Volume 5, Number 1

Print ISSN 1944-656X
Online ISSN 1944-6578

BUSINESS STUDIES JOURNAL

Gary Schneider
Quinnipiac University

The official journal of the
Academy for Business Studies,
an Affiliate of the Allied Academies

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LETTER FROM THE EDITOR

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MONETARY POLICY CONVERGENCE IN THE NAFTA REGION: EVIDENCE FROM COINTEGRATION ANALYSIS AND CONTAGION EFFECTS

Radhamés A. Lizardo, Southwestern Adventist University
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ABSTRACT

This paper examines the evolving, time-variant, long-run equilibrium relationship among the target interbank interest rates of Canada, the United States and Mexico to assess whether or not monetary policy in the NAFTA region is truly converging, as suggested by the leaders of these countries at a recent meeting in Montebello, Canada. Only recently has is it become feasible to analyze monetary convergence in the NAFTA region, as rolling cointegration analysis requires long-term data, such as that used in this study for the period of 1997 through 2007. We also test for cross-border contagion effects from the financial difficulties faced by Countrywide Financial Corporation during the recent U.S. real estate meltdown. This study of empirical financial and economic phenomena employs multivariate cointegration test and, for robustness, calculates σ-convergence in the NAFTA region. Our findings support the hypothesis of monetary policy convergence in the region. In general, the analysis tends to confirm a broad, ongoing economic convergence in the NAFTA region. We also find support for the proposition of cross-border contagion effects from the financial difficulties faced by Countrywide, which adds robustness to the presence of monetary convergence.

Keywords: Rolling cointegration, cross-border contagion, monetary policy convergence. *JEL Clasificación*: E52; E58; E63.

INTRODUCTION

Background

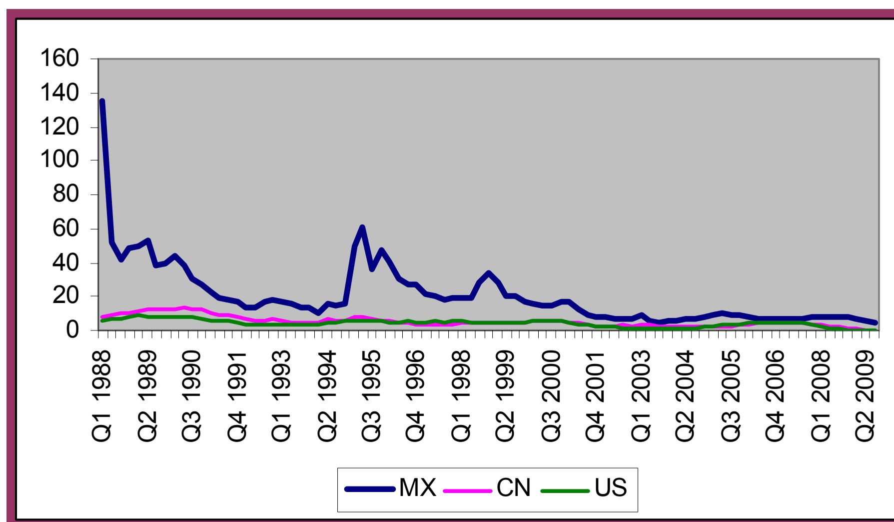
On March 23, 2005, the President of the United States, the President of Mexico and the Prime Minister of Canada launched the Security and Prosperity Partnership of North America (SPP). These leaders of the North American Free Trade Agreement (NAFTA) region issued a joint statement declaring that the objective of SPP was to "improve trilateral regulatory cooperation among the governments of the United States, Canada and Mexico, in order to bring about: lower costs to North American businesses, producers, governments and consumers;

maximum trade of goods and services across North America's borders; and assurance that North America remains the most economically dynamic region of the world." (http://www.spp.org). Subsequently, on August 20, 2007, the leaders of these nations met in Montebello, Canada, to assess the progress of SPP and declared ongoing progress in the achievement of a "deep economic integration." Such a statement is in line with Carranza's (2002) argument that NAFTA started a unique process of regional economic integration between a less-developed country (Mexico) and two industrial powers (Canada and the United States).

Now, twenty three years after implementing the Free Trade Agreement (FTA) between Canada and the United States, seventeen years after NAFTA allowed Mexico to become part of the North American free trade zone, and six years after the launching of SPP, many believe that the next step is formation of the North American Union (NAU). In fact, in October 2004, the Independent Task Force on North America recommended the establishment of a North American economic and secure community by 2010, similar to the European Community that preceded the European Union (http://www.cfr.org/content/publications/attachments/NorthAmerica_TF_final.pdf).

This series of events suggests that economic integration in the North American region has been in progress for some time. Such a position can be observed in Figure 1, which depicts movements of the target interbank interest rates (also called the federal funds rate in the U.S.) in the NAFTA region for the past few decades, beginning before passage of NAFTA in 1993. The data lends support to the proposition that leaders of the United States, Canada, and Mexico encourage ongoing monetary policy integration, evidenced by the convergence of a key monetary policy tool in each of these countries - the target interbank rate

Figure 1 : Long-Term Trend between the Interbank Rates in the NAFTA Region



Notes: Constructed by the authors using data from Data Stream
MX = Mexico, CN = Canada, US = United States

The goal of this study is to test the hypothesis of an increasing time-variant monetary policy cointegration in the NAFTA region by analyzing the empirical behavior of the interbank interest rates of the three participant countries. If persistent monetary policy cointegration is found to be statistically significant, the next step will be to test for contagion in the financial markets. For example, it can be postulated that if the NAFTA region is becoming more integrated in regard to monetary policy, then financial shocks in one country should have ripple effects across all countries in the region. The focus of this study, therefore, is monetary convergence between members of the NAFTA region, following the theoretical framework used in Brada et al. (2005) that assessed monetary convergence between the European Union's core countries and its recent members. In order to avoid distortion from the global economic crisis that significantly affected the years 2008 and 2009, the analysis is conducted with two distinct time frames. The initial analysis will consist of data that excludes the years 2008 and 2009, followed by an analysis that includes those years to add robustness to the assessment of σ-convergence in the NAFTA region. The specifics of each analysis are presented below in the methodology section.

LITERATURE REVIEW

There is a great deal of disagreement about the effects of NAFTA on Mexico, Canada, and the United States. For example, Gould (1998) finds that NAFTA has improved trade among these countries, while Cavanagh et al. (2002) suggests that workers, communities, and the environment in all three countries have suffered from the agreement's flaws. Others point to the dismal growth of Mexico's economy for most years since 1994, along with suffering in the U.S. from a decrease in manufacturing employment, while some others find that NAFTA has positively influenced economic growth in the region (for an expanded overview see Hufbauer and Schott (2005)). Salvatore (2007) blames some of these conflicting views on methodology inadequacy.

Burfisher et al. (2001) analyze the impact of NAFTA on the United States and Mexico and find that NAFTA has had relatively small positive effects on the U.S. economy and relatively large positive effects on Mexico. They acknowledge, however, that NAFTA has many opponents who voice a number of understandable concerns. Opponents cite a negative impact on the labor market in the U.S. Yet, a rebuttal is observed by Yoskowitz et al. (2002), when analyzing the relationship between increased levels of trade moving through the southern border of the U.S. and the macroeconomic variables of employment, per capita income and unemployment rates. Using bootstrapping techniques, they find that growth rates in employment and per capita income are lower post-NAFTA, but the rate of change in the unemployment rate stays constant.

David de Ferranti, World Bank Vice President for Latin America and the Caribbean, commented on the findings in a comprehensive research paper entitled, *Lessons from NAFTA for*

Latin America and the Caribbean Countries: A Summary of Research Findings, that was, in turn, co-authored by World Bank economists Daniel Lederman, William F. Maloney and Luis Serven (2003). He declared that, "NAFTA has had positive effects in Mexico, but they could have been better. Free trade definitely brings new economic opportunities, but free trade alone is not enough without significant policy and institutional reforms."[1] The study concludes that even though NAFTA spurred economic development in Mexico, economic convergence with Canada and the United States has not been achieved, even in the long-run, and such convergence cannot occur without appropriate investments in innovation, infrastructure and institutions.

Another strand of the literature investigates the evolving nature of stock market interdependencies in the NAFTA region and their association with potential diversification gains for U.S. investors. For example, Phengpis and Swanson (2006) find the existence of a time-varying and statistically unstable long-term relationship among stock market prices in the NAFTA trading bloc. Atteberry and Swanson (1997), on the other hand, investigate which stock market leads or lags, in addition to testing the stability of stock market relationships over time, and find that more causal relationships are identified during periods of economic uncertainty than during periods of relative calm, which leads the authors to conclude that the potential benefits associated with diversification across equity markets in the North American region appear to diminish during periods of economic uncertainty. Ewing et al. (1999) find that cointegration is not present in the North American stock markets for the decade after the U.S. stock market crash of 1987, even for the years post-NAFTA. They conclude that the stock markets of North America are segmented and that passage of NAFTA has not resulted in greater integration, which suggests that the potential for long-run international diversification still exists across the stock markets of North America.

Aggarwal and Nyonyo (2005) use unit root and cointegration tests to examine integration of the three participant equity markets before and after the 1993 passage of NAFTA. They find that stock prices are non-stationary, while stock returns are generally stationary across all three markets in all periods. In general, they observe increases in financial integration and co-movement in these three equity markets after passage of NAFTA, but cointegration is found only for the post-NAFTA period.

The current literature supports the premise that convergence of monetary policy tends to precede comprehensive economic convergence, leading to cross-border contagion in the banking industry. For example, Groupp and Vesala (2004), in a 1996-2003 sample of predominantly large, stock market-listed E.U. banks, found strong evidence that cross-border contagion may have increased in importance after convergence of monetary policy was achieved in the Euro region. Brada et al. (2005) use rolling cointegration to measure monetary convergence between developed countries in Europe and some transition countries newer to the E.U. that have been included in other cross-border contagion studies (e.g., Brada and Kutan, 2001 and Estrin et al. 2001).

The contribution from our study is the assessment of monetary convergence in the NAFTA region that includes, as in the study by Brada et al. (2005), two developed countries (the United States and Canada) and one developing country (Mexico). For robustness, we analyze cross-border contagion effects for a time period that excludes 2008 and 2009 to avoid distortions caused by the worst financial crisis in the U.S. since the Great Depression in the 1930s, and conduct an additional analysis of σ-convergence for the same period.

The remainder of the paper is organized as follows: Section Two describes the methodology, Section Three describes the data set, and Section Four presents the empirical analysis, followed by the Conclusion that discusses extensions for further study.

METHODOLOGY

As in this case, studies of empirical financial and economic phenomena almost always involve nonstationary and trending variables. If two random-walk price series have a long-run equilibrium relationship, they cannot drift apart indefinitely. The deviation from their equilibrium relationship must, therefore, be stationary and generate a zero mean. This can be translated into a testable relationship, whereby there is a combination of the two nonstationary series that is, itself, stationary (Greene, 2003). In such a case, according to Engle and Granger (1987), the two series are said to be cointegrated and this concept can be extended to a multivariate setting (Chou et al., 1994). As such, a deviation from the long-run relationship among the price variables can be constructed only from a combination of the entire price series involved. Due to the multivariate nature of our study, we employ the multivariate cointegration test used by Johansen to test for the existence of cointegration (Johansen, 1988). There are two test statistics for cointegration under the Johansen approach, which are formulated as follows:

$$\lambda_{trace}(r) = -T \sum_{i=r+1}^{g} \ln(1 - \hat{\lambda}_i) \quad (1)$$

and

$$\lambda_{\max}(r, r+1) = -T \ln(1 - \hat{\lambda}_{r+1}) \quad (2)$$

To assess contagion effects, this study follows the framework of Madura and Bartunek (1994). Specifically, the unique responses of three indexes - Canada's DS Bank Stock Index, Mexico's DS Bank Stock Index and the United States' DS Bank Stock Index - to information about difficulties at Countrywide Financial Corporation (CFC) are measured through a system of equations. The failure of Countrywide preceded the folding of Lehman Brothers, and the latter has been associated with initiating a crisis in the global financial system. Each equation listed

below focuses on the response of each Bank Stock Index to news about financial problems at CFC.

$$R_{US_t} = \alpha + \beta_1 R_{m_t} + \sum_{a=1}^{A} \gamma_a D_a + \varepsilon_{US_t}$$
$$R_{MX_t} = \alpha + \beta_1 R_{m_t} + \sum_{a=1}^{A} \gamma_a D_a + \varepsilon_{MX_t} \qquad (3)$$

where: R_{it} = Stock Index of country *i* at time *t, I* = US, CN, MX

R_{m_t} = Daily return on a broad Stock Market Index at time *t*

D_a = Dummy variable equal to 1 if bad news, and 0 otherwise

α, β_1, γ = Estimated parameters

ε_i = Error term

Since news about CFC's financial difficulties covers nearly the entire period of January through September of 2007 (see Table 1), the entire event window (i.e., all of the periods between and including a = 1 and a = A) is collapsed into a single dummy variable to eliminate the possibility of misplacing individual event periods. Such an approach is suggested by Lamdin (2001) for this type of situation.

Equation (3) fits into the seemingly unrelated regression SUR approach suggested by Zellner (1962) and may be generally expressed as follows:

$$\tilde{R} = \tilde{X}\beta + \tilde{\varepsilon} \qquad (4)$$

The parameters of Equation (3) are jointly estimated using generalized least squares, which assumes that $\tilde{\varepsilon} \sim$ i.i.d within each equation, but allows the disturbance variance to differ across equations. Within this context, heteroscedasticity and contemporaneously correlated disturbances are incorporated into one joint hypothesis: $\gamma_1 + \gamma_2 + ... + \gamma_A = 0$. In the SUR framework, this represents the formal test for significance of a stock market's reaction to the events in question (Carow and Heron, 1998).

As previously mentioned, the procedures proposed above exclude the years of 2008 and 2009 to avoid any distortion caused by the unprecedented economic shocks observed during these years. For robustness, we calculate σ-convergence in the NAFTA region using the approach found in Gudici and Mollick (2008) for assessing the degree of σ-convergence occurring in the Eastern Caribbean Region. The analysis calls for examination of the time trend for the coefficient of variation, which is defined as the ratio of standard deviation and the average real

gross domestic product index at every point in time. As explained in Gudici & Mollick (2008), advantages of using such a measure are that it is dimensionless and easy to interpret. For example, if countries are converging to a common level of income, the coefficient of variation would approach zero, but a coefficient of variation having a steady state other than zero would suggest a persistent income gap among the countries.

THE DATA AND DESCRIPTIVE STATISTICS

Data for Cointegration Tests

The data are monthly observations of the United States' target interbank rate, Canada's target interbank rate, and Mexico's target interbank rate. These represent the interest rates at which depository institutions lend to other depository institutions, generally on an overnight basis. The interbank market permits banks to trade among themselves in order to manage liquidity objectives from customers' demands for deposits, withdrawals, and borrowings and to fulfill other operational purposes.

The central bank in each country can implement monetary policy by influencing the target interbank interest rate. In the U.S., this is the federal funds rate, which is impacted by open market operations consisting mainly of buying and selling treasury securities. The central banks of the three countries that form the NAFTA region have been following similar mechanics regarding interbank interest rates for the last decade (see endnotes 2, 3, & 4). Since rolling cointegration analysis requires long-term data, only now has is it become feasible to analyze monetary convergence in the NAFTA region. The series were obtained from Data Stream for the period of 1997:1 to 2007:9. To ensure that the series from Data Stream were accurate, we also downloaded the U.S. target federal funds rate from the Federal Reserve Bank of St. Louis[2], the target Canadian interbank rate from the Bank of Canada[3], and the target Mexican interbank rate from the *Banco de Mexico*[4] (Central Bank of Mexico) and our analysis found no discrepancies between the rates.

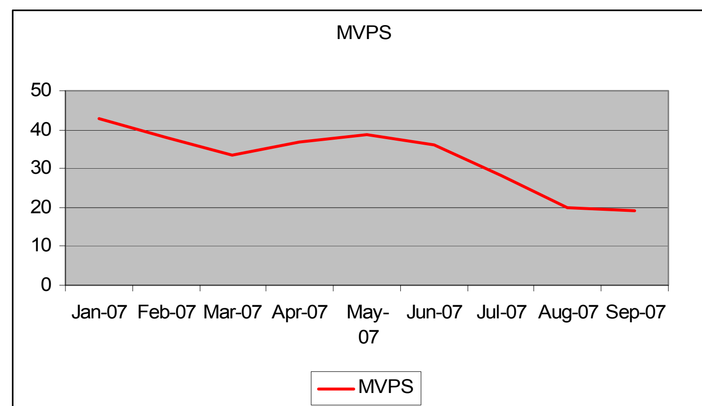
Data for Contagion Effects Analysis

The data to test cross-border contagion effects in the banking sector comes from daily observations of the following series: Canada's DS Bank Stock Index (code BANKSCN), Mexico's DS Bank Stock Index (code BANKSMX), and the United States' DS Bank Stock Index (code BANKSUS), all from Data Stream for the period of 1997:1:1 to 2007:9:30.

The trigger of adverse conditions is defined as negative news about Countrywide Financial Corporation. The housing market in the United States crashed during the first six months of 2007 due to a financial crisis in the sub-prime mortgage market that led to a sharp rise in foreclosures, threatening the solvency of a number of banks and other financial institutions,

such as Countrywide Financial Corporation and New Century Financial Corporation. [5] CFC had been described as the "23,000% stock" by *Fortune* magazine because CFC did, indeed, deliver an incredulous return of 23,000% between 1982 and 2003, exceeding the returns on the stocks of Washington Mutual and Wal-Mart[6]. By August 15, 2007, however, Merrill Lynch advised its clients to sell their stock in CFC and Reuters announced that CFC could face bankruptcy, precipitating a loss of over 55% on the stock's YTD value by September 30, 2007 (see Figure 2).

