a few glitches were encountered in specializing functions, unwilling to change.

Antonio Vaghi says: “I only finally managed to organize the company thanks to my brother’s completely different professional experience. He had worked for many years for a big company and was used to team work and organization. I managed the business based on my guts. Stepping down hasn’t been easy. There had been some difficult moments: when he made changes I didn’t always agree, but I managed not to interfere. My relationship with my brother prevailed: we often fought outside the job, but our family tie always had the upper hand. This changed the company.”

During 2004 – 2005 the company first worked with a private equity fund, having sold a minority share of an Austrian company to a fund that bought the whole stock. The processes of the fund to determine the company’s value lead the Vaghi brothers, especially Antonio, to think of Tieffe’s value and his assets. It is at this moment that the idea of a withdrawal starts to form, due to his mental weariness after forty years spent “on the front line” and to the will of monetizing, fully or partially, his company assets. On the other hand, he also knew that the company still needed his support and that retirement couldn’t but take long.

Tieffe organizational structure, in fact, though having an autonomous production, was still heavily relying on his founder for all technical and R&D activities. It was then necessary to form, around Antonio Vaghi, a team that could work starting from his experience to further develop it, in order to allow his retirement.

Gianni Vaghi says: “Now my brother is completely untied from his daily activities, has no time boundaries and the company always knows what to do, regardless of his presence. He loves working at night, he has even created a small lab at home and often works from there. Our American customers are very happy about this, given the different time zones,
in fact, they can now talk to him when it’s afternoon in the US”.

It seemed initially difficult to match the almost “artistic” activity of Antonio Vaghi with the functioning and organization of a technical department, this solution, nonetheless, actually seems to be working and it is starting to produce first results. The young technicians Antonio is training are becoming more and more autonomous and are proving to be able to pursue the funder’s ideas and solutions.

The arrival of the private equity fund was an exceptional thrust to the making of a management team around the person of the current CEO, Giovanni Vaghi, for two main reasons, both due to the explicit will of the Fund to finalize the investment in a relatively short time (5 to 8 years). The possibility of a periodical reorganization of the ownership and therefore of the company structure forced its top brass to state their intention for the future and to program careers of the managing team. It has immediately been located, among the managers, the person who will be CEO/general director after Giovanni Vaghi, and who will become part of the company through the stock option plans. This particular tool, stock option, has become, also thanks to the fund and his “way out” needs, very effective to prompt and motivate managers, starting from Giovanni Vaghi, that, with the private equity transaction increased from a 2% to a 7% stock shares.

Giovanni Vaghi himself explains the main idea: “The assumption that the fund will eventually sell its shares made us think of the possible ways out. Key managers could become associates of a new fund that could buy the company. We have now set up a stock option plan to allow the current commercial director and our productive unit in Czech Republic manager to enter into Tieffe stock. This way we mean to encourage results achievement and to strengthen the bond with the company in a far-seeing perspective. As to this, I have already stated that the current commercial director will assume my position as CEO when, in about ten years, I will retire.”

From previous observation, we can infer the fundamental thrust the fund has given to the development of new organizational skills. Having set a deadline within which the person so far having held all key competences will have retired served as an extraordinary incentive for all people involved. Familiar manager meaning to stay within the company must acquire new skills to justify and strengthen their nomination for leadership; non familiar manager, tied to a stock option plan, are on the other hand forced to legitimate their run for the same position toward the organization and to become associates. The organization must thereby acquire all skills so far held by the outgoing leadership and current owners know their retirement, as well as the value of their assets are closely linked to the actual willingness to communicate and transmit to others their competences and experience.

### 4.6 Private Equity Fund influence on goal and personal interests setting

The intervention of the fund has been promoted by succession uncertainty and misalignment of owner families’ goals and interests.

The cooperation with the Fund produced changes, not only in the company but also in the people working in it, thus leading to a general shifting of personal interests and goals according to one’s position in the company and of the new opportunities brought by the fund.

Assets are a very important aspect to take into consideration when analyzing the fund’s effects. Associates and funders Antonio Vaghi and Gennaro Calanchi were able to liquidate a significant part of the assets invested in the company and could thereby deal with the delicate succession issue without putting on the plate their whole wealth.