Figure 2: CFC Market Value per Share



Notes: Constructed by the authors using data from Compustat
MVPS = market value per share

Negative news concerning CFC is gathered using Lexis-Nexis Academic Universe. The chronology of such events is presented in Table 1.

Table 1. Chronology of Adverse Events Leading up to CFC's Difficulties

Date	Designated Event Date	Event description	Source
01/10/2007	E1	CFC's CEO exercises options for 70,000 shares	AP
01/17/2007	E2	CFC warns investors of financial difficulties	Daily Deal
01/29/2007	E3	Analysts doubt BOA is interested in buying CFC	AP
02/23/2007	E4	CFC lags on S&P500, outlook not good	Business News
03/02/2007	E5	CFC says delinquency is significantly higher.	American Banker
03/05/07	E6	CFC pulls S&P 500 to lower close	AP
03/22/07	E7	CFC says foreclosures up 10%	Business News
03/30/07	E8	CFC announces changes in board of directors	News Wire
04/05/07	E8	CFC fails to block probe	AP
04/17/07	E9	CFC's CEO exercises options for 46,000 shares	AP
04/19/07	E10	CFC's CFO exercises options for 70,000 shares	AP
04/26/07	E11	CFC 1Q profit falls 37%	Business News
06/07/07	E12	CFC resists oversight	Time Wires
06/25/07	E13	CFC reports 2Q profit falls	News Wire
06/26/07	E14	CFC execs to plead guilty to insider trading	Business News

Table 1. Chronology of Adverse Events Leading up to CFC's Difficulties			
Date	Designated Event Date	Event description	Source
06/28/07	E15	CFC CEO sells shares	AP
07/24/07	E16	CFC's profit sinks	Business News
07/27/07	E17	CFC's CEO predict long road for housing slump	J. of Commerce
08/03/07	E18	Morgan Stanley cuts price target on CFC	Business News
08/09/07	E19	CFC's CEO exercises options for 92,000 shares	Business News
08/14/07	E20	Lawyers file Security Class Action Lawsuit against CFC	Business News
08/15/07	E21	CFC's stock plunges on downgrade	AP
08/28/07	E22	CFC's estimate slashed	LA Times
09/05/07	E23	CFC finds itself struggling	Business News
09/06/07	E24	CFC cuts about 900 jobs	Business News
09/07/07	E25	CFC cuts 12,000 more jobs	Business News
09/10/07	E26	CFC to slash additional jobs	Business News
09/27/07	E27	Moody downgrades CFC	Business News
09/29/07	E29	CFC's CEO unloads stock	Business News
News was retrieved from various sources using Lexis-Nexis Academic Universe			

Descriptive Statistics

Table 2 presents key descriptive statistics of the series used in this analysis. Tests for the shape of the distributions indicate that all series are leptokurtic, which implies that these distributions are higher, or more peaked, than the normal distribution.

Table 2. Descriptive Statistics						
	USTIR	MXTIR	CNTIR	USBSI	MXBSI	CNBSI
Mean	3.91	13.95	3.71	1679	48160	2178
Median	4.75	9.95	3.50	1659	41351	2179
Maximum	6.50	39.84	5.75	1889	79507	2656
Minimum	1.00	4.90	2.00	1477	28770	1689
Std. Dev.	1.85	8.12	1.15	102	13673	278
Skewness	-0.41	1.20	0.19	0.22	0.85	-0.04
Kurtosis	1.60	3.97	1.77	1.94	2.36	1.71
Jarque-Bera (P-value	13.87 (0.00)	34.63 (0.00)	8.80 (0.01)	42.85 (0.00)	106 (0.00)	53.1 (0.00)
Observations	127	127	127	766	766	766
Notes: USTIBR, MXTIBR, and CNTIBR denote target interbank interest rates in the United States, Mexico, and Canada, respectively. USBSI, MXBSI, and CNBIS refer to the respective Bank Stock Indexes. P-values for the Jarque-Bera tests are reported below the statistics.						

Some of the series are also moderately skewed. As a result, the Jarque-Bera tests reject the null ($p<0.01$) of underlying normal distribution for all the series. Due to the sample size (127 / 766 observations) and implications of the central limit theorem, non-normality was considered

to not be an impediment for our analysis (see Sarno and Thornton, 2003). For the U.S., both interest rates and the stock market were less volatile than those in Mexico and Canada.

EMPIRICAL ANALYSIS

Unit Root Test

Table 3 shows the unit root tests. As can be seen, the United States' target interbank rates (US), Mexico's target interbank rates (MX), and Canada's target interbank rates (CN), are all non-stationary series. This is a very important finding because non-stationarity is a necessary condition for our analysis. In other words, the variables must be *I*(1) variables.

Table 3. Unit Root Tests on Monthly Data

Series	Trend?	ADF (k)	DF-GLS (k)	KPSS (4)
1997:01 – 2007:9				
US	Yes	-1.50 (3)	-1.67 (3)	0.41***
Δ(US)	No	-3.07 (2)**	-3.08 (2)***	0.39*
MX	Yes	-2.42 (0)	-2.32 (0)	0.28***
Δ(MEX)	No	-11.80 (0)***	-1.81 (2)*	0.07
CN	Yes	-2.06 (2)	-1.73 (2)	1.96
Δ(CN)	No	-5.07 (1)***	-5.09 (1)***	3.65***

Notes: Data are of monthly frequency. US, MX and CN denote the target interbank interest rates in the United States, Mexico and Canada, respectively. The symbol Δ refers to the first difference of the original series. We include the deterministic trend only when testing in levels, as suggested from graph inspection. ADF (k) refers to the Augmented Dickey-Fuller t-tests for unit roots, in which the null is that the series contains a unit root. The lag length (k) for ADF tests is chosen by the Campbell-Perron data dependent procedure, whose method is usually superior to k chosen by the information criterion, according to Ng and Perron (1995). The method starts with an upper bound, $k_{max}=13$, on k. If the last included lag is significant, choose $k = k_{max}$. If not, reduce k by one, until the last lag becomes significant (we use the 5% value of the asymptotic normal distribution to assess significance of the last lag). If no lags are significant, then set k = 0. Next to the reported calculated t-value in parenthesis is the selected lag length. DF-GLS (k) refers to the modified ADF test proposed by Elliott et al. (1996), with the Schwarz Bayesian Information Criterion (BIC) used for lag-length selection. The KPSS test follows Kwiatkowski et al. (1992), in which the null is that the series is stationary and k=4 is the used lag truncation parameter. The Symbol of * or [**] or (***) attached to a figure indicates rejection of the null at the 10%, 5%, and 1% level, respectively.

The variables are *I*(1) if they have a unit root at level, but are stationary when first differenced. This implies that a variable is stationary when its mean and variance are constant over time and the value of the covariance between the two time periods depends only on the distance, or lag, between the two time periods, rather than the actual time at which the covariance is computed (Gujarati, 2003). Since some tests are more robust than others with respect to the presence of heteroscedaticity, we include the traditional approach of the augmented Dickey and Fuller test (1979), in addition to the modified augmented Dickey and Fuller test

proposed by Elliott et al. (1996) and the KPSS method suggested by Kwiatkowski et al. (1992). Additional information concerning these tests has been included at the bottom of Table 2. In general, these tests indicate that the differenced series are $I(0)$, which support the traditional view that most financial and macroeconomic variables, including interest rates, are $I(1)$ processes (Stock and Watson, 2001).

Time Invariant Cointegration Test

The cointegration test results are reported in Table 4. The null hypothesis of no cointegration (r = 0) is rejected at the 1% level (Trace) and 5% (Max-Eigenvalue). Such a test seems to support the proposition of a long-run equilibrium relationship among the included series, which validate the proposition of an ongoing monetary convergence in the NAFTA region. There is a strong rejection of the null hypothesis (at the 1% significance level) of no cointegration vector (R = 0) There is a mild rejection of the null hypothesis (at the 10% significance level) of at most one cointegration vector (r ≤ 1), indicating that there might be a second cointegrating vector among the United States, Canada, and Mexico. Furthermore, at the 10% significance level, the null of two or fewer (r = ≤2) cointegrating vectors is mildly rejected as well. In other words, the notion of a dominant and clearly identifiable cointegration vector in this system of series is supported at the 1% significance level. Combining this result with the Unit Root tests strengthens the belief of a cointegrating relationship among the interbank interest rates of the United States, Canada, and Mexico.

Table 4. Multivariate Cointegration Test

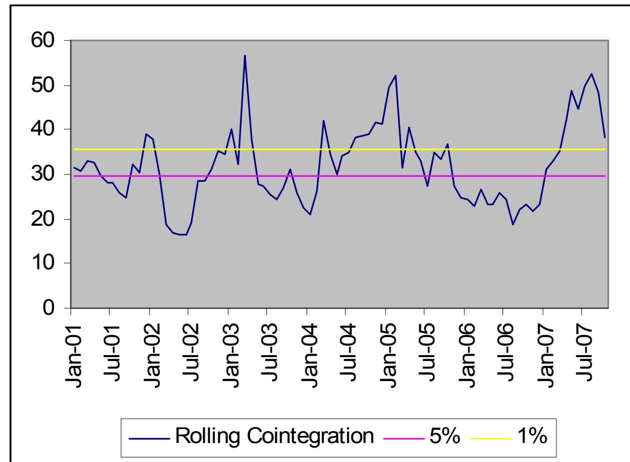
H0:	Eigenvalue	Trace	Max-Eigenvalue
R = 0	0.165	34.526***	21.154**
R ≤ 1	0.075	13.371*	9.143*
R ≤ 2	0.036	4.228*	4.228*

r = number of cointegrating vector. The symbols * [**] (***) attached to the figures indicate rejection of the null at the 10%, 5%, and 1% levels, respectively.

Time-variant Cointegration Test

Figure 3 shows that the long-run equilibrium relationship among the three countries' interbank rates is time-variant, which implies that, in the short-run, the equilibrium error term is not zero. The vector error correction of a VAR with optimum lag length of 9 lags shows that about 2.6% of the previous month's deviation from equilibrium is adjusted during the current month, which is statistically significant at the 1% level ($t = 2.78$).

Figure 3: Rolling Cointegration of the Interbank Rates in the NAFTA Region



Note: Constructed by the authors using data from Data Stream

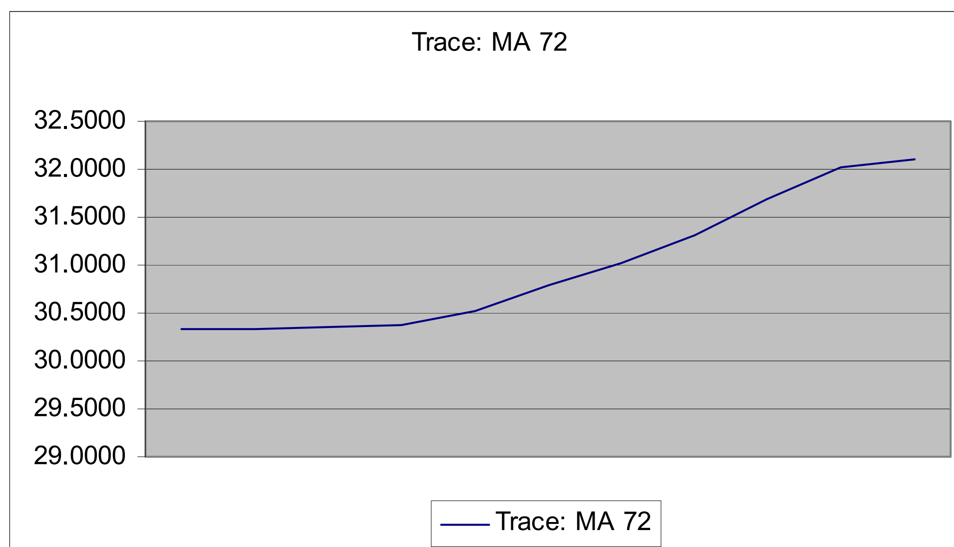
It should be noted that the strength of the relationship has gone up and is over the 1% confidence level as of September 30, 2007. This finding agrees with Figure 1 that showed a significant level of convergence during 2007. The combined evidence of Figure 1 and Figure 3 support the hypothesis that the cointegrating relationship among the tested series is growing stronger over time. In addition, these tests lend credibility to the statement recently made by the leaders of NAFTA nations that expressed ongoing monetary policy integration in the region.

The cointegrating function presented in Figure 3can be magnified by reducing the short-term volatility of the time series. A smoothing technique, such as moving averages, can be computed according to equation (5) presented below:

$$\bar{y}_t = \frac{(y_t + y_{t-1} + \ldots + y_{t-n-1})}{n} \qquad (5)$$

In equation (5), y is the trace time series, *t* is the current month and *n* is the number of months in the average. Now, moving averages can be computed. First, a 12-month moving average is computed, then a 24-moving average, and so on. To save space, only the 72-month moving average is presented in Figure 4.

Figure 4: 72-month Moving Average



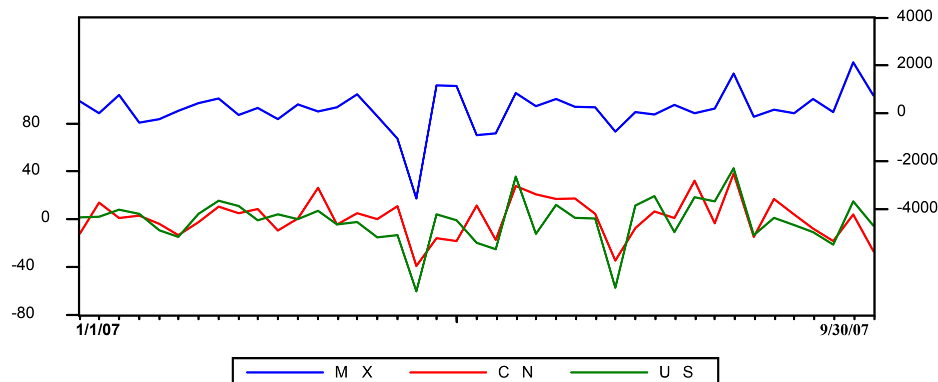
Notes: Constructed by the authors using data from Data Stream
MA 72 = 72-month moving average

Figure 4 clearly shows that the long-run trend of the trace time series is upward. Such clear-cut evidence adds support to the proposition of a cointegrating relationship among the target interest rates that is increasing over time.

Cross-border Contagion Effects from CFC's Financial Difficulties

One way of confirming monetary policy convergence is by analyzing cross-border contagion effects (Brada et al., 2005). We apply two broad approaches to assess contagion effects in the NAFTA region. First, we graphically analyze the co-movements over time of Canada's DS Bank Stock Index (code BANKSCN), Mexico's DS Bank Stock Index (code BANKSMX), and the United States' DS Bank Stock Index (code BANKSUS).

Figure 5: DS Bank Stock Indexes Co-movements over Time



Notes: Constructed by the authors using data from Data Stream. The top series represents the stock index of Mexico. The lowest series (as of the end of the time frame) represents the stock index of Canada.

Figure 5 shows that these series move in a synchronized pattern, which lends support to the hypothesis of cross-border contagion effects. It is important to notice the synchronization of the movements. Specifically, a spike in one market is followed by a similar spike in the other markets.

The second approach to test for contagion effects is to use the traditional event study methodology following Madura and Bartunek (1994) and Carow and Heron (1998). Details about the trigger condition are the same as those described in Section 3.2. Here, we consider the effects of CFC's difficulties on banks in the United States, Canada, and Mexico. Table 5 presents the univariate SUR analysis of the contagion effects in the region. As can be seen below, the cumulative effect of the events described in Table 1 significantly affect the Bank Stock Indexes of the United States, Canada, and Mexico (all significant at the 1% level).

It is important to note that the coefficients are close, which implies that the cumulative effects of the described events symmetrically and simultaneously affect the involved series. Such a remarkable finding adds support to the hypothesis of cross-border contagion effects, which is linked to the convergence of monetary policy in the NAFTA region.

The ninety-five percent confidence interval is included to illustrate the consistency of the parameter of interest. As can be seen, zero is not included in any of the ninety-five percent confidence intervals of γ. Additionally, the intervals are very similar. In general, there seems to be an agreement between the information conveyed by Figure 4 and Table 5, the univariate SUR analysis of the contagion effects in the NAFTA region.

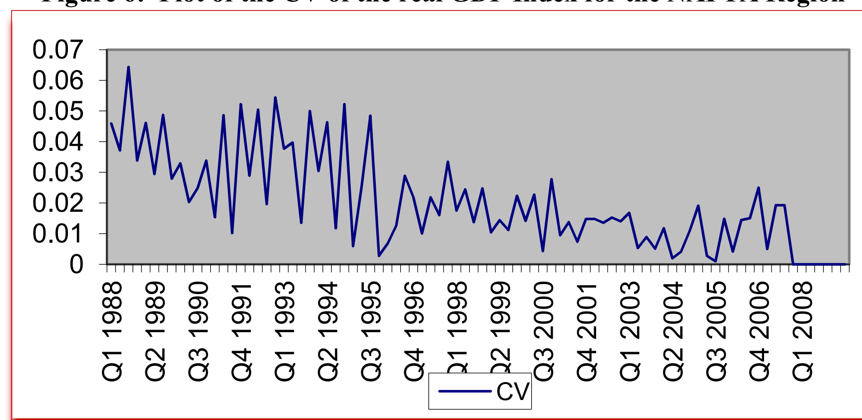
Table 5. Univariate SUR results							
		Coef.	Std. Err.	Z	P>|z|	95% Conf.	Interval
US	Γ	-0.0112	0.0022	-5.10***	0.000	-0.016	-0.007
	A	0.0013	0.0009	1.52	0.128	-0.001	0.003
CN	Γ	-0.0077	0.0014	-5.39***	0.000	-0.011	-0.005
	A	0.0012	0.0006	2.21**	0.027	0.000	0.002
MX	Γ	-0.0090	0.0022	-4.09***	0.000	-0.013	-0.005
	A	0.0023	0.0009	2.63***	0.008	0.001	0.004
Observations		194	194	194	194	194	194

Note: US, CN, and MX denote the United States, Canada, and Mexico, respectively. The dependent variable is the bank stock index return (*Rit*) in country *i*. The null hypothesis is that $\gamma 1 + \gamma 1 + \ldots + \gamma n = 0$. The symbol of * or [**] or (***) attached to a figure indicates rejection of the null at the 10%, 5%, or 1% level, respectively.

σ-convergence in the NAFTA region

For each cross section, we compute the average real gross domestic product index, its standard deviation, and the coefficient of variation (CV). The resulting time series of the CV is plotted in Figure 6. We can see from the graph that members of the NAFTA region have a coefficient of variation that declines over time, suggesting an absolute convergence over time.

Figure 6: Plot of the CV of the real GDP Index for the NAFTA Region



Notes: Constructed by the authors using data from Data Stream

Figure 6 adds robustness to our findings. In general, these analyses tend to confirm a broad, ongoing economic convergence in the NAFTA region.

CONCLUSION

We analyze the evolving, time-variant, long-run equilibrium relationship of the target interbank interest rates of Canada, the United States, and Mexico to assess whether or not monetary policy in the NAFTA region is truly converging, as pronounced recently by the leaders of these countries in Montebello, Canada. As an additional step, we test for cross-border contagion effects from the financial difficulties faced by Countrywide Financial Corporation during the U.S. real estate meltdown.

The null hypothesis of no cointegration ($r = 0$) is rejected at the 1% (Trace) and 5% levels (Max-Eigenvalue). Such results seem to confirm the proposition of a long-run equilibrium relationship among the included series, which lends support to the hypothesis of ongoing monetary convergence in the NAFTA region. The vector error correction of a VAR with optimum lag length of 9 lags shows that about 2.6% of the previous month's deviation from equilibrium is adjusted during the current month, which is statistically significant at the 1% level ($t = 2.78$). Secondly, we test for contagion effects using the traditional SUR study methodology. Univariate SUR analysis of the contagion effects shows that the events described in Table 1 significantly affect the Bank Stock Indexes of the United States, Canada, and Mexico (all significant at the 1% level).

The cumulative effects of the described events symmetrically and simultaneously affect the involved series. Such a remarkable finding provides additional support for the hypothesis of cross-border contagion effects, which is linked to convergence of monetary policy in the region. In summary, our findings are in agreement with studies concerning monetary convergence and contagion effects in the banking industry for the E.U. region, as presented in Brada and Kutan (2001), and Estrin et al. (2001). Including other events (e.g., news about difficulties at specific financial institutions in the United States as a consequence of the housing market collapse in that country) may cause the magnitude of the contagion effects to increase. Such additional considerations are left for future research. Computation of σ-convergence provides additional evidence of an ongoing, absolute convergence in the NAFTA region.

ENDNOTES

[1] The Summary of the Research findings can be downloaded from http://web.worldbank.org/wbsite/external/countries/lacext/extlacofficeofce

[2] http://research.stlouisfed.org/fred2/

[3] http://www.bankofcanada.ca/en/

[4] http://www.bankofcanada.ca/en/

[5] See Stempel, Jonathan. "Countrywide plunges on downgrade, bankruptcy fear", Reuters, Aug 15, 2007.

[6] *Fortune*, "Meet The 23,000% Stock", September 2003

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IDENTIFYING ORGANIZATIONAL CLIMATE AFFECTING LEARNING ORGANIZATION

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ABSTRACT

In trying to successfully respond to a world of interdependence and change, some companies are adopting the principles of a Learning Organization. However, while promoting a Learning Organization, the organizational climate may exert an influence on the behavior of employees. Consequently, the researchers believe that an appropriate organizational climate is needed to facilitate the efforts of the Learning Organization. The purpose of this study is to examine the effects of the different organizational climates on Learning Organizations' various learning dimensions. Data was gathered through questionnaires from 101 employees working in small and medium size companies from different industries. The results of the statistical analysis indicated that organizational climates do affect the various dimensions of the Learning Organizations. It also identified the organizational climates that significantly affect a given LO dimension and their degree of influence. In addition, this study also determined the best combination of climates that affect a particular LO dimension.

INTRODUCTION

In these turbulent times, "the only constant is change" (Heraclitus, undated). However, change can be daunting sometimes. One of the new approaches to embracing change in organizations is by transforming their organizational culture. Thus, in order to successfully respond to a world of interdependence and change, some companies are adopting the principles of a Learning Organization. Learning Organization refers to a culture that has developed the capacity to adapt and change continuously by promoting a learning environment that embraces both individual and organizational learning (Robbins and Judge, 2011). Nevertheless, to facilitate this transition, the proper organizational climate that can aid in this process is needed. Hence, the purpose of this research is to investigate whether certain organizational climates promote a Learning Organization.

Ideally, a Learning Organization is "skilled at creating, acquiring, and transforming knowledge, and at modifying behavior to reflect new knowledge and insights" (Garvin, 1993, p. 80). It demands that an organization makes a conscious effort to facilitate learning activities and generate adaptation and development capabilities (Lien et al., 2006).

Nowadays, organizations are under severe pressure to learn faster and effectively in order to grow and outperform their competitors (Garvin, 1993). A Learning Organization has the

capacity to empower people within and outside the workspace. This will increase both productivity and learning (Marquart, 1999). Past research has indicated the Learning Organization's positive relation with knowledge performance (Power and Waddell, 2004; Selden, 1998), commitment, lower turnover, and employee satisfaction (Egan et al. 2004; Ellinger et al., 2002; Sta. Maria and Watkins, 2003).

Watkins and Marsick (2003) developed a survey that assesses learning activities at all levels within the organization. According to Watkins and Marsick, there are seven dimensions essential for an organization to become a Learning Organization: Continuous Learning (creating opportunities for continuous learning), Inquiry and Dialogue (promoting feedback, communication, trust and respect), Team Learning (encouraging team learning and collaboration), Embedded Systems (integrating systems to capture and share learning), Empowerment (empowering employees toward a collaborative vision), System Connections (linking the organization to its environment and community), and Strategic Leadership (providing leadership by supporting and strategically utilizing learning).

In sum, a Learning Organization is an organization that facilitates learning for all its members and consciously transforms itself and its context (Pedler et al., 1991). According to Senge (1990), organizations learn best only when individuals are willing to learn. Pritchard & Karasick (1973) argued that organizational climates exert an influence on the behavior of employees. Consequently, the researchers believe that an appropriate organizational climate is needed to facilitate the efforts of the Learning Organization.

ORGANIZATIONAL CLIMATE

Litwin and Stringer (1968, p.1) viewed organizational climate as "a set of measurable properties of the work environment, perceived directly or indirectly by people who live and work in this environment and assumed to influence their motivation and behavior". Organizational researchers have shown strong interest in the study of organizational climate partly due to its hypothesized relationship to other organizational phenomena such as commitment, leadership behaviors, job performance, job satisfaction, productivity, motivation and the quality of work group interaction (Stringer 2002; Laschinger, et al., 2001; Goleman, 2000; Schnake, 1983; Pritchard and Karasick, 1973; Friedlander and Greenberg, 1971). For example, Bhaesajsanguan (2010) explored the behavior of 840 Thai Technicians in the Telecommunication private sector and found that organizational climate goes hand in hand with job satisfaction. He also found that organizational climate is positively related to organizational commitment through job satisfaction. A study by Castro and Martins (2010) examined potential contributors toward the job satisfaction of 696 employees in a South African call center, and found that the indirect correlate of their satisfaction and work environment perception was the degree of supportiveness of the organizational climate in which they were placed. Also, Poon and Ainuddin (1990) examined the relationships between organizational climate and job satisfaction and performance

using data from 462 employees of a large car manufacturing company in Malaysia. Results indicated significant relationships between several organizational climate dimensions and job satisfaction. However, only one of the climates was found to have an influence on perceived performance. On the other hand, Stringer (2002) concluded from research and consulting work that different organizational climates can arouse different kinds of motivation.

Although there are multiple organizational climate dimensions used by researchers (Denison, 1996), the main organizational climates that have been identified (see for example Stringer, 2002; Litwinand Stringer, 1968) are: Structure (sense of employees' being well organized and that their roles, and responsibilities are clearly defined), Responsibility (encouragement of individual judgment and discretion, employees' feeling of "being their own boss"), Risk (willingness to take chances on employees' ideas), Reward (basing positive rewards on performance and outweighing punishment in the organization), Warmth and Support (warmth in the relationships among employees supported by a relaxed and people-oriented atmosphere), Conflict (maintaining good interpersonal relations and avoiding open arguments and disagreements), Expect Approval (pride and loyalty toward the organization and work group).These climates will be used as the bases for our research.

OBJECTIVE OF THE STUDY

The purpose of this study is to examine the effects of the different organizational climates on Learning Organizations' various learning dimensions. This research will try to answer the following queries:

Q1: Which Organization Climate affects a given Learning Organization dimension?

Q2: Which Learning Organization dimension is mostly affected by a given Organization Climate?

Q3: Which combination of the main Organizational Climates best suit a given Learning Organizational dimension?

METHODOLOGY

The study is conducted within Lebanese organizations. Data were gathered through questionnaires distributed randomly to employees working in small and medium size companies from different industries. Analysis of the data is based on seven climates and their relationship with Learning Organizations. Preliminary statistical analysis based on pilot study found several climates significantly related to different dimensions of the learning.

The study is based on a questionnaire composed of three parts: demographic questions, Learning Organization questions and organizational climate questions. The Learning

Organization part is based on a questionnaire developed by Watkins & Marsick (1997). Basim et al. (2007) demonstrated its reliability and validity. This part contains seven sets of questions corresponding to the seven dimensions of Learning Organization. Similarly, the organizational climate part, developed by Litwin & Stringer (1968), has seven sets of questions corresponding to seven organizational climates. Each Learning Organizational dimension and each organizational climate is composed of several questions or statements rated on a seven-point Likert scale ranging from 1= strongly disagree to 7 = strongly agree, with 4 = neutral. A score based on the average is calculated for each Learning Organization dimension and each organizational climate. The Learning Organization scores are labeled as follows: Continuous Learning Score (CLS), Dialogue and Inquiry Score (DIS), Team Learning Score (TLS), Embedded Systems Score (ESS), Empowerment Score (ES), System Connections Score (SCS), and Provide Leadership Score (PLS). The organizational climate scores are labeled as follows: Structure Score (SS), Responsibility Score (RS), Risk Score (RKS), Reward Score (RWS), Warmth and Support Score (WSS), Conflict Score (CS), Expect Approval Score (EAS). These variables are used to conduct the statistical analysis.

RESULTS AND DISCUSSION

The objective of this research was to examine the effect of the different organizational climates on the Learning Organization dimensions.

The statistical analysis showed that the 101 respondents in the sample consist of 50.5% males and 49.5% females. The age distribution is 51.5% in the 25 years or below range, 34.7% in the 26 to 30 years range, and 13.8% above 30 years. Most of the respondents are employees 72.3 %, while 7.9% are supervisor and 19.8% managers. The employee's years of experience found 68.3% in the range of 0-5 years, 19.8% in the range of 6-10 years, and 11.9 % with more than 11 years of experience. The distribution of the monthly salaries is 42.6 % below than $1000, 55.4% between $1000 and $3000, and the rest in the range of $3000-$6000. These distributions could be explained by the fact that older more experienced people in high level positions with higher salaries maybe too busy to take the time to fill in the questionnaire.

To study the effects of organizational climate on the different dimensions within a Learning Organization, we designated the various dimensions of the Learning Organization as the dependent variables and the different organizational climates as the independent variables.

The overall reliability of the Learning Organization dimensions was checked and the computed Cronbach's alpha value was 0.947. Similarly, the overall reliability for the organizational climates resulted in Cronbach's alpha value of 0.86. Therefore, we can conclude that the data was reliable and valid for statistical analysis. The descriptive statistics for the various scores are given in the table below.

Descriptive statistics of LO and OC Scores													
	SS	*RS*	*RKS*	*RWS*	*WSS*	*CS*	*EAS*	*CLS*	*DIS*	*ESS*	*ES*	*SCS*	*PLS*
Mean	4.4	4.2	3.9	3.9	4.2	3.5	4.6	4.4	4.5	4.3	4.4	4.5	4.8
Standard deviation	0.7	0.7	0.8	0.7	0.8	0.7	0.7	0.9	1.0	1.2	1.0	1.1	1.0
Minimum	2.4	3.0	1.5	1.3	2.3	1.8	2.8	1.4	2.3	1.5	1.2	1.0	2.0
Maximum	5.9	6.0	6.0	5.3	6.4	6.5	6.8	6.7	7.0	7.0	6.3	7.0	7.0
1st quartile	4.0	3.8	3.5	3.4	3.7	3.3	4.1	4.0	3.8	3.8	4.0	3.8	4.2
Median	4.5	4.2	4.0	3.9	4.1	3.5	4.6	4.4	4.3	4.3	4.5	4.5	4.8
3rd quartile	4.9	4.7	4.5	4.3	4.6	4.0	5.1	5.0	5.0	5.0	5.0	5.2	5.3

Correlation analysis conducted to determine which organizational climate affects the dimensions of a Learning Organization resulted in the following coefficients:

	SS	RS	RKS	RWS	WSS	CS	EAS
CLS	.375**	.214*	-.058	.516 **	.510**	-.393**	.356**
DIS	.247*	.162	-.083	.417**	.594**	-.386**	.350**
TLS	.311**	.243*	-.090	.558**	.565**	-.419**	.376**
ESS	.375**	.302 **	-.194	.506**	.433**	-.366**	.294**
ES	.286**	.372**	-.012	.644**	.535**	-.385**	.377**
SCS	.322**	.148	-.091	.595**	.599**	-.341**	.269**
PLS	.429**	.280**	-.197*	.539**	.521**	-.192	.400**

The critical values for the two tailed test at a level of significance of 0.05 are ±0.196 and ±0.255 for a 0.01 level. The correlation matrix indicates the following:

- The structure climate score is positively correlated at a level of significance of 0.01 to all learning climate scores, except for (DIS) where the level of significance is 0.05. The highest correlation is between the structural climate and the leadership dimension in a Learning Organization.
- Although the responsibility climate score (RS) show less effect on the LO dimensions than the structural climate, nevertheless, the effect of the responsibility climate on empowerment is significantly higher. The other significant dimensions were ESS, PLS at a level of 0.01, and CLS and TLS at 0.05 levels. The LO dimensions dialogue and inquiry, and system connections are not significantly correlated with the responsibility climate.

- The risk climate is negatively correlated with all LO dimensions. However, it is only significantly correlated with the leadership dimension where the level of significance is at 0.05.
- Reward, and warmth and support climates both have very high positive significant correlation with all LO dimensions. The reward climate has the most effects on the empowerment dimension, followed by the system connections and the team learning dimensions. The warmth and support climate affect the systems connections and the dialogue and inquiry dimensions the most.
- The conflict climate is negatively correlated with all LO dimensions. All correlations are significant at a level of 0.01 except for the leadership dimension which is almost correlated at a 0.05 level. The highest negative correlations correspond to team and continuous learning.
- Similar to the reward and the warmth and support climates, the expect approval climate is positively correlated with all LO dimensions at a level of significance of 0.01. However, the association between the expect approval climate and each LO dimension is less than the association between the reward and the warmth and support climates and their effect on LO dimensions. The highest correlation corresponds to the leadership dimension.

The correlation analysis addressed both Q1 and Q2. The researchers believe that organizations may possess more than one climate dimension that could influence learning in any organization. That is why regression analysis was carried out to investigate the best combination of climates that can positively influence LO.

For each Learning Organization dimension, a regression model having the seven climate scores as the independent variables was constructed. The results are summarized in the following table. In each row, we give the model p-value and the coefficient of determination as well as the p-values for the individual variables.