While the Calanchi family had already stated their disengagement will, Antonio Vaghi couldn’t make this decision without also thinking of the company’s activities continuance.

Any potential dislocation would have been bound to make him reconsider his retirement plan. Things went actually substantially well. The company passed with flying colors the 2008 and 2009 financial crisis, and 2011 seems to be carrying on the company’s previous growing trend. Organizational structure is proving to be efficient even during the funder’s absence, as well as the new technical department and R&D that, though still being lead by Antonio Vaghi, are becoming more independent. This propped Antonio Vaghi’s decision to leave the business, a decision made official to the fund early in 2011, though including the possibility for Vaghi to fill the role of commercial and technical consultant.

More complex is the position of Giovanni Vaghi, currently having taken over the company from his brother as CEO. The entrance of the fund into company stocks further strengthened his position, given his role in the buyout process and his unique managerial experience that makes him the only suitable for the role of liaison with the financial partner. His successful takeover from Antonio reinforced his awareness of the company’s potential even without its funder direct contribution and this enhanced his interest in the business. Giovanni Vaghi says: “When I first started working in Tieffe I was looking for an entrepreneurial experience and my brother, in order to help me do it, sold me a 2% stock share. Shareholders sold me another 5% as an award for the successful private equity process. So far I’ve always invested all my savings in the company, because I strongly believe in the business and I’m not planning on retiring for at least 10 more years. When the fund will sell its shares, if I may, I’m ready to reinvest all profits from the operation into the company to increase my share. I would even consider a
possible buy-back if my brother’s family agreed to stay”.

The same goes for Lara Vaghi. Initially involved in the company with an administrative position, on the occasion of the LBO operation she received from her father a 2% shares and took on the responsibility of company administration and reporting, directly managing the relationship with the fund. The growing de-personalization of the company from its prevailing figure, along with the gaining of new managerial skills, strengthened her interest in the business. The company, which she initially saw as his father exclusive turf, becomes more and more within her reach, once acknowledged that besides technical aspects, in which she could never have been involved, there also were other important activities she could have easily taken care of, not connected to technology.

Lara Vaghi describes her experience as follows: “My father’s management was initially so self-centered that even an engineer son could have succeeded. Imagine a daughter with administrative skills like me! In that situation I didn’t feel up to his succession. After the fund intervention and thanks to the experience I achieved as chief department, I had the opportunity of getting more involved. I became aware of the multitude of activities necessary to lead a company and I came to know all existing leadership styles, different from my father’s one. I don’t think my family will be back in the business, but if given the opportunity I would be ready.”

Empirical observation so far expounded show how the family experienced the “after funder” phase with the arrival of the Fund, without a finality limit. During a period of changes, introduced in the organization and management by the fund, players involved could change, sometimes even radically, their own interests and goals inside the company. This could lead to a general stakes shifting, therefore the possibility of a new prevailing coalition, possibly even within the family, that could take the baton back from the previous leadership.

4.7 **Private Equity influence on corporate governance practices**

A Private Equity Fund buying a company stock’s majority inevitably stresses the separation from ownership and company management. The fund, in fact, doesn’t have specific business skills and relies on current entrepreneurs for management strategies, thereby mainly acting as controllers.

The Cape Fund had the same approach with Tieffe, though having bought the 60% of equity, governance structure, in fact, still allowed for the operative management to be run by the Vaghi brothers, while Board of Directors and Board of Statutory Auditors are controlled by the fund. The Board of Directors has 5 members, 3 of which, without operative powers, are nominated by the Cape Fund, while the other 2 are nominated by the Vaghi family, Antonio Vaghi, as President, and Giovanni Vaghi, as CEO. The Board of Statutory Auditors is composed by 3 members, 2 of which, among whom is the President, are nominated by the Fund, and 1 by the other associates.

The economic power still held by the Vaghi family, though the company is legally controlled by the fund, is a well known issue for both sides. As to this, Antonio Vaghi says: “With the entrance of the fund I haven’t experienced particular differences, in fact, never having had an absolute majority, I have always been used to stake everything to pursue my ideas. I’m used to pursuing goals with stoutness and perseverance. Besides, it’s us managing the company, therefore it’s us who know products and hold relationships with customers, our opinion cannot be ignored”.