	SS	RS	RKS	RWS	WSS	CS	EAS	R^2	p-value
CLS	0.059	0.762	0.696	0.005**	0.312	0.007**	0.260	0.430	2.77E-09
DIS	0.946	0.812	0.352	0.323	0.000**	0.129	0.182	0.406	1.73E-08
TLS	0.499	0.649	0.362	0.001**	0.083	0.006**	0.181	0.483	4.01E-11
ESS	0.030*	0.102	0.033*	0.008**	1.000	0.002**	0.443	0.432	2.48E-09
ES	0.818	0.083	0.884	0.000**	0.416	0.006**	0.116	0.546	1.32E-13
SCS	0.625	0.183	0.571	0.000**	0.011*	0.037*	0.868	0.490	5.34E-12
PLS	0.031*	0.122	0.027*	0.065*	0.029*	0.596	0.002**	0.477	6.51E-11

The above table reveals that all regression models are extremely significant and identifies the significant individual climates for each LO dimension. Note that some climates identified by the regression to be not significant for an LO dimension were previously found to be significantly correlated to the same LO dimension. The reason for this is that correlation analysis determines whether the association between one climate and a given LO dimension is significant without any consideration of the other climates. On the other hand, regression analysis identifies the significant climates for a given LO dimension when all climates are considered simultaneously. It is important to identify the best climate combination for promoting a particular dimension of a Learning Organization since an organization may possess the characteristics of more than one climate and at varying degrees. From the above results we conclude the following:

- The continuous learning dimension is significantly affected by the rewards and conflict climates, at a level of significance of 0.01, and somewhat by the structure climate, p-value = 0.059. Hence, the continuous learning dimension thrives in a structure and reward climate with a very low level of conflict.
- The inquiry and dialogue learning dimension is only affected by warmth and support at a level of significance of 0.01. From this we can conclude that in order to promote feedback, communication, trust and respect, the organization must stimulate a warm and supportive climate.
- Similar to the continuous learning dimension, team learning is significantly affected by the rewards and conflict climates, at a level of significance of 0.01. Therefore, a rewarding climate with a very low level of conflict encourages team learning and collaboration.
- The embedded systems learning dimension is significantly affected by the rewards and conflict climates, at a level of significance of 0.01, and by structure and risk, at a level of significance of 0.05. This means that in order to integrate systems to capture and share learning, an organization must promote a highly rewarding climate with a very low level of conflict. In addition, the roles and responsibilities of the employees must be clearly defined along with a willingness to take chances with employees' ideas.
- The empowerment learning dimension is significantly affected by the rewards and conflict climates, at a level of significance of 0.01. Therefore, empowering employees toward a collaborative vision is encouraged by a rewarding climate with a very low level of conflict. This will encourage team learning and collaboration.
- The system connections dimension is significantly affected by the reward climate at a level of significance of 0.01, and by warmth and support and conflict climates at a level of significance of 0.05. Therefore, linking the organization to its environment and community is promoted through a highly rewarding, warm and supportive climate with a low level of conflict.
- The strategic leadership dimension is significantly affected by the expect approval climate, at a level of significance of 0.01, and by structure, risk, reward, and warmth and support at a level of significance of 0.05. This means that providing leadership by supporting and strategically utilizing learning is promoted by the feeling of pride and loyalty toward the organization. Leadership also thrives in a structured, rewarding, and warm and supportive climate within an environment that is unwilling to take high risk. We would like to point out that these findings are supported by an earlier in-depth study by the same authors on the effects of organizational climates on the leadership dimension only (El-Kassar and Messarra, 2010).

CONCLUSION

This research aims at identifying the organizational climates affecting the Learning Organization dimensions and determining the extent of the relationships. The relationships were tested empirically by collecting information based on a reliable and valid questionnaire distributed to Lebanese employees working in small and medium size companies from different industries. The results of the statistical analysis indicated that organizational climates do affect the various dimensions of the Learning Organizations. It also identified the organizational climates that significantly affect a given LO dimension and their degree of influence. In addition, this study also determined the best combination of climates that affect a particular LO dimension (see table for summary of results):

Learning Organization Dimensions	**Climates Affecting LO Dimension**	**Best Combination of Climates For Promoting LO Dimension**
Continuous Learning	Rewards, Warmth and Support, conflict, Structure, Expect Approval, Responsibility	Rewards, Conflict
Inquiry and Dialogue	Warmth and Support, Reward, Conflict, Expect Approval, Structure	Warmth and Support
Team Learning	Rewards, Warmth and Support, Conflict, Expect Approval, Structure, Responsibility	Rewards, Conflict,
Embedded Systems	Rewards, Warmth and Support, Structure, conflict, responsibility, expect approval	Rewards, Conflict, Structure, High Risk
Empowerment	Rewards, Warmth and Support, Conflict, Expect Approval, Responsibility, Structure	Rewards, Conflict
System Connections	Warmth and Support, Rewards, Conflict, Structure, Expect Approval	Rewards, Warmth and Support, Conflict
Strategic Leadership	Reward, Warmth and Support, Structure, Expected Approval, Responsibility, Risk	Expected Approval, Structure, Low Risk, Reward, Warmth and Support

Managerial Implications

This study adds to the literature on organizational climate and its relationship to Learning Organization so that organizations can identify the ideal climate or climates needed to facilitate the efforts of the Learning Organization. By identifying climate gaps that could influence

learning or a particular learning dimension, leaders can then prepare strategies that can help improve such climates which will ultimately improve learning.

Limitations

This study like most others has limitations. First, the sample selected was small and limited to employees working in small and medium size Lebanese organizations. Future research could explore whether these finding are global or are culture specific and using a larger sample. Second, although demographic factors were collected, their relationships to the different variables were not tested. Further study could consider whether demographic factors influence our findings.

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THE CHANGING ROLES OF JAPANESE WOMEN IN THE JAPANESE BUSINESS WORLD

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ABSTRACT

The roles of Japanese women in the Japanese business world have changed significantly through the years. An examination of the societal, cultural, and business influences on the lives of Japanese women reveals several major changes. First, Japanese women now have access to higher education. Second, as a result of their educational opportunities, they are entering the business and political worlds, working in management positions, and staying in the work force longer. Third, they are delaying marriage and having fewer children. These changes, coupled with the fact that foreign companies with businesses located in Japan are providing career opportunities for Japanese women, indicate that the roles of Japanese women will continue to evolve.

INTRODUCTION

Globalization is having a profound effect on the world as we know it. Economies are now interconnected. Perceived distances are shrinking. Traditional work roles are changing. Cultures are being transformed. In short, the world of 2012 is not the world of 1912, 1932, 1952, 1972, or 1992. Change is occurring rapidly in some cultures and slowly in others. But it is occurring as societies are creating futures that may be unrecognizable when compared to their pasts.

Japan is one of the cultures that is undergoing significant societal change. One of the major change areas involves women and the roles they play in creating and sustaining a cohesive, viable, and successful society. The four most significant roles involving Japanese women are societal, familial, educational, and work roles. All of these roles are intertwined, and distinguishing where one begins and another ends is often difficult.

Exploring the past of these four significant roles is vital to understanding their present, and both are necessary for predicting the future. Thus, this article examines the past, present, and future of Japanese women in their four most significant roles.

SOCIETAL ROLES

During the early twentieth century and before World War II, Japanese women held a specific place in society. Japanese women were considered inferior to men. Young Japanese women were used as a source for cheap labor until they married. Traditions were rigid. In their early twenties, women were expected to marry and produce children to make the Japanese society stronger. During and after the war and the occupation of Japan by the Allied Powers, the roles of Japanese women began to evolve because of the structural and legal changes that were implemented.

The Past (1900 – 1979)

To understand the roles of Japanese women, one must know something about the past. Japan has always been a collectivist society, and this structure provided a strong cultural foundation for all aspects of life. Long work hours for low wages was the norm, and life expectancy was low (in 1935, 50 years for women and 45 years for men in Japan, compared to 64 years for women and 60 years for men in the United States) (Iwao, 1996; Central Intelligence Agency, 2011). Medical care was rudimentary, and significant technological advances had not yet occurred. But the allegiance of its citizens to the greater good of the nation built a strong society, albeit one in which women were considered to be inferior to men in most societal roles.

As Japan recovered from the war and rebuilt its economy, life expectancy improved. By 1950, it had increased to 60 years for women and 55 years for men (compared to 71 for women and 65 for men in the United States). In 2011, Japan's life expectancy surpassed that of the United States, with 86 years for women and 79 years for men, compared to the United States' figures of 81 for women and 76 for men (Iwao, 1996; Central Intelligence Agency, 2011).

Just as life expectancy in Japan improved, so did women's rights. Prior to World War II and the Allied occupation of Japan (1945–1952), women had very few rights. Their role in society was to obey and serve. First they obeyed their fathers, and then they obeyed and served their husbands. Women were not allowed to divorce their husbands; however, their husbands could divorce them. This low status of women began to change after the war. The new constitution of 1946 and the postwar reforms provided new opportunities for women. All men and women were given the freedom of thought, religion, marriage, and education. The legal status of women changed when all people were declared equal and women were given the right to vote. The new rights and freedoms afforded to women were the beginning of change in their roles.

However, in spite of the postwar reforms, women were still expected to be "good wives and wise mothers" (Tanaka, 1990, p. 753). Once a woman reached her early twenties, she was expected to leave work, get married, and have children. If a woman was not inclined to leave her job to get married, her boss would introduce her to a suitable partner (Kaminski & Paiz, 1984).

The Present (1980 - 2011)

In 1985, women would typically leave their jobs at the age of 25 to get married. This age increased to 28 in 1995. Today, Japanese women and men are waiting longer to get married; and unlike their mothers, Japanese women are less willing to stay in an unhappy marriage (Iwao, 1996). Thirty-year-old unmarried women are referred to as Loser Dog, known as make-inu in Japanese. Married women are called Winner Dog, known as kachi-inu in Japanese (Faiola, 2004). Women are not alone in this area. An unmarried man who is over 35 is considered to be a failure and his lack of a wife and family can affect his career.

A significant societal trend concerns the birth rate. Married couples are having fewer children. The birthrates began declining after the occupation of Japan ended in 1952. In 1950 the average child per family was 3.56; in 1991, 1.53; and in 2011 it was 1.2 (Iwao, 1993; Iwao, 1996; Central Intelligence Agency 2011). In addition to the declining birthrates, the population is aging. These two factors are a concern for the future.

In 1998, Japan's population was 126,166,000. At that time, women exceeded men by 2,556,000. In 2011, the population was 126,475,664, with 3,249,084 more women than men. A closer look at this difference shows that men under 65 outnumber women by 1,133,103, but in the over-65 category women outnumber men by 4,382,187 (Central Intelligence Agency 2011). Because the population is aging and it is not being replenished, the gender shift in the population may significantly affect the future roles of Japanese women in the Japanese business world.

A final aspect of Japanese society involves the type of jobs that are viewed as appropriate. Part-time jobs are acceptable, but only for women. Men are expected to be employed in full-time positions.

The Future (2012 +)

History and tradition have been of paramount importance in Japanese society. But now Japanese women are caught between tradition and change. What will be acceptable for the future? The younger generations of women in business have benefitted from legislative changes and the evolving attitudes of society toward the issues of women. These women recognize the opportunities and understand what their foremothers did to pave the way. Unlike American women who are viewed as desiring complete equality, Japanese women want to be seen as different from men, but valued equally (Renshaw, 1999).

The changing population is a concern. In the postwar years, women outnumbered men. Now these women are part of the aging population 65 or older, and there are more men than women in the younger generations, ages 15 to 64. This gender shift may or may not hinder the progress Japanese women are making in the business world. Progress will depend on the values and attitudes of this younger generation. Do the Japanese men of this generation hold the same

values and attitudes that their fathers and grandfathers held, or are they less traditional and open to working side-by-side with Japanese women in business and in the home?

Child care is an obstacle and will continue to be a problem for Japanese women in the future. The Japanese government recognizes the need for quality child care and has established laws to govern the child care industry. In 2004, more than one million children were enrolled in child care facilities and more than 24,000 children were on waiting lists (JETRO, 2005).

FAMILIAL ROLES

Family represents stability, and success of the family is the central focus in Japanese life. The role of the Japanese woman is instrumental to the success of the family. The woman's duty is to run the household. Within the family, the Japanese woman holds many roles including those of wife, mother, role model, cook, and accountant. How are those roles changing?

The Past (1900 – 1979)

According to Iwao (1993), young women in Japan knew their destiny was to marry and have children to increase the population and continue the family line. They were not recognized as adults until they were married with children. Women were considered weak, but mothers were considered strong. Marriage was a necessity for survival and for the future of Japan. Men worked and supported their family monetarily while women supported the man's need for a clean home, warm meals, well-tended children, and clean clothes. Watching over the family and maintaining strong family ties was of great importance (Iwao, 1996).

Hall (2000) explained that the husband worked and brought money home to his wife, who in return used it to manage the household budget. She was in charge of the household finances and was known by her husband as the "minister of finance."

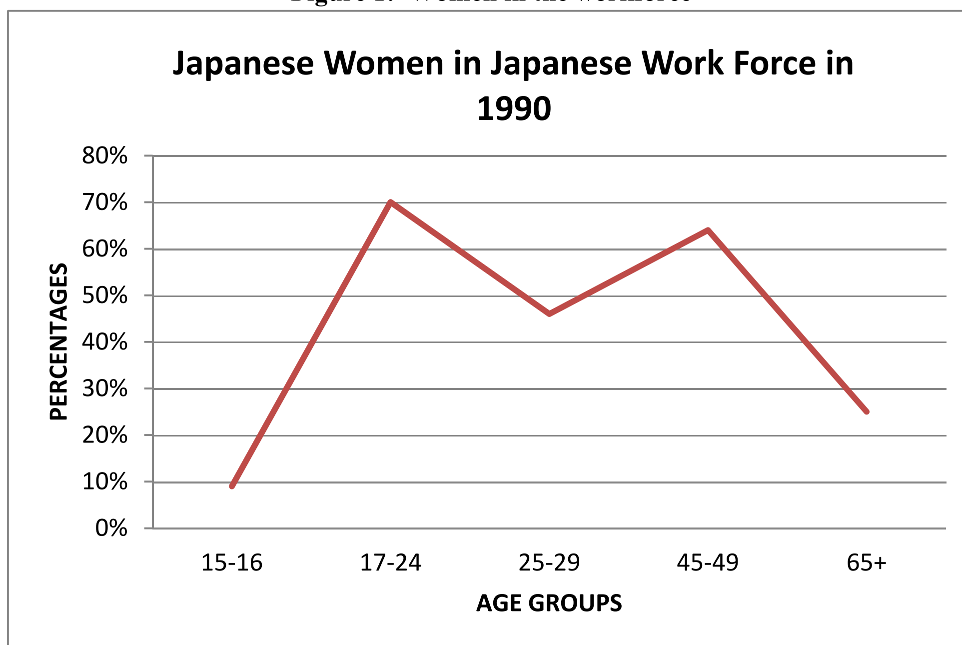
The attitudes toward having children have changed. Prior to the war, children were considered "a gift from the gods" (Iwao, 1993, p. 129). Women believed that as mothers, their path in life was not tied to their own desires, but rather to the phases of their children's lives. The first generation after the war viewed having children as the expected path in life (Iwao, 1993).

The Present (1980 - 2011)

Young women are expected to take a job out of school and remain employed until marriage. Most young women in their twenties work to make money that they can use any way they choose. Women generally leave the work force between the ages of 25-29 to get married and raise a family. Once their children are older, they return to the work force. Approximately 70 percent of women between the ages of 17-24 joined the work force in 1990, 46 percent of

women between the ages of 25-29 were in the work force, 64 percent of women between the ages of 45-49 rejoined the work force, and 25 percent of women age 65 or older were still in the work force. Charted, these figures form an "M-Shaped" curve which represents the participation of women in the labor force (See Fig. 1) (Lam, 1992; Renshaw, 1999; Kumamoto-Healey, 2005). The use of such a curve is unique to Japan.

Figure 1: Women in the workforce



Lam (1992) states that the traditional roles of wife and mother have not changed, except that now the husband might occasionally take out the trash. Another role played by women is that of caregiver for the elderly family members. In Japan, elderly parents often live with their oldest son, and the wife's duty is to care for them. Lam (1992) emphasizes that family responsibilities are the greatest contributors to holding women back in the Japanese business world.

Present day women are more educated and independent than their ancestors. Because they can work to support themselves, marriage is now considered an option and not a necessity. Many women who choose to marry and have children also choose to return to work after childbirth; however, the lack of social services that provide child care facilities hinders women from being able to work if they have small children (Lam, 1992).

The Future (2012 +)

Women have a desire for marriage and children, but they also have a desire for a career. They do not want to give up their goals of being successful in the workplace (Iwao, 1996). This desire, and the increasing belief that raising children and working outside the home is viable, provides women with the knowledge that the future can be everything they want it to be.

Families are having fewer children due to the cost of education. This low birth rate contributes to children having less experience with group-oriented behavior (Iwao, 1996). The children are raised to be independent and to provide for themselves. In addition, the hope is still strong that the children will be able to care for their aging parents. This belief is a serious concern for the future and may be a problem, especially if parents outlive their children.

EDUCATIONAL ROLES

Equal opportunities in education were not provided to Japanese women until after the implementation of the Fundamental Law on Education in 1947 (Iwao, 1993). This law created new opportunities for women, and it allowed for change in the roles of Japanese women in education. These changes provided for growth and prosperity in their societal, familial, and work roles, which are intertwined. For example, the mother is the greatest influence in the family; and if she attended a university, then her female children are more likely to do so as well (Edwards & Pasquale, 2002).

The Past (1900 – 1979)

In the early years, women were provided with basic education that included conducting the tea ceremony, arranging flowers, and cooking. Anything beyond taking care of a husband, children, and home was not necessary. After the Fundamental Law on Education was implemented, high schools that were previously segregated by sex became co-ed and universities for women were opened (Friedman, 1992).

According to Lam (1992), in 1965, more than 50 percent of female university graduates went into teaching. Two decades later, this figure dropped to 20 percent. Instead, female university graduates were more interested in positions in the corporate sector including specialist, technical, and clerical jobs.

The Present (1980 - 2011)

The number of women attending and graduating from four-year universities has increased significantly. This rise has led to women having greater ambition in many areas of their lives. They now aspire to succeed in both their personal sphere and in the business world. Educated

women want to marry educated men, which creates a link between marriage and education. This link is an important qualification when choosing a mate. In addition, the more education a woman has, the more likely she is to postpone marriage and focus on her career. Japanese men are following similar patterns.

Japanese women are perceived as some of the most highly educated women in the world (Iwao, 1996). In 1996 at the age of 100, Shidzue Kato, a pioneer feminist, said, "Japanese women are now among the best educated and richest in the world, but we need to push ourselves forward more, to elbow our way into more decision making jobs. . . Men's attitudes will not change unbludgeoned" (Low, 2007).

The Future (2012 +)

The Japanese desire for education is increasing. Japan is seen as having "education fever" (Iwao, 1996, para. 20). The desire for education is not focused on one group; it affects both women and men. Iwao (1996) stresses that "The amount of time, energy and money being spent on education is staggering" (para. 20). The education process usually begins with children around the age of four. They are involved in everything educational and cultural because their parents hope to enroll them in the best possible elementary school. This action leads to top-notch high schools, cram schools (known as Juku in Japanese), and universities. The time and expense involved do not matter; Japanese women will continue to immerse themselves in education and personal development (Iwao, 1996).

WORK ROLES AND THE ECONOMY

Japan is the third largest economy in the world and the tenth most populous country. The Japanese economy has historically depended on the labor of women to grow strong. As the economy has changed over the years, so have the roles of women. These changes, from the past through the present, demonstrate the desire for equality in work roles and prosperity.

The Past (1900 – 1979)

According to Friedman (1992) and Lam (1992), young Japanese women, ranging in age from 12 to 20, from poor, rural areas provided the primary source of labor for the textile and basket industries. They were forced to live away from their families and work in less-than-sanitary conditions for low wages. These young Japanese women made it possible for the Japanese economy to grow. They contributed to the strength of society and were the foundation of the economy, yet they did not have any rights.

During World War II, women worked in factories, mills, and mines, in addition to taking care of their families. This period in time changed Japanese society as women realized they were capable of providing for their families when necessary.

After the war and the implementation of the New Constitution of 1946, the roles of women began to change. The Labour Standards Law of 1947, which created workplace equality, was implemented. This law provided equal pay for equal work and mandated a series of protective measures for women in the work force including work hours, night work, underground work, holidays, and restrictions on dangerous work (Lam, 1992).

A labor shortage in Japan in the 1960s forced companies to use high school and university graduates and middle-aged women in part-time positions. During this time and thereafter, the number of part-time workers increased, and many of the part-time positions were held by housewives (Lam, 1992).

In the early years, office work was performed primarily by men. Young women were hired as temporary employees to work as office ladies (Or-Eru) also known as "office flowers." The thought was that they "bloom and disappear by the age of 25" (Renshaw, 1999, p. 80). These women were hired at the age of 18 or 19 and worked for five or six years, until it was time to get married and leave their jobs. The office ladies worked in unchallenging positions performing simple duties including filing, typing, making copies, and serving tea (Renshaw, 1999).

The Present (1980 - 2011)

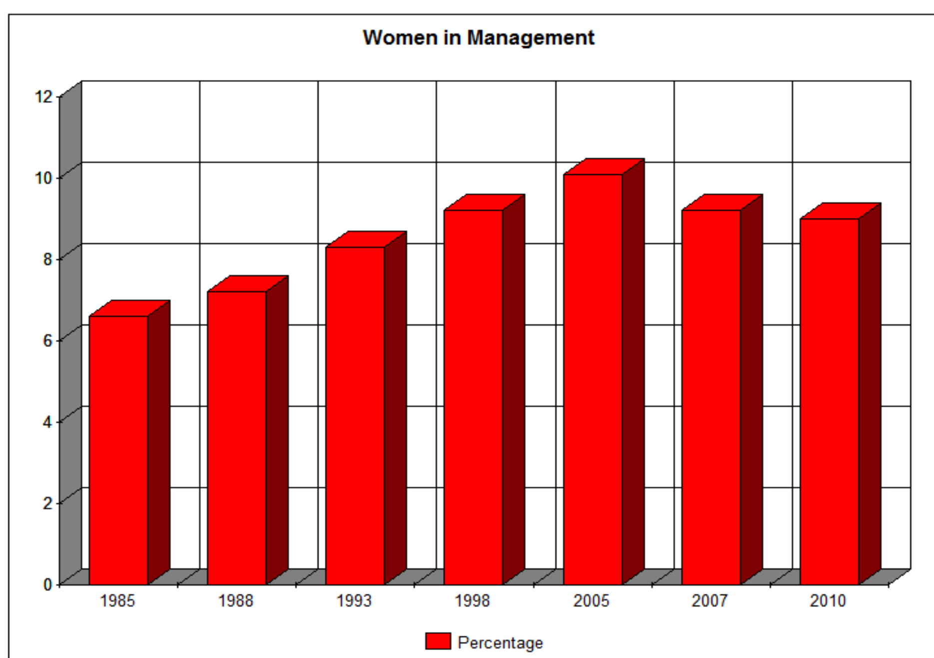
Pressure from other countries caused Japan to update its legislative framework in 1999 to meet international standards. Therefore, the Equal Employment Opportunity Law of 1986 was amended in 1997; however, it was not enacted until 1999 (Lam, 1992). One of the benefits of the Equal Employment Opportunity Law was the lifting of the ban on night work for women. Prior to 1999, women were protected by the Labour Standards Law of 1947; and they were not allowed to work at night. This ban was lifted in 1999, and it opened the door for automobile manufacturing companies to hire skilled female workers.

Many companies began using a selection system for hiring known as the career tracking system (kosubetsu koyo-seido). This system includes a two-track employment approach, which consists of the management career track, known as sogoshoku and the general career track, known as ippanshoku (Lam, 1992; Kumamoto-Healy, 2005). The two-track system is primarily used in large companies. Neophytes may be offered a choice of different career tracks when hired. Men are automatically placed in the management career track. Women are usually placed in the general career track; however, a talented and intelligent woman might be offered the management career track (Iwao, 1993). In addition to the two-track hiring system, firms consider women only for specific positions; and they use different requirements for recruiting and hiring men and women.

In the past 50 years, the number of women in the Japanese work force has increased. In 1955, 5.3 million women were in the Japanese work force; in 1990, 18.3 million; and in 2009, 27.7 million (Lam, 1992; Lah, 2010). In 2009 there were eight million part-time workers in Japan, and 89 percent of them were women, resulting in a significant part-time workforce of seven million women.

Of the Japanese women in the work force in 2010, women primarily worked in lower-level management positions, and fewer than 9 percent were managers. The percentage of women in management positions has varied from 1985 through 2010, ranging from 6.6 in 1985 to 9 in 2010, as shown in Fig. 2. A significant fact is that out of the 9 percent in 2010 who were managers, only 2.8 percent were in top-level management positions (Fackler, 2007).

Figure 2: Women in management 1985 – 2010



Due to the labor shortage and the high cost of training new employees, businesses are recruiting previously employed women who had left their jobs to marry and raise a family. Many Japanese companies believe it is more cost effective to train former employees than to train new employees (Inada, 2007).

One constant in Japan is the traditional mind set of women serving men. Even though women are working in the same positions as men, women are still required to perform menial tasks for male managers including serving tea and making copies. If female employees complain, they are told that businesses cannot hire someone just to serve tea (Faiola, 2007).

Although Japanese companies choose to employee men in management positions, rather than women, globalization has resulted in a significant employment change. Foreign companies with operations in Japan are providing more opportunities for Japanese women. They are being recruited for management positions that offer good pay and the opportunity to travel (Iwao, 1993). These foreign companies include Morgan Stanley, IBM, Microsoft, Intel, Pfizer, and Procter & Gamble.

Japanese businesses that do employ women in management positions often anticipate that women will put their family first, ahead of work responsibilities. As a result, these women are susceptible to losing important career opportunities. Foreign companies do not appear to have these culturally bound preconceived beliefs.

The Future (2012 +)

Women will continue to compete with men for positions; however, the number of women in the future workforce may decrease due to the aging population and the shift in the number of women versus men in the population. Traditional values are complicated and will not change quickly. Therefore, predicting whether Japanese companies will move toward hiring more educated and qualified women is difficult. However, opportunities for women with foreign companies that have offices in Japan will continue to increase because these companies consistently hire employees based on qualifications, not on gender.

The desire of both women and men for a life away from business is increasing in Japan. As the younger generations begin to enter the workforce, their dedication to work is likely to decrease. Unlike their fathers and grandfathers, who devoted their lives to their employers, the new generations may continue to move in the opposite direction by seeking lives that allow for quality time outside of work (Iwao, 1996).

CONCLUSIONS

In the past, traditional roles were mandatory for Japanese women. They were not prepared to compete with men, and they were forced to work in roles that did not deprive men of positions. The roles of Japanese women in the Japanese business world have changed significantly through the years. More Japanese women are highly educated. They are entering the business and political world, working in management positions, and waiting longer to get married. Women are now better prepared to compete with men.

Strong societal and cultural implications are evident. The traditional role of Japanese women as wives and mothers is changing. Japanese women are staying in the workforce longer, delaying marriage, and having fewer children. These changes are due to opportunities created by economic changes, access for women to higher education, and the implementation of labor and equal opportunity laws.

World globalization will continue to open doors for Japanese women in the business world. Highly educated Japanese women are viewed as an untapped resource, and foreign companies with offices in Japan will continue hiring them. Japanese women will continue to take advantage of the opportunities for advancement in their careers offered by these companies. Notwithstanding the opportunities and changing roles, recent evidence suggests the progress of the growth pattern may be tapering off. However, this decrease will depend on the values and attitudes of the future generations. Will Japanese women continue to evolve into managers, mayors, and governors, or will the traditions of years past become popular again? Only time will tell.

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SOCIAL MEDIA'S KEY SUCCESS FACTORS: AN ANALYSIS OF CUSTOMER REACTIONS

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ABSTRACT

Undeniably, social media has become integral part of consumers' daily routine. Can companies successfully use social media for marketing? Do customers consider it invasion of their private discussions with important others? What are the key success factors that may encourage the use of social media in marketing strategies? This study seeks to provide understanding to these questions. Findings of multiple one-on-one interviews indicated that users believe companies should include social media—a more personal communication channel than traditional media—to advertise, stay up-to-date, and share relevant company information. Interviews reveal patterns of use, unmet needs of users, perceptions about social media, specifically Facebook, and views of how companies can use social media.

INTRODUCTION

Social media has existed since the 1990s; however, only in the last several years has it made substantial gains in popularity worldwide. In turn, companies are beginning to use social media as a marketing communication tool. The forerunners of social media include several social networking tools that ease one-to-one and one-to-many communication options. For example, Usenets allowed users to post articles or news items to newsgroups. Bulletin Board Systems (BBSs) were the first type of sites allowing users to log on and interact with other users. Online services followed with such programs as CompuServe, Prodigy, and Genie were considered the first "corporate" attempts to access the Internet. These services contained features such as chat programs, games, mail, and instant messaging (Webdesigner Depot 2010). Yet another precursor to social media was online gaming. MMORPGS (Massively multiplayer online role-playing games) became popular in the early 2000s (Webdesigner Depot 2010).

As increasing numbers of people went online, social networking continued with dating sites, which encouraged customers to create a personal profile and communicate with other users. The first major Internet dating site is said to have been a combination of kiss.com and match.com. By 1996, sixteen dating sites were listed in Yahoo! Similar websites such as Friendfinder.com and OneandOnly.com had emerged as well ("History of Online Dating"). In 1997, social networking took another step with the debut of the first modern "non-dating" social

network, SixDegrees, a web site enabling users to create profiles and connect with friends, family members, and acquaintances. Emerging in 1999, LiveJournal differed from SixDegrees in that it operated by constantly updating blogs. It also encouraged users to follow one another and form groups, a strategy several social media sites use today. In the 2000s, social networking and social media had shown a sharp took off among international web users. In 2003, MySpace emerged and by 2006 had grown to be the most popular social network in the world. It differentiated itself from its competitors by allowing users not only to customize their profiles, but also to post music and embedded videos from other sites in their profiles. MySpace communication was originally through private messages, public comments, and bulletins sent to friends. In 2006, it introduced MySpace IM, an instant messaging feature allowing users to chat with their friends. MySpace also implemented real-time status updates and a news feed (Webdesigner Depot 2010). In 2004, Mark Zuckerberg, a Harvard student, started Facebook as a Harvard-only social network. It expanded to other universities, high schools, and businesses worldwide by 2006. Surpassing MySpace's popularity in 2008, Facebook allowed users to post photos and videos and to customize their profile content. Its communication practices include private messages, wall posts, chat messaging, news feeds, and notes. Users can also change privacy settings to authorize which friends can see certain parts of their profiles. A more recent feature is the interactivity between Facebook and apps; (the same interactivity is available with MySpace) (Webdesigner Depot 2011). As of 2010, Facebook is the number-one social network worldwide with a use rate of nearly six hours per person per month, five hours more than compared to MySpace's use rate (Grove 2010).

Other popular social media sites include YouTube and Twitter. Launched in 2005, YouTube became the first major video hosting and sharing site. Users can upload up to ten-minute videos. Its major social features include ratings, comments, and the option to subscribe to YouTube channels (Webdesigner Depot 2011). Untold hours are spent watching music videos, television clips, hilarious mishaps, home videos, and news stories on YouTube, which is so well-known that Fox News correspondents regularly draw attention to videos on the site. News articles and features about videos can reach to have a million hits (or viewings) in a couple of months depending on the content. Founded in 2006, Twitter involves a communication technique referred to as tweets, real-time status updates that everyone can see. Especially celebrities have millions of followers looking for their tweets. Research indicated that Twitters spend approximately thirty-six minutes per month communicating (Grove 2010).

As the use of social media becomes more prevalent among adults and a staple in today's mainstream culture, businesses are realizing the importance of incorporating social media into their business strategies to help with branding and networking. Micek and Whitlock note that "If you're in business and you're not already feeling these changes, you will soon enough. The New Media world of blogs, podcasts, social networks, wikis, and more are enabling participation and connection like never before in history" (2008, p.). As discussed in Saperstein and Hastings' article (2010, p.2), "… the necessity to improve communication with customers requires

businesses to completely re-think their contact processes." (Businesses need to understand customers—who they are, what they do, what they need, and what they want. Social media makes improving this customer intimacy easier by using continuous customer interaction. According to Michael Joseph, "change is real as customers are truly empowered through tools on the Internet", and "consumers are actively gathering information to determine what a brand and offering are all about (Saperstein and Hastings 2010, p3)". "The Lasting Effects of Social Media Trends on Advertising" (Wright 2010) explores social media trends and marketing opportunities. In discussing the history of marketing concepts and the evolution of marketing strategies, Wright notes that marketers are at a point where they must explore new media platforms and establish more intimate relationships with their customers. With the advent of social media, such relationships can easily be fostered. Marketers must be aware of new trends and join the world of social media (2010).

Social media become an integral part of individual's lives. Research about teenage girls and why they use social networking sites revealed that young girls used these sites for identity creation and management, peer acceptance purposes as well as communicating with their contacts (Dunne 2010). Brands and marketers played important role in portraying one's ideal image. Befriending a brand was considered as personal endorsement. As positive word of mouth spread, girls enjoyed safety from embarrassment and rejection.

While a small, influential group of businesspeople is paving the way for how social media can be used, many of the biggest businesses are behind. According to Ostrow's 2010 study, "only 36% of the CEOs at the world's 50 largest companies are engaging via social media or their company websites"(p.1). The study also found that for those CEOs using social media, "most of the activity (28%) was akin to traditional one-to-many communication methods. Also, video was the strongest component among CEOs using social media, with 18% having a video presence via their websites or YouTube channels. Only a small percentage reported having a profile on Twitter (8%), Facebook (4%), and MySpace (4%)" (p.1). Some of the companies using social media find it to be valuable for not only business but also customers (Swallow 2010). According to Micek, "It's not that you have to become a New Media expert. You don't even need to blog, podcast, or tweet every day. What it does mean is that you need to be aware of the New Media Marketplace and keep track of it even if you're not actively participating in it just yet" (2008). Eventually, however, businesses must commit to routinely using social media. Just having a Twitter account or a Facebook page is unlikely to produce a significant impact; instead, it is better to concentrate on a specific goal or objective, such as increased brand awareness, increased sales, accelerated new-product adoption, customer retention, or real-time insight(Maddock and Vitón 2009).

The goal of this paper is to take the social-media discussion a step further by getting customers' perspectives. By talking to individuals who use social media on a regular basis, insight is provided that will help businesses understand its significance. This paper explores

customers' perceptions, feedback, and recommendations for companies incorporating social media.

METHODOLOGY

Research data was collected over four months. Respondents in this qualitative study were ten college students plus two high school students and three adults. Statistics about Facebook users indicated that the core users were 18-24 year olds. They were also the fastest growing segment with 74% growth per year (Facebook, 2012). In order to increase the variation users from older age group were included. To ensure confidentiality, each respondent chose a pseudonym (listed in Table 1). All interviews were conducted by one of the researchers who was a college student majoring in marketing. She was trained in qualitative research techniques and interviewing skills before actual interviews were conducted.

Grounded Theory suggested that the interview process should continue until saturation was reached in theoretical sampling (Strauss and Corbin 1998). Sampling and analysis happened sequentially until no new concept emerged from the additional interview. All researchers were involved in open and axial coding of the data; hence all members of the research team knew the categories being investigated.

Participants were told that the study concerned social media and included questions about personal experiences and companies' use of social media. Each interview began with general questions about interests, hobbies, and lifestyles. Then the participants were asked questions about the following: their use of social media, likes / dislikes regarding social media sites, and thoughts about social media trends. The interview concluded with the following questions: whether or not companies should use social media, what companies should do with social media, and what customers want to see on companies' social media sites. The purpose was to gain users' perspectives on how companies should incorporate social media into their business strategies.

The interviews lasted as long as participants were willing to continue, about thirty minutes to one hour. The researcher recorded and then later transcribed each interview verbatim. Each interview was analyzed, and recurring themes were recorded. They were validated against previous data. Researchers constantly evaluated their interpretations by making modifications and additions against incoming data. Quotations from the interviews were categorized by theme. The findings are presented in the following section.

RESULTS AND DISCUSSION

The respondents reacted differently to each question, but they also had many of the same responses. Thirteen themes were identified, divided into two categories (the importance of social

media for individual users and for companies) and then subdivided into different core values. These themes are described in order and are supported by interviewees' quotations.