Maurizio Perroni, Tieffe’s Director appointed by the private equity firm, shares this position: “When we enter a business, de facto we financially back an entrepreneur in some project of his, we do not buy a company. If the manager is fair and proves to be resolute in pursuing his project, even if we control the company, we ask for permission. It doesn’t matter who owns shares, what matters is who is controlling the business.”

Nevertheless Tieffe, as its funder said, had always had a financing member. Gennaro Calanchi, in fact, never really had an operative involvement in the company, though being Chairman and having the same poker as Antonio Vaghi. He regularly visited the company to check accounts and financial aspects, while he shared with Antonio Vaghi decisions on main strategies and investments. There have never been interferences in the management.

On the other hand, Private Equity fund and the investing associate are substantially different: while the first one, as all institutional investors, immediately set a 3 to 5 years time limit to his engagement, the second one never had selling objectives; his association with the Vaghis, in fact, also thanks to the satisfactory balance achieved, has been lasting more than 30 years.

Control systems are also different: though Cape fund, in fact, has always respected the Vaghis’ managing independence, administrative controls on Tieffe’s pattern are definitely more thorough than those made by Calanchi, as previously outlined.

A first control is made in the governing organs, attending to BOD three – monthly meetings, and verifying Board of Statutory Auditors also three – monthly meetings.

Much more effective than formal meetings are informal ones, weekly or monthly, with one of the administrators nominated by the fund to consult and monitor the company. Maurizio Perroni, in charge of this task along with Marco Bortot says: “These are very informal meetings, in which daily business related issues are discussed with CEOs. For example, we discuss future investments, treasury management,
economic situation trends, we meet with banks…in these last two years of financial crisis I think the Fund presence has been tangible and a mutual trust was built between us and the entrepreneurs.”

This activity, combining controlling and consulting services, is matched with frequent phone conversations, even daily ones in critical phases.

Besides visits and formal meetings, the Fund is regularly informed from management control and accounting. The company weekly communicates total pay-off and incoming orders, and three times a month liquid assets and treasury budget for the next twelve months. The company monthly draws a management budget, to be discussed with others about internal working fairs, warehouse, profitability configurations (gross margin, ebitda, ebit). Also monthly, the company provides a series of indicators about internal efficiency control, for example cost per kilogram of raw materials.

CEO Giovanni Vaghi explains: “When the private equity firm bought the majority of Tieffe we already had a well developed information system, the Fund, in fact, didn’t need to use a new CFO. Besides, we already produced for ourselves all information requested, so when we started providing regular reports, the fund’s administrator just had to pick the most suitable for their needs.”

Our observations show how the private equity buyout significantly modified the managing structure, that went from being mere formal legal entities, to real consulting and strategies’ defining tools. The new professionalisms of the BOD, non operative ones but constantly in touch with CEOs, allowed the whole organization to acquire new finance and control related skills. This is obvious in Tieffe too, even though the company wasn’t completely de-structured even before the arrival of the fund: ownership was, in fact, composed by operative and financing associates and had advanced information system, besides an official organizational structure.

5 Analysis and discussion

This paper extends previous literature by providing evidence on the topic of the family business exit. To date, little research has been devoted to improving knowledge on the role business exit may take in entrepreneurial family firms (Habbershon and Pistrui, 2002). Recent literature indicates that exit may stem from failure as well as success, but research should devote more effort to focusing on which specific route is employed (Wennberg, Wiklund, DeTienne and Cardon, 2010).

Considering both the family and the firm level, we investigated factors leading to the exit decision. Moreover, our research also covered the exit strategy, aiming at understanding the effectiveness of the private equity buyout as a governance mechanism by which the resulting transition was carried out (Dawson, 2011; Scholes, Wright, Westhead and Bruining, 2010; Wright, Amess, Weir and Girma, 2009; Wright, Hoskisson and Busenitz, 2001). This approach is consistent with recent advances in entrepreneurship research addressing the exit as a stage of an entrepreneurial process (DeTienne, 2010; Wennberg, Wiklund, DeTienne and Cardon, 2010).