Table 1: Profile of Participants				
	Respondent	**Gender**	**Age**	**Education**
1	Bob	M	20	BS in progress
2	Jimmy Bobby	M	19	BS in progress
3	Ted Gimble	M	22	BS in progress
4	William Wallace	M	19	BS in progress
5	Sally	F	19	BS in progress
6	Jade	F	19	BS in progress
7	Cherry	M	18	BS in progress
8	Harry Henderson	M	23	BS in progress
9	Mary	F	21	BS in progress
10	Jed	M	21	BS in progress
11	Pollyanna	F	Mid-40s	BS
12	Lucille	F	17	High school
13	Irmalene	F	16	High school
14	Fred	M	31	BS
15	George	M	29	MS

The Importance of Social Media for Individual Users

The first category deals with the importance of social media for individual users. The core values include community, mobility and efficiency, and popularity. The following is a discussion of each theme and supporting comments:

(1) *To keep in touch*. When asked why they use social media, most interviewees said to keep in touch with people, including those they encounter everyday and those with whom they no longer come into contact. They indicated that the social media phenomenon is an easy way to stay connected with people and to catch up with people from the past.

> *"I mean one of the main goals, I think, of Facebook is to keep people connected, so I like talking or keeping up with people I haven't seen in a while."*

> *"The upside is encouragement, learning people's needs, getting in touch with people I haven't seen for 20 years and catching up with what's going on with them and their families."*

"It makes an easier way to keep in touch, I mean it's a whole lot easier than calling somebody up and you're not sure if they're busy, and it's a lot easier than texting."

"…it's nice to keep in touch with people I might never see for years at a time."

"I really like being able to communicate with people that I don't see that much…"

(2) To track Most interviewees admitted that they read other people's posts and statuses rather than posting information about themselves. Male respondents prefer this activity more than female respondents. They keep up with what others are doing more than telling others what they are doing.

"…I'm not big on posting things about myself, but I'm reading the other people's posts, statuses, photos."

"Most of the time I just want to see what everybody else is up to, see if anybody's done anything fun…"

"I usually get on there probably three times a day just to see what's going on with everybody, check statuses, and stuff."

"…others just like to be in other's business, like to check into other people's business, check up on people…be stalkers."

(3) People are there but not really there. When talking about the importance of interaction on social media sites, respondents mentioned that although the people with whom they interact are not physically present, they are still "with" them. Social media sites provide a comfortable sense of community and connection.

"It's kind of like you're hanging out with your friends, but they're not really there."

"Well, they are not physically there with you, but I mean they are there on their computers and you can talk to them."

"I think a lot of people use Facebook as a conduit for interaction and prefer it actually over actual physical interaction."

(4) It is everywhere. One of the most common themes is the accessibility of social media. With new technology like smart phones and other electronic devices, people can easily access social media sites.

> *"It's just so mobile. Everybody has it at all times; nobody is ever truly disconnected from anybody they don't want to be."*

> *"…it's everywhere we go, we can access it."*

> *"Accessibility is something that makes it really attractive. You can go anywhere you want to and pretty much you can get on and interact with people."*

(5) Lightning fast. When asked about the changes in communication practices, most interviewees agreed that having social media presence allows for faster, more efficient communication and feedback than other means of communication.

> *"It would be a lot faster and less expensive probably to have everything on the Internet as far as sending mail to people…"*

> *"…people are able to tell each other things rather quickly and cheaply…"*

> *"So yeah, I think people really like the instant communication, the instant gratification of knowing who is listening, who is watching."*

> *"It is an excellent is because everyone else was using social media so it was the "cool" thing to do. Also, social media are popular because everyone uses them tool to keep up with people at a faster pace."*

(6) Not just for kids. Almost all interviewees know older people who participate in social media. For example, they have older Facebook friends, including Facebook family members (moms, dads, aunts, uncles, and grandparents), fellow church members, and parents' co-workers. Interviewees agreed that older people use social media for many of the same reasons younger people do: keeping in touch with friends and playing games.

> *"My mom for instance is on there. I have aunts and uncles on there. One of my best friends from a long time ago, his grandpa is on there."*

"…they hear their kids talking about it and they want to keep track of what their kids are doing… they go on there to see how their kids are doing, see what old friends are doing, they can look up old friends from high school…"

"They are there and it's kind of nice to have like more mature people who are saying stuff on Facebook and things like that."

(7) It is the cool thing to do. Most interviewees said the main reason they first wanted to use social media was its popularity: everyone else was using it, and doing so was the "cool" thing to do.

"Well, I probably started in like junior high with MySpace just because it was what everybody was doing, it was what was cool, so I did it too and then I sort of got hooked."

"I first started using it because everybody had it, it was the thing."

"Well, my friends I guess, like they kept talking about it and stuff, and I was just interested in it…"

(8) Access to many people. This theme links the two categories (individual users and companies). The core value is accessibility, which coincides with the two categories because it is important not only to individual users, but also to companies. Some respondents talked about accessibility from an individual's standpoint, while others discussed it from a business perspective. Most interviewees agreed that social media provides access to many people simultaneously. Also, some noted that it provides companies' access to many customers.

"So it's a good way to keep in touch with a lot of people and get your voice out to a lot of people."

"Then, you have instant access to an audience, to people who might be interested in the things you're offering."

"I think it's, like I said, it's very vital for companies to advertise on Facebook and use it as much as they can because the younger generation, how much they get on and look at it and how much time is consumed on Facebook from people browsing other people's stuff, I think it's a very good tool to use."

"I guess ultimately it's a smart thing to do because they know that people are using it and I mean that's the best way to get your product out there, go somewhere people are going to be."

"Everybody's on Facebook, so companies should be on Facebook."

As the era of handwritten letters and making telephone calls has waned, social media have emerged as the conduits for interaction and networking. This study found that social media sites are used to establish a sense of community. People use them to maintain relationships; stay updated on other people's lives; and, most importantly, to keep in touch with people.

When social media sites first emerged, people did not realize how much they could affect their lives. These sites were seen as "cool"; and people were only interested in them because everyone else was using them, not because they needed a way to communicate with others. However, after people learned more about social media, communication modalities experienced a major shift. Now more and more people of all ages are involved with social media.

This study found that people primarily use social media to communicate with others. That purpose could be seen as a bad sign for traditional communication media, but social media has kept relationships going that would have otherwise never survived. Convenient and practical, social media can be accessed from multiple devices at any moment.

Importance of Social Media for Companies

The second category deals with social media's importance for companies. The main area of inquiry was how companies should utilize social media. The associated core values include advertising and effectiveness. The following is a discussion of the five themes correlated with this category:

(9) *Inexpensive advertising.* Almost all interviewees agreed that using social media would be cost effective and beneficial for companies. They said it would be less expensive, if not free, and easy to implement. They were assuming that companies do not pay social media providers any fee. They simply can open an account and invite others to be their "friends" or "like them".

"I think it's a good idea, it's free, and it's just a way to get out there."

"Yeah, I think it's really cheap and pretty much free advertising."

"…it is a pretty good way to advertise because there's like millions of people that use it and it's like a free way…"

(10) Annoying but necessary ads. Interviewees indicated that what they dislike most are the ads on social media sites, but they also understood their purpose. Without ads, the sites would not be free for the customers. However, there is a limit for their patience. Social media providers should pay attention not to overcrowd the space with advertisements.

> *"I hate ads. I pay the least attention to ads. And on Facebook it's getting worse, there are ads everywhere and it's just really annoying."*

> *"I think they are necessary."*

> *"As long as it's not excessive it's not that bad, and I think it's necessary."*

> *"I mean I don't like when I look at them, but I can't help but see them, and from the business perspective I think they're a great tool to get your name out there…"*

(11) To stay up-to-date. Interviewees value up-to-date information they said companies using social media should announce new products or events. To avoid leaving its page idle for a long period of time, a company should update often, but not so much (in the form of spamming) as to annoy customers or overwhelm them. Also, staying updated by using social media is much more convenient for the customer than having to go to every company's website.

> *"…keep people updated on stuff whenever it may be instead of just having a Facebook page there and expect people to go look at it."*

> *"…just stay active, don't fill out a profile and post one thing."*

> *"…it's a lot less trouble to look at updates on Facebook than it is to go and look up every individual site."*

(12) Facebook is personal; a website is corporate. Several respondents said a company's Facebook page is seen as more personal while the website is seen as more corporate. Also, the two are accessed and used in different ways and have different functions.

> *"With Facebook they can be more personal I guess and their website is more like business."*

> *"Yeah, it's a little bit more personal than corporate."*

"Well, Facebook for one thing, you check it every day and businesses can post on it every day and you're constantly seeing what that business is doing. With a business's website you're only going to see it if you go look it up…"

"…it's kind of the same thing, I mean you can't obviously order items on Facebook, but you can still see what kind of deals they have and what they're doing and stuff."

"Because you can see more stuff on their website, like what they carry and the products and that kind of stuff, and get prices. On Facebook you can't see all of that."

"…if I was looking up information about a product or something I would want to go to the actual website and not the Facebook website…"

"…the website should have everything a consumer might need, while the Facebook page should be used more like a hook to draw the consumer to the main site."

(13) Social Responsibility. Several interviewees expressed their desire to see on a company's Facebook page how a company is involved in the community and what the company is doing for the world. Basic information about the company is expected, but individuals react more positively to seeing a company's concerns for the community and the world on social media sites.

"I would like to see what they're doing in their communities, I like to see how they're helping out, I like to see new products also, but I would much rather see them helping out the community, what their main objective is rather than make money and make products."

"…if companies do good things in the community and stuff, I mean pictures from that would…I like seeing that. It just looks good on the company that they actually care about giving back to the community."

Because social media sites are extremely accessible and millions of people are citizens of these realms, businesses need to the opportunities these sites provide and include social media in their marketing strategies. This study found the first thought that came to mind when participants were asked about companies using social media was effective, affordable advertising. Using these sites gives a company access to many consumers; and because these consumers spend so much time on these sites, they come into contact with many advertisements. In addition, this study's participants expressed that although advertisements are annoying, they are also necessary. Without these advertisements, the social media sites would not exist because funding

would be lost. Furthermore, rather than just advertising through social media, companies should have more of a presence, whether with a profile page, video feed, or an account. All the interviewees said that businesses should use social media. When asked what they want to see on a company's profile, they provided several responses. The most important advice was for companies to keep their social media sites up to date. Users do not like idle media sites that never seem to have new information. Participants also said they like to see how companies are making a difference in the world. Several individuals expressed that they look favorably on businesses sharing those details and experiences. They would rather see this type of information than how much money the company makes or what new products it is launching.

Because social media sites are so accessible and people spend a considerable amount of time on them, companies should realize that these sites can be used not only to attract customers but also to share information with them. Furthermore, people view company profiles as more personal than company websites, resulting in their being more receptive to engaging with companies. And just as people use social media sites to keep in touch with their friends, companies can use them to keep in touch with customers. Moreover, managers should be strategic with social media. Although interviewees expressed that they want companies to stay up-to-date, they do not want to be annoyed or overwhelmed by them. For instance, on a site like Facebook where status updates are used, most said that company updates once or twice a week are sufficient. Customers like to see those updates in the form of sales promotions, coupons, deals, new products, and special events.

CONCLUSION

Social media play important roles both in the individual users' lives and in the business world. With social media being so popular and so widely used, companies should realize the potential benefits, which include access to many people, feedback, online word of mouth, and affordable advertising.

The purpose of this study was to provide explanatory power and deeper understanding of core social media users. As grounded theory methodology suggested (Strauss and Corbin, 1998), researchers started this project without literature review in order not to insert bias or assumptions into interviews. This way, data would not be forced on previously conceptualized notions. Researchers would be able to listen closely to what respondents were saying and how they were saying it. Later, researchers conducted literature review on existing research on how consumers used social media and what their reactions were to companies using social media. Surprisingly little research was found reflecting consumers' point of view. Majority of the academic focus seemed to be on normative suggestions promoting social media presence for companies. Therefore, future research should be diversified and representative of emerging social media populations. For example, middle-school aged children are an increasing number of younger

children who are using these social media sites. Research should also include an older population, including working adults, housewives, and retirees.

Avenues for future research may also include more in-depth studies about other social media such as those that respondents mentioned; Twitter, YouTube, MySpace, and Skype. Most of this study's conversations dealt primarily with Facebook as preferred by the respondents. Another avenue would be interviewing business owners. One of the respondents in this study had a business perspective because this person uses social media for his company. Future research could include interviews with both small-business owners (entrepreneurs) and corporate executives to determine how social media has affected business.

One of the last questions asked in this study was if users believed social media would last or change; most respondents agreed that in some capacity social media would continue to be a part of society. Social media is here to stay, so research about it will always be relevant.

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COLLEGE STUDENT KNOWLEDGE OF THE BETTER BUSINESS BUREAU

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ABSTRACT

This study examined the knowledge of college students about the Better Business Bureau (BBB). The overall knowledge of the BBB by students was low and less than that of the public at large. There were no differences of knowledge scores between male and female students. The knowledge scores of juniors/seniors were significantly higher than freshmen level students.

An important issue facing the BBB is reaching the Millennial (18-29 years) age group with its message. One approach is the use of guest lecturers at community colleges and four-year universities and to reach out to college student leaders. Given the technology savvy of the Millennial person, the use of social networking should be considered. Time and money costs are obstacles to using social networking by Better Business Bureaus. They must be overcome.

INTRODUCTION

The BBB dates back to 1912 when Vigilance Committees of Advertising Clubs were established to correct abuses in advertising. The BBB's original function has expanded to monitor activities in the marketplace.

The BBB provides many services for consumers and BBB members. A 2004 survey by the Princeton Survey Research Associates International showed that 89% of principal owners and top managers of member and non-member U.S. businesses say they have heard or read something about the BBB (Princeton, 2004). Even more telling is the finding that specific knowledge about the BBB and its activities is lower than might be expected. Only the most basic of BBB service areas are commonly known to business leaders overall, taking and processing consumer complaints (78%), and providing consumers with prepurchase information about companies (Princeton, 2004).

Despite the important role of BBB's in the U.S. economy, there have been few studies of them. Young (1994) found that 81% of BBB members surveyed used the BBB to check the reliability of unknown companies before doing business with them. Some 68% belong to the BBB because the BBB warned customers of scams (Young, 1994).

The findings of a survey conducted by Princeton Survey Research Associates International found that seven in ten consumers indicated that knowing that a firm is a BBB

Accredited business makes them more likely to do business with it (Princeton Survey Research, 2004). Last, Lacho and Mitchell (2010) describe how a BBB Accredited member small business owner can use the services of the Bureau to benefit the firm and contribute to its profitability.

The purpose of this study is to examine the knowledge of college business students about the Better Business Bureau. Specifically, we have speculated that there may be overall differences in their knowledge of the BBB between male and female students and between freshmen and juniors/seniors (see Research Questions 1 and 2 below). These students are the business leaders, small business owners and potential BBB members of the future. The literature shows no study of college students and the BBB. The results of this study should provide some guidelines as to how to promote to and work with today's college student.

Research Question 1: There will be no differences in BBB knowledge scores between male and female students.

Research Question 2: There will be no differences in BBB knowledge scores between freshmen and juniors/seniors.

METHOD

Subjects

Subjects in the sample were approximately 179 students from a four-year public university in the South. The students were roughly 112 from freshmen level class and 67 from junior/senior level class (Table 1). The students were roughly 47% female and 53% male with 64% in the 18-22 age group and 28% in the 23-27 group. Sixty-three percent of these students were working full-time or part-time. Some 61% of them were taking 4 or 5 courses and 30% were taking 6 or more courses.

Data

In this study, we measured the knowledge of college business students about the BBB with a series of 32 statements using a true/false scale. These statements include the BBB's governance and functions/services.

RESULTS

Table 1 summarizes the statements about the BBB's governance, operations, and functions/services that received the lowest scores from students. The biggest misconception is "There is at least one BBB office in all 50 states." Only 9% of the students answered this correctly. The next is "There is no difference between being an accredited BBB business

member and simply having a good rating" with 16.8% answering correctly. The statement "The New Orleans BBB provides excellent opportunities for person-to-person networking" has 17.3% answering correct. Thirty-three percent answered "The BBB accepts verbal complaints" correctly. "A company can ignore consumer complaints from the BBB" and "BBB board members are paid a fee to serve on a local BBB board" have roughly 43% answered correctly. "Not all businesses can belong to the BBB" and "The BBB is a local government agency" have 44% and 47.5% respectively being answered correctly. Table 1 lists another eight statements which have correct percentages from 50% to 60%. Since a true/false scale is used in this study, there will be a 50% chance of guessing correctly and therefore the statements below 60% should also be looked at closely. These statements are:

- BBB accredited businesses are guaranteed a higher grade than non-accredited businesses.
- Sally Hunter is looking for an air conditioning service. She contacts the BBB. The BBB will recommend an air conditioning service to her.
- The BBB has the authority to impose fines or put companies out of business.
- The BBB is a credit reporting agency.
- The BBB is a for profit business organization.
- Angie's List" has local offices to serve their customers.
- The BBB helps collect past due accounts.
- BBB's report on charities (local and national).

Overall, the juniors and seniors have a higher correct percentage than freshmen on 12 out of the 18 items listed in Table 1. This seems to indicate that as students take more and more business classes, they may become more knowledgeable about the business environment, including the BBB.