Thus, our research responds to recent claims for extending knowledge on the role of families and family firms in entrepreneurial processes (Chirico and Nordqvist 2010; Dyer and Handler 1994; Kellermanns, Eddleston, Barnett and Pearson 2008; Nordqvist and Melin, 2010; Rogoff and Heck, 2003; Salvato, Chirico and Sharma, 2010). This paper also contributes to value creation perspectives on corporate governance, addressing its enterprise dimension and emphasizing the need to improve our understanding of the role of corporate governance practices for sustaining or obstructing strategic transitions in entrepreneurial firms (Filatotchev, 2007; Filatotchev and Toms, 2003; Filatotchev, Toms and Wright, 2006; Gedajlovic, Lubatkin, and Schulze, 2004; Zahra and Filatotchev, 2004). With this in view, our paper provides new evidence on the role of private equity transaction as a moderator of strategic transitions in family firms. In figure 2 we propose a model of the entrepreneurial exit in family firms by the bridging role of a private equity transaction.

Specifically, our research provides three main theoretical contributions.

A first insight lies in the role of organizational capabilities as a contingency influencing the exit within the entrepreneurial process. When succession uncertainties arose in 2005, Tieffe was carrying out a transformation process of its resource base. The organizational change was managed by the founder’s brother with the aim of improving organizational capabilities and reducing Tieffe’s dependence on its founder. However, at that time family members involved in the running of the business agreed that the most valuable resource was the entrepreneur’s acclaimed capacity in designing new products. Tieffe needed a period of time for transforming the entrepreneur’s capacity into an organizational capability by learning, experiencing and establishing R&D processes. To this end, Giovanni Vaghi said: “I usually say that Tieffe is a rear-wheel drive, because our success relies upon the distinctive value of our products. Their well recognized quality and innovativeness are our most effective marketing effort”.

Therefore, despite the existence of family members with a potential to succeed, the lack of firm-specific organizational capabilities for successfully facing with strategic challenges led to the family business exit. Accordingly, a provision in the private equity buyout agreement required the entrepreneurial family commitment in the business for the following years up to the next ownership change and ensured their strategic and managerial leadership. In the private equity firm view, the entrepreneurial family
was the driver for exploiting the firm’s value with the aim of taking advantage of the next ownership change. Even though previous research recognizes that the firm’s organizational structure may imprint the firm, hence influencing the entrepreneurial exit (DeTienne, 2010), inadequate attention has been devoted to how organizational capabilities may impact the exit decision and the effectiveness of the following transition. Furthermore, our findings are consistent with previous research addressing capabilities as facilitators of trans-generational value creation in family firms as well as for dealing with new strategic dynamics in entrepreneurial firms (Chirico and Nordqvist, 2010; Zahra and Filatotchev, 2004).

Figure 2. The model

Specific family members’ characteristics were also relevant when shaping the exit decision and the ownership transition. When struggling with the generational succession issue, not only the founder-entrepreneur, but also two members of the entrepreneurial family were actively involved in the running of the business. They had the potential to succeed because they were interested, as they currently are, in maintaining their commitment in the family business. The founder’s daughter in those years did not hold a position of responsibility, but the founder’s brother had matured 12 years experience in managing the firm as a Director and he was also the leading actor of the organizational restructuring. Differing goals, career expectations, and incentives characterized each member of the entrepreneurial family as well as differing time horizons conditioning individual concerns. The family emerged as an entrepreneurial team balancing incentives, goals and attitude of its individual members which resulted in the family firm’s entrepreneurial behaviour (Aldrich and Cliff, 2003; Kellermanns, Eddleston, Barnett, and Pearson, 2008; Sharma and Manikutty, 2005). Multiple generations involvement have been identified as a source for fostering the family business enterprise together with modifying ways of doing things (Eddleston and Kellermanns, 2007; Kepner, 1991; Litz and Kleysen, 2001; Salvato, 2004). Thus, because of their family ties, the entrepreneurial family engaged in finding an exit option suitable for overcoming divergences and balancing both family and perceived requirements of the firm. In this way, options such as selling the company or entering in vertically integrated groups were rejected because they would reduce the family strategic involvement in the business. Therefore, a further insight of this paper is that family-specific attitudes, as in this case was the intention of balancing the interests and goals misalignment inside the entrepreneurial family may affect the entrepreneurial process, hence leading to the exit
decision. Moreover, unique family characteristics will impact the entrepreneurial family capacity of selecting the effective exit route. In a corporate governance perspective, goal and interests alignment acted as a governance practice substituting alternative formal control mechanism, such as board of directors.