Table 1: BBB statements with the lowest correct

	All students	1000 level students	3000 level students
There is at least one BBB office in all 50 states.	9.5	14.3	1.5
There is no difference between being an accredited Business member and simply having a good rating.	16.8	21.4	9.0
The New Orleans BBB provides excellent opportunities for person-to-person networking.	17.3	17.0	17.9
The BBB accepts verbal complaints.	33.0	33.9	31.3
A company can ignore consumer complaints from the BBB.	43.0	40.2	47.8
BBB board members are paid a fee to serve on a local BBB board.	43.6	42.0	46.3
Not all businesses can belong to the BBB.	44.1	40.2	50.7

Table 1: BBB statements with the lowest correct			
	All students	1000 level students	3000 level students
The BBB is a local government agency.	47.5	49.1	44.8
BBB accredited businesses are guaranteed a higher grade than non-accredited businesses.	50.3	42.0	64.2
Sally Hunter is looking for an air conditioning service. She contacts the BBB. The BBB will recommend an air conditioning service to her.	52.0	50.9	53.7
The BBB has the authority to impose fines or put companies out of business.	52.0	46.4	61.2
The BBB is a credit reporting agency.	52.5	48.2	59.7
The BBB is a for profit business organization.	55.3	52.7	59.7
"Angie's List" has local offices to serve their customers.	58.1	57.1	59.7
The BBB helps collect past due accounts.	59.8	53.6	70.1
BBB's report on charities (local and national).	59.8	57.1	64.2

Our first research question considered the possibility that male and female students may have different levels of BBB knowledge. An ANOVA was used to test if the overall scores are different between male and female students. The ANOVA result is not significant. This implies that male and female students seem to have roughly the same level of knowledge of the BBB. On average, male students scored 19.45 (61%) out of 32 questions correctly and female students scored 18.78 (59%) out of 32 correctly.

Our second research question examined whether there would be a difference in BBB knowledge between freshmen and juniors/seniors. An ANOVA was used and the result is significant. On the average, the juniors/seniors have significantly higher scores (20.45 which is 64%) than freshmen (18.23 which is 57%). This finding is consistent with the results in Table 1. Not only juniors/seniors scored higher on the misconceptions of the BBB (Table 1), they just scored higher in general.

DISCUSSION

The Princeton Study (2004) provides a picture of the public's knowledge of the BBB. Highlights show that the majority of Americans know about the core services that the BBB provides. On the other hand, some 74% of the American public cannot identify what type of organization the BBB is. Some 27% believe the BBB is a government agency. Little more than one- half of young adults under the age of 30 (55%) identify the BBB as a government agency.

The findings of this study suggest that student respondents have less knowledge of the BBB than the public at large. What is disturbing in this study is that a large percentage of students had misconceptions about some basic aspects of the BBB. These include the perception

that the BBB is a local government agency, it is a for profit organization, it will recommend a business in response to an inquiry, and there is no difference between being an accredited BBB member and simply having a good rating. An important issue today facing the BBB is how to get its message across to young people 18-29 years of age, also known as the Millennials.

Reaching the Millennials

The Millennials represent the new face of the United States (Keeter & Taylor, 2009). They are most familiar with digital technology and social media. Many have their own Facebook page. They far outdistance prior generations in the use of cell phones to text, create a personal social networking profile and to have a wireless internet away from home (Keeter and Taylor, 2009).

One approach to reaching Millennial students is old-fashioned selling by having BBB representatives give guest lecturers in classes at community colleges and four-year universities. A variation of this approach is to invite student campus leaders to the BBB office or luncheon events. A BBB booth could be set up at campus career day. Promotion could be carried out by advertising in the school newspaper or if the school has one, the campus radio station. Advertising may be purchased in local media using those which target the 18-29 age group. In addition, advertising may be purchased on Facebook. The BBB would pay by the number of clicks. Another means is to announce the Facebook page on the BBB website.

The BBB has to have a well-done website for the Millennial to use as well as a Facebook page. Social networking via a Facebook page and Twitter are free, however, there are time and personnel costs. A social-media expert may be needed to be put on staff, although this person may be used to maintain the BBB website as well.

A BBB may not have the funds to have a full-time person to keep and update a Facebook account. On the other hand, this administrative cost may be necessary given the Millennial person of today and the future. The BBB has already taken a step into the age of Star Trek. BBBs reports are now formatted to fit individual smart phones.

This study suggests areas for future research about college student knowledge of the BBB. Research could be expanded to other colleges, e.g., large, small, private, and rural. Student knowledge of the BBB can be examined by age, race, parental education and occupation, and urban versus rural areas. The use of social media by BBBs should be studied in different Better Business Bureau markets, e.g., by population size, size of BBB membership, urban versus rural, and geographical area of the United States. Of those BBBs using Facebook, what have been their successes obstacles?

CONCLUSION

The knowledge of the BBB by college students is weak. The level of education stages shows that students further along in their college studies have a better knowledge of the BBB. This college age group (18-29) needs to be made aware of the nature of the BBB. A major way

of reaching this group is by staff member lectures to classes and special events for campus leaders. More importantly, given the technological savvy of this age group BBB chapters need to get into social networking.

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ACCOUNTING FOR GREEN HOUSE GAS EMISSION SCHEMES: ACCOUNTING THEORETICAL FRAMEWORK PERSPECTIVE

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ABSTRACT

This paper presents a discussion of a theoretical framework perspective of accounting for green house gas (GHG) emission schemes. The paper focuses on cap-and-trade emission schemes and uses both FASB and IASB's current and proposed accounting theoretical frameworks and their deliberations of the GHG emission scheme accounting issue. the paper concludes that GHG emission schemes trigger both an asset and a liability that need to be recognized from the initiation of the scheme's compliance period. the asset and liability need to be revalued each reporting period using actual and projected emissions, number of allowances on hand, and their current fair market values. a net presentation model can be used in financial statements.

KEYWORDS: green house gas, emissions, conceptual framework, accounting

INTRODUCTION

Green house gas (GHG) emission schemes (programs) have been gaining some momentum and political support over recent decades especially in europe and north america with many regulations and programs enacted into law or voluntarily adopted by private organizations. since signing the Kyoto Protocol in 1997[1], members of the European Union (EU) have undertaken to cut their GHG emissions according to targeted amounts and time limits. the EU countries have also established an Emission Trading Scheme (ETS) as a cornerstone in their effort to cut GHG emissions. under the ETS, participating companies can trade emission allowances they receive and sell any allowances surplus they might have. the United Nations (UN) has also established its own program to encourage emission reduction by companies operating in developing countries. under the UN program, participating entities may receive Certified Emissions Reductions (CERS) from the UN, which have market value since the EU is willing to accept either CERS or the EU allowances in satisfaction of an entity's yearly compliance obligation under the EU's ETS. the global carbon market has grown rapidly in recent

years to reach a market value of $144 billion in 2009. however, because of the recent worldwide financial crisis and particularly the economic slowdown in Europe, the global carbon market value slightly declined in 2010 to reach $142 billion (World Bank, 2011).

However, accounting research on financial reporting for these schemes has lagged behind research from environmental, economics, and other social science perspectives. There is currently no guidance issued by the International Accounting Standards Board (IASB) or the Financial Accounting Standards Board (FASB) on accounting for GHG emission schemes. with the lack of definitive guidance on how GHG emission schemes should be accounted for, companies follow different accounting treatments, which raises a challenge for accounting regulators to decide which method is appropriate and acceptable (Deloitte, 2007). As suggested by Elfrink And Ellison (2009), absence of guidance and diversity in practice could threaten the comparability and usefulness of financial statements, especially if the use of emission schemes and allowances grow in the future. There is a lack of any definitive rules-based guidance on how to account for these GHG emission programs (Andrew And Cortese, 2011). Such lack of guidance makes it important to address the main theoretical framework concepts associated with their financial reporting, since participating entities are more likely to follow some version of principles-based accounting model in their financial reporting for these programs. As noted in Mete et al (2010), with the absence of specific guidance on how to account for emission allowances, organizations rely on accounting conceptual framework for recognition and measurement of assets, liabilities, and expenses resulting from their participation in any GHG emission scheme.

This paper analyzes the main accounting issues regarding accounting for GHG emission schemes from an accounting theoretical framework perspective. The paper discusses whether or not a participating entity should recognize asset and liability as a result of participating in the scheme, and the timing of recognition given current and proposed definitions of asset and liability in accounting theoretical framework. The paper, however, is not trying to prescribe detailed accounting model for GHG emission schemes. The analysis in the paper focuses more on theoretical framework issues pertaining to accounting for Cap-and-Trade schemes at the inception of compliance period rather than accounting for subsequent transactions since most of challenging accounting theoretical questions regarding asset and liability recognition are faced at the inception of compliance period.

GHG EMISSION SCHEMES

GHG emissions schemes can take different formats, but the following two are the most common forms: **(**Wackerbauer, 2003**).**

Cap-and-trade scheme

In this scheme, also known as the Allowance-Based scheme, an absolute emissions CAP is assigned to every participating entity. The government mitigates the program cost to entities by allocating free tradable allowances for each period. Emission allowances can be freely traded among participants in the scheme and participants hold property rights over all their allowances. During the compliance period, government entities supervising the program monitor actual participating entities' emissions, and the entities follow specific reporting requirements for their actual emissions. At the end of each compliance period, every participating entity should pay for its actual emissions by surrendering allowances previously granted to them or buying allowances from the market in case of any shortfall. Entities also can sell any surplus allowances or bank them for future periods, Baseline-and-Credit scheme in which a baseline is defined for emissions allowed for participating entities. Participating entities that manage to operate below the baseline during the period are given credits from government that can be sold in the market to entities who exceeded their baseline. Entities have to buy credits when their emissions exceed the baseline assigned to them, and they obtain credits if they over-fulfilled their obligation by keeping their actual emissions below the baseline. Under this scheme, participating entities will have property rights over any credits received, and can sell them in open market, only by over-achieving their emission targets and keeping their actual emissions below the assigned baseline. This is different from property rights over allowances in Cap-and-trade programs, which is obtained from the beginning of compliance period. all other things being equal, participants in Cap-and-trade schemes and in Baseline-and-Credit schemes will be in a similar position if the level of allocated emission allowances is equal to the assigned baseline. assuming that participants do not trade their allocated emission allowances, they will end up with the same number of excess or shortfall of emission allowances (Cap-and-Trade) or credits (Baseline-and-Credit) at the end of compliance period.

PROGRAMS IN THE U.S

In the U.S., there have been some initiatives to officially or voluntarily adopt GHG emission programs, and some proposed legislations in the congress for a national Cap and trade program. the U.S. programs include: (Fornaro et al, 2009)

The Acid Rain program

This is a mandatory program that started in 1995 under the Clean Air Act oF 1990 to reduce the sulfur dioxide (SO_2) by 50% below the 1980 level. under this program, the

Environmental Protection Agency (EPA) sets emission limits for utility companies and allocates enough allowances to them to meet their limits each year.

The Chicago Climate Exchange (CCX)

This was a voluntary program that started in 2003 and had some legally binding compliance feature subject to third-party verification. The program members were prominent u.s. and international companies as well as some government organizations and municipalities. Members were allocated annual emission allowances that could be traded or banked for future use. The ccx was the largest voluntary emissions trading scheme in the world and worked like a government mandated Cap-and-Trade scheme. the second compliance period for the CCX program expired at the end of 2010 and was not renewed.

The Regional GHG Initiative

This program was established in 2005 by 10 northeastern U.S. states with the goal of reducing ghg emissions by 10% by 2018. this program is considered the first mandatory Cap-and-Trade program in the U.S. that targets GHG emissions.

The Western Climate Initiative

This is a voluntary program that was established in 2007 by seven U.S.states and four Canadian provinces. it is a Cap-and-Trade program that is scheduled to start in 2012 and aims to reduce GHG emissions by 15% below 2005 levels by 2020. as THe Western Climate Initiative (WCI) enters its first compliance period in 2012, its current active partners include california and four canadian provinces, and it stays open to any other U.S. states, Canadian provinces, or Mexican states.

In addition to the above regional and voluntary schemes in the U.S., there have been some efforts to enact a national GHG emission program in the U.S. The Lieberman-Warner Act was introduced to the U.S. senate in october 2007 as a national Cap-and-Trade program, but was never brought to a full senate vote.

ACCOUNTING FOR GHG EMISSION SCHEMES

On the financial reporting perspective, there have been some tries by U.S. and international accounting organizations to set accounting standards for participating entities to account for GHG emission schemes. on december 2004, the International Financial Reporting Interpretations Committee (IFRIC) of the IASB issued IFRIC 3 (IFRIC, 2004) that set guidelines for entities to account for GHG EMISSIONS scheme. under IFRIC 3, emission allowances obtained by participating entities should be accounted for as intangible assets in the balance sheet. Any intangible asset allowances received from government organizations at no cost or at less than their fair value should be reported at their fair value when received. Such intangible asset would be subject to periodic impairment and, under the Revaluation Model, any increases in the fair value is recognized in equity with any decreases recognized in income to the extent it exceeds the revaluation reserve previously recognized. on the liability side, IFRIC 3 required that the difference between allowances' fair value and any price paid for them, if any, to be recognized as deferred revenue and amortized and recognized in income over the related compliance period on systematic basis. IFRIC 3 didn't allow any offsetting between the recognized assets and liabilities related to GHG emissions scheme. The IFRIC 3 was rejected by the E.U. authorities because of claimed complexities and inconsistencies, and was finally withdrawn by IASB on June 2005. however, in October 2005 the IASB has added the emissions trading scheme accounting project to its agenda in coordination with FASB. However, discussions of the emissions scheme accounting project were deferred in November 2010 when IASB and FASB decided to amend the timetable of some projects. with the absence of definitive guidance, participating entities in the E.U. follow some form of principles-based approach that could be an amended version of IFRIC 3. a common practice by many E.U. companies is to recognize allowances as current asset investments (A form of intangible asset) at open market value, with a matching credit to a government grant reserve. As carbon dioxide emissions are made, a liability (provision) is recognized for the obligation to hand over allowances, with a matching debit to expense account. At the same time, transfers are made to recognize the government grant in earnings. At the balance sheet date, asset, liability, and government grant reserve are revalued to current market value. The surrender of allowances is recognized by extinguishing the liability and the matching value of allowances within current asset investments. For presentation purposes, the allowances are intangible assets but are included within current asset investments in the balance sheet since they are not held for continuing use.

In England, the Accounting Standards Board (ASB) has noted that emission allowances should be treated as current assets since they are transferable certificates and the participating entity can either sell or use them to settle its obligations under the scheme. ASB rejected the intangible asset classification of emission allowances since they are not intended to be used on a continuing basis and should be surrendered at the end of reporting period (Mete et al, 2010).

In the U.S., the current major guidance used to account for emission allowances is the unified systems of accounts (USA) issued by the Federal Energy Regulatory Commission (FERC) in 1993 and used by utilities and other regulated energy companies to account for emission programs under the 1990 Clean Air Act. The FERC Guidance requires participating entities to recognize allowances obtained in their balance sheet as inventory asset based on their actual historical cost, if any in case of purchase, using the weighted average cost flow assumption. A periodic expense should be recognized based on the cost of allowances needed to match actual emissions during that period. Based on this guidance, if a utility company uses only free allowances received from the Environmental Protection Agency (EPA), the cost basis of allowances inventory asset will be zero and no asset or expense is recognized. The unified systems also requires that allowances acquired for speculative purposes shall be accounted for as investment asset.

The only official guidance the SEC has is general disclosure guidance under Regulation S-K and requires registrants to disclose material information about their exposure to climate-related financial and non-financial risks. Such guidance requires registrants to assess and disclose any material negative consequences of emission control schemes in which the registrant is participating, or any climate change regulation that is reasonably likely to have a material effect on registrant's financial condition or results of operation. Those negative consequences might include costs to reduce emissions or losses arising from changing in demand for goods and services produced by the registrant, which is related directly or indirectly to climate change regulations (SEC, 2010).

Because of diversity in practice, FASB started to address this issue in 2003 when the Emerging Issues Task Force (EITF, 2003) discussed issue no. 03-14 "participants' accounting for emissions allowances under a Cap-and-Trade program". the EITF held only one meeting in the issue before deciding to remove it from the agenda partially because members believed that the issue needs to be considered within more comprehensive framework. on February 2007, FASB added an agenda project to address participants accounting for Cap-and-Trade programs, and in 2008 agreed to work jointly with IASB in a project titled "EMISSIONS TRADING SCHEMES". FASB held many informational meetings on the project and some joint meetings with IASB but is yet to issue any exposure draft on the project.

THEORETICAL FRAMEWORK ANALYSIS

The asset question

Under the current accounting conceptual framework (SFAC NO. 6), assets are defined as "probable future economic benefits obtained or controlled by a particular entity as a result of past

transactions or events". According to this definition, an entity recognizes an item as asset only when this item embodies some future benefits that can contribute, directly or indirectly, to future cash flows, the entity can obtain benefits and control others' access to it, and the transaction or event that created entity's right to control those benefits has already happened. SFAC NO. 6 asserts that an asset can be obtained at no cost, and legal enforceability of claim or right to future benefits is not a prerequisite. In addition, SFAC NO. 6 states that assets' future benefits can take the form of being used to settle liabilities. a major criticism of that definition of asset is that it places undue emphasis on identifying past transactions or events that gave rise to asset, instead of focusing on whether the entity had access to economic resource at the balance sheet date.

The undergoing joint FASB/IASB conceptual framework project proposes a new definition of asset to mean "a present economic resource to which the entity has a right or other access that others do not have". Under this definition, entity recognizes item as asset if that item represents economic resource that will, directly or indirectly, affect entity's cash flows, the entity has right or access to economic resource that others don't have, and both the economic resource and the right currently exist. Contrary to the current asset definition, the proposed one states that the right or other access that others do not have should be enforceable by legal or equivalent means.

Will emission allowances qualify as an asset?