A final, but central contribution of this paper refers to the bridging role of the private equity buyout in the entrepreneurial process of a family firm. Literature well recognizes private equity buyout as a governance mechanism which may enable efficiency improvements or which may foster entrepreneurship by providing external resources (Cumming, Siegel and Wright, 2007; Dawson, 2010; Scholes, Wright, Westhead and Bruining, 2010Wright, Amess, Weir and Girma, 2009; Wright, Hoskisson, Busenitz and Dial, 2000). In the case we studied, a differing role exerted by the private equity buyback emerged as crucial if considering the exit in the context of the entrepreneurial process of a family firm. We addressed it as a bridging role which refers to providing a temporary governance structure which enables a transformation of the firm’s resource base along with required changes inside the entrepreneurial family. The private equity buyout, by stabilizing the ownership structure, enabled the entrepreneurial family to address suitable solutions to the issues which previously led to the exit decision. The entrepreneur’s brother could carry on the development of organizational capabilities and especially R&D capabilities because of their crucial role. This task was recently perceived as reached when employees from the R&D function were able to solve a critical technical problem affecting a new product. After years of work-shadowing with the founder-entrepreneur, Tieffe is currently able to design new products and to deal with technical concerns previously managed by the founder-entrepreneur.

Furthermore, family-related issues overcame uncertainties and evolved into appropriate solutions. Antonio Vaghi, interested in his retirement and in his own family wealth protection through the private equity transaction, took advantage of the firm’s value by selling a main share of his equity. Currently he owns 16% shares and he serves as the Board Chairman. He is not involved in the running of the business, but provides consultancy for R&D activities. On the other hand, his brother was interested in maintaining the family involvement in the business and also in extending his role. Through the private equity transaction he was appointed as CEO and increased his shares to 7%. In this way, as well as by the firm’s improved organizational capabilities, Tieffe’s entrepreneurial leadership could shift from technical into managerial competences, hence providing a new option for the next ownership change. In fact, the bridging role of the private equity buyout matured conditions for a family buyback, overcoming succession uncertainties. Then, according to the buyout agreement, if Tieffe reaches its mid term expected goals and performance, Gianni Vaghi will also have the opportunity to take advantage of the further increase of the firm’s equity value. Finally, Lara Vaghi over the last few years gained managerial competences and increased her responsibilities, taking charge of accounting and finance. She then matured her interest in the family business continuity and her awareness of her potential role in the firm increased. Lara Vaghi said: “When we were faced with succession issues, I feared taking charge of high responsibilities because I have neither a technical nor commercial background. I only managed administrative tasks and couldn’t imagine the firm’s future without my father and so I agreed to the exit decision. Over the last years I have improved my competences and my role, also being involved in relationships with the private equity firm. Therefore, today I’m interested in managing the family business and my view about succession and exit has changed”.

In this way, the private equity buyout sustained the firm’s growth and its value creation strategies neither by cutting costs nor by providing external resources, but by enabling the entrepreneurial family to exploit internal resources. Accordingly, corporate governance practices post buyback ensured a high level of accountability, but let the entrepreneurial family exert its strategic leadership with discretion.

6 Concluding remarks

This study attempted to investigate factors influencing the exit as a stage of the entrepreneurial process in the context of a family firm and how a private equity buyout may represent a corporate governance mechanism ensuring the firm’s growth and value creation strategies. It analyzed the case of Tieffe, an Italian firm which, faced with succession uncertainties, carried out the exit decision while maintaining its involvement in the business. Its experience represents an interesting example showing how corporate governance practices may affect the entrepreneurial process favouring or obstructing a firm’s survival. It also evidences the close link between the exit decision and the exit route, identifying previously neglected topics in entrepreneurship and family business research. We also shed light on relevant relationships between corporate governance mechanisms and entrepreneurial challenges which are supported by our case data, subsequently addressing a process view to deal with the investigat ed topic.

Our study aims to develop knowledge at the intersection of corporate governance and entrepreneurship research, considering the role of family specificities. This stream of research promises to advance knowledge in a contextual approach to corporate governance, but it also has implications for an appropriate design of corporate governance practices in family firms.
References