Emissions allowances, whether purchased by the entity or allocated to it at no cost, are transferrable certificates that the entity can either sell or use to settle its obligations under the GHG scheme. This fact is a testimony that allowances meet the definition of an asset and should be recognized as such. A supporting argument for this opinion is that emission allowances possesses all the three essential characteristics mentioned above for an asset. Participating entity is the only one entitled to future benefits of allowances either by selling them or using them to satisfy emission obligations under the GHG scheme. according to this argument, allowances have value because they allow the entity to emit GHG and the entity can obtain this value either through emitting gases (and saving cash flow or cost that should have been used to curb these emissions) and/or by selling the allowances. However, the counter argument is that emission allowances provided by scheme administrator are merely a license or permit to emit and don't provide participating entity with any entitlement or control over a benefit until the end of compliance period. In addition, allowances do not satisfy the third essential characteristic of an asset based on the first definition, since they do not result from any specific past transaction or event. Based on this argument, emission allowances represent a "contingent asset" that might be recognized as such only at the end of compliance period when benefit, depending on the actual emissions, is ultimately controlled by the entity and no longer contingent on emissions level. The asset non-recognition argument states that an entity has no asset for a particular future economic

benefit if the transactions or events that give it access to and control over the benefit are yet in the future. However, allowances received from scheme administrator may actually have a future economic benefit since the administrator will accept them in settlement of the entity's obligations under the scheme. Accordingly, an allowance asset may be recognized when allowances are received from administrator at the inception of compliance period. When participating entities purchase allowances for cash or other consideration, they are required to recognize them as assets. Since allowances allocated at no cost or at cost less than their fair market values are indistinguishable from purchased ones, the allocated allowances are assets in their own and should be recognized accordingly. Allocation of free allowances by administrator to participating entity is by itself the event that gives entity control over allowances' future benefits and, therefore, allowances should be recognized as an asset from that moment.

The asset type

If emission allowances are recognized as asset, the next critical question is the type of asset under which it will be categorized. The following asset categories are possible options to be considered for GHG Scheme Allowance Asset:

Intangible asset

Intangible assets are defined as assets (not including financial assets) that lack physical substance (FASB Codification Section 350-10-20). If emission allowances not classified as financial asset, the intangible asset definition may properly apply to them. They clearly lack physical substance and are comparable to some items currently classified as intangible assets such as broadcast rights, airline routes, and take-off and landing slots in airports. This classification assumes that emission rights are not financial assets since they are not cash and don't convey either ownership or contractual rights to cash or other financial instruments. According to FASB Codification Section 350-30-25-1, an intangible asset that is acquired either individually or with a group of other assets shall be recognized.

Financial asset

Financial assets are defined by FASB as "cash, evidence of an ownership in an entity, or a contract that conveys to a second entity a contractual right (a) to receive cash or another financial instrument from a first entity, or (b) to exchange other financial instruments on potentially favorable terms with the first entity". To be a financial asset, it must arise from a contractual agreement between two or more parties, not by an imposition of obligation by one

party on another. Supporting arguments for this classification include that emission allowances ultimately give rise to cash when sold in open market or exchanged with scheme administrator to satisfy emission scheme obligations. In addition, emission allowances are based on contractual agreement between participating units and the administrator under GHG emission scheme. However, the fact that emission allowances are transferrable is not, by itself, a sufficient argument to classify them as financial asset. For example, some items like commodities are transferrable but not necessarily classified as financial assets. Another argument against financial asset classification (that might also support the following inventory classification) is that allowances may be consumed or used up as a result of participating entity's operations and emissions, which is not normally the case for ordinary financial assets or marketable securities.

Inventory

Inventory is defined as the aggregate of those items of tangible personal property that have any of the following characteristics: (a) held for sale in the ordinary course of business, (b) in the process of production for such sale, or (c) to be currently consumed in the production of goods or services to be available for sale. One supporting argument for this classification for emission allowances is that they are similar to supplies consumed during production process and should be included as part of full production cost. Participating entities "consume" these allowances as part of their production process that produces emissions instead of incurring additional production costs to curb them. However, such argument is contradicted by the fact that allowances are not tangible property. One can argue that the dollar amount assigned to emission allowances, although it could be included as part of the full cost of the entity's finished or in-process inventory, cannot be recognized as a stand-alone inventory account. In this regard, these allowances will be more like the labor cost than direct material cost and cannot be capitalized as a stand-alone inventory asset. The SEC staff has advised accounting firms that the SEC would not permit mark-to-market accounting for emission allowances classified as inventory unless it was the hedged item in a fair value hedge (Deloitte, 2007).

Asset classification is based on management intention

One combination of the above classifications is that the asset type should depend on management's intention or plans for using emission allowances. If management plans to use allowances in its own operations by exchanging them with scheme administrator in satisfaction of emission requirements, allowances should be classified as either intangible or inventory asset. However, if management plans are to trade allowances in open market in anticipation that their market prices will decline and the entity can buy them back at lower prices at the end of

compliance period to meet its emission obligations, they should be accounted for as financial asset.

For allowance asset recognition and measurement in financial statements, some unofficial guidance offered by SEC staff to accounting firms advised that emissions allowances are intangible assets, but the SEC would not object to the inventory model. based on the SEC's views, entities should choose either inventory or intangible asset model, and should apply it consistently. The SEC also indicated that it would not permit mark-to-market accounting for emission allowances classified as inventory unless it was the hedged item of a fair value hedge (Deloitte, 2007).

The liability question

Under the current FASB conceptual framework (SFAC NO. 6, PAR. 35), liability is defined as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events". According to this definition, an entity needs to recognize a liability when it is obligated to transfer or use asset upon the occurrence of a specified event in the future when the transaction or event that obligated the entity has already happened. One of the shortcomings of this definition of liability is that it places too much emphasis on identifying future outflow of economic benefits, instead of focusing on economic obligation that currently exists. Another criticism of this definition is that it places undue emphasis on identifying past transactions or events that gave rise to the liability, instead of focusing on whether the entity has an economic obligation at balance sheet date.

Under the Cap-and-Trade version of GHG emission schemes, participating entity is under obligation to transfer allowances and/or cash at the end of compliance period. however, a question may arise about past transaction or event that triggered the obligation. if actual emission of GHG is the triggering event of entity's obligation, no liability should be recognized until actual emissions take place. On the other hand, if entity's participation in the scheme is the triggering event, an entity may recognize liability when it receives allowances from the government at the inception of compliance period. The past event required for recognition of liability in GHG emission schemes may be the receipt of allowances rather than actual production of emissions in the future. as mentioned in SFAC NO. 6 (PAR. 39), liability may result from obligations imposed on entity by government to deliver allowances or pay penalty.

The new proposed definition of liability may lend more support to recognizing liability under the GHG schemes. under the proposed conceptual framework, both FASB and IASB have tentatively adopted a working definition that defines liability of an entity as a "present economic obligation for which the entity is the obligor". This proposed definition might give more support

to recognizing liability upon receipt of allowances from government since the entity's obligation is present, enforceable, and doesn't necessarily depend on past triggering event or transaction.

it may be important to note that allowance assets and obligation have independent existences with no contractual link between them although participating entities may decide to hold allowances solely for the purpose of using them to settle their obligations under the scheme. therefore, entity's allowance assets and other liabilities could be accounted for separately.

The liability question can be summed up into three different approaches with respect to liability recognition timing in Cap-and-Trade emission schemes:

Recognition when allowances are received

This approach states that participating entity has a stand-ready contractual or performance obligation to either incur some costs to curb its emissions and/or deliver some allowances to the regulatory agency by the end of compliance period. Once the participating entity joins the scheme, it is subject to the requirements of a statute, law, or regulation that is enforceable by the regulatory agency and results in a contractual obligation by the entity. Participating in the scheme and receiving free allowances is equivalent to a performance-related government grant that creates a performance obligation. As a going concern entity, participating entity in a Cap-and-Trade emission scheme should assume that "it will emit" in the future and, therefore, currently recognize its liability under scheme contractual obligations. However, such logic would also entail the recognition of other liabilities (such as future direct labor costs) that are not currently recognized as liabilities.

Recognition based on actual emissions

According to this approach, participating entity under no obligation and shouldn't recognize a liability until it actually starts emitting green house gases and becomes under its enforceable contractual obligations to deliver allowances or pay penalties. Although an entity may be subject to the requirements of a scheme laws or regulations, no government or other party can enforce those requirements until the entity violates these laws or regulations or until an event occurs that triggers the requirements. Such triggering event is basically the actual emission of GHGs and, therefore, the entity's liability should be tied in its measurement and recognition to this event.

Recognition based on excess emissions

Under this approach, participating entity should recognize liability only when its actual emissions exceed the emissions cap allowed under the scheme during compliance period. According to this approach, entity has no obligation to be recognized as long as it also has enough allocated allowances to cover its actual emissions and, therefore, the entity will not be forced to acquire any additional allowances from the market or pay any penalty in the future. One argument in support of this approach is that ghg emission scheme is similar to a tax imposed by regulatory agency on participating entity which is simultaneously accompanied by an advance tax credit to cover this potential tax. However, the logic of this approach may also lead to non-recognition of the allowance asset itself since it is merely an offset for expected liability. This matching between ghg scheme asset and liability might lead to conclude that dealing with emission schemes "one leg at a time" may prove inappropriate, and it might lend some support to the net presentation model mentioned below.

Because one of the requirements of liability recognition is that the entity incurred a responsibility to sacrifice assets in the future, a critical question is whether participating entity has actually incurred such responsibility merely by participating in the scheme and abiding by its regulations or by the actual event of ghg emissions. Following the second approach above, a ghg scheme liability cannot be recognized until the occurrence of the event or circumstance that obligates the entity to transfer assets or provide services to other entities in the future. In case of cap-and-trade ghg schemes, the event that triggers such obligation is the actual emission rather than the allocation of allowances at the inception of compliance period. The liability is tied to actual emissions of the entity and should be recognized only once the entity starts emitting ghg. Therefore, only the obligations arising from actual emission events and exist independently of entity' future actions can be recognized as liabilities. Following this argument, participating entity should recognize a liability at each reporting period based on the current market price of allowances expected to be delivered (in addition to any extra cash to be paid) to regulatory agency given the gross actual emissions made by the entity up to the reporting period.

On the other hand, one can argue that company's liability is triggered and recognized during compliance period only when actual emissions exceed the emissions level allowed to company under the scheme. When participating entity exceeds its allowed emissions cap, it becomes under obligation to pay cash to government or buy additional allowances from open market. Such liability would be recognized at reporting date based on the current market value of excess allowances the company is expected to pay for or deliver given its actual emissions level up to the reporting date. However, such argument may not be valid if the accounting model adopted doesn't link accounting for allowance asset to accounting for allowance liability and, instead, accounts for them separately.

PERFORMANCE OBLIGATION MODEL

The initial allocation of allowances for less than their Fair Market Value may give rise to a government grant. The grant might be recognized as a conditional liability with its final settlement depending on actual emissions and compliance costs. As stated by SFAC NO. 6, receiving a grant of cash or other assets with no strings attached to it does not create liabilities because the receiving entity is not required to sacrifice assets in the future. Because granted allowances come with requirements to keep emissions below the assigned Cap, participating entity may have to recognize liability at the inception of compliance period under GHG scheme.

The above theoretical discussion might lead to proposing a workable and practical accounting model for GHG emission Cap-and-Trade schemes that treats allocated allowances as conditional grants associated with a performance obligation by participating entity to keep its emission levels at or under scheme limits. Based on this proposed model, allocated allowances are recognized upon receipt as assets at their fair market values. In addition, liability is recognized at the inception of compliance period at the Fair Market Value of allowances to be delivered if participating unit exactly fulfilled its emission limit obligation without any over performance or under performance. Therefore, both recognized asset and liability will have the same recognized value at the inception of compliance period. However, recognized asset will need to be revalued at each reporting date based on the number of allowances participating entity still holds at the reporting date and the current fair market value of allowances on that date. Similarly, recognized liability will need to be revalued at each reporting date using the actual emissions up to the end of the reporting period and projected emissions through the end of the compliance period.

Both asset and liability will be presented on the balance sheet following a net-presentation or an offset model where the two balance sheet items are presented on one side and netted against each other resulting in either a net emission asset or liability. One can make the case that allowance asset and related scheme obligations have independent existences. While participating entity may intend to use allowances it holds to settle its obligation, it cannot be compelled to do so. Instead the entity may choose to sell allowances and either reduces its actual emissions, buy allowances at future date, or pay assessed penalty. Therefore, although many entities might decide to hold the allowances solely for the purpose of settling their obligations, there is no contractual link between the asset and the liability.

Based on the level of actual emissions at the reporting period, if participating entity concludes or estimates that it will over-perform its obligations under the scheme, it might reduce its recognized liability and recognize revenue or gain. However, if the entity concludes or estimates that it will underperform its obligations under the scheme, it might increase its recognized liability and book additional expense or loss.

CONCLUSION

Although the current economic and political environments and mode worldwide seem less enthusiastic for extending the current GHG emission schemes and enacting new ones, it is a matter of time before the u.s. and other economic and regulatory entities resume their interest in enacting national GHG emission programs designed to combat climate change. There is currently a lack of guidance on accounting and financial reporting for these schemes in the financial statements of entities participating in them. It is imperative for the accounting profession to initiate and continue deliberations on the appropriate recognition and measurement standards pertained to these schemes, including the accounting theoretical framework perspective covered in this paper. In addition to the accounting theoretical framework perspective discussed in the paper, it also proposes a performance obligation model of accounting for ghg emission schemes.

ENDNOTE

[1] The current Kyoto protocol is set to expire at the end of 2012 with its renewal to a second phase is uncertain.

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A PROPOSED NEW VISION FOR FINANCIAL STATEMENTS: A PRIMER FOR NON-FINANCIAL EXECUTIVES

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ABSTRACT

The manner in which a company presents the information contained in its financial statements is central to the conveyance of this information to both financial and non-financial users. However, alternative presentation formats currently allowed under both US and international accounting rules can, and frequently do result in transactions and events not being reported or classified consistently from one financial statement to another. This often results in a decrease of user comfort and of utility of financial statements, especially to non-financial executives. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have both acknowledged the difficulties in this approach and each body added a financial reporting project to their agendas in 2001. The FASB and the IASB in 2004 united to undertake a joint project on financial reporting. The objective of this international convergence movement is the creation of a common international standard which would improve how information is organized and presented in financial statements. Based on input and feedback collected from individuals and groups interested in the fundamentals of financial reporting, each Board individually issued, in 2010, a Staff Draft proposing a new, unified, international set of guidelines for financial statement presentation. This paper provides non-financial users with an overview of the FASB Staff Draft which contains the results to date of this joint FASB-IASB project. In addition, this paper explores, via discussion and comparative statement presentation, the difficulties that could be encountered from the proposed changes in financial statement presentation as well as pointing out facets of the proposal with which non-financial users are already familiar.

INTRODUCTION

Non-financial users, both internal and external, look to financial statements for information regarding the financial position, cash flows, and operations of a company and frequently consider them key resources for decision making. Many of these users, particularly non-financial executives, have often spent years learning to decipher and understand not only the financial statements of their own company, but also those of its competitors. However, current US GAAP and *i*GAAP (i.e., IFRSs) both allow alternative formats for statement presentation.

Accordingly, transactions and events are not necessarily being reported or classified consistently from one statement to another. Thus, articulation among the financial statements as well as the relationships among the items being reported is frequently difficult for all users, especially non-financial executives, to understand.

As businesses have expanded internationally, so has the need for consistency and comparability in the financial reporting of events and transactions in the financial statements. In addition, the lack of detail and disaggregation of information in the statements themselves has been a cause for concern for all users. Both the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have initiated steps toward the harmonization of US GAAP and *i*GAAP with both organizations modifying their respective standards in several areas. However, the presentation and content of information in the financial statements for US companies operating in areas where *i*GAAP has been adopted and for international companies operating in the United States is still overseen by two separate and frequently divergent sets of rules. International accounting standards, or IFRS, tend to provide only minimum presentation requirements. On the other hand, US GAAP relating to financial reporting provides somewhat more, albeit fragmented, guidance in a disjointed and piecemeal fashion throughout a myriad of reporting standards. Thus, the existing reporting environment consists of rules and guidance by degree; i.e., an environment that allows companies to apply their own unique interpretation of the requirements bit by bit while still complying with those requirements. As a result, comparability between different companies' financial statements as well as the usefulness of such statements for users is lessened and financial statement analysis is hindered.

The FASB and the IASB have both acknowledged the difficulties in this approach with each body adding a financial reporting project to their respective agendas in 2001 and uniting in 2004 to undertake a joint project on financial reporting. The objective of this international convergence project is the creation of a common international standard which would improve how information is organized and presented in financial statements. Utilizing input from parties interested in the fundamental issues of financial statements as well as outreach activities and academic research, each Board individually issued a Staff Draft proposing a new, unified, international set of guidelines for financial statement presentation in 2010. Unfortunately, if adopted, this new vision for financial statements may leave many executives, especially non-financial executives, astonished, if not flabbergasted, with the look and content of these once familiar statements. There is little doubt that the proposed financial statement formats are some of the most innovative and far-reaching changes in financial reporting that most business executives have encountered.

This paper overviews the results to date of this joint FASB-IASB project on financial statement presentation with the objective of providing non-financial executives with an introduction and primer on the proposed changes contained in the FASB Staff Draft. The first section offers non-financial executives a simplified summary of the proposed guidelines for the

financial statements as a whole. The second section allows the non-financial executive to compare financial statements prepared under the current guidelines to those prepared under the proposed format. The final section summarizes the current status of the project.

THE VISION FOR FINANCIAL STATEMENT PRESENTATION

The goal of the joint project, as noted in the FASB Staff Draft, is to "establish a standard that will guide the organization and presentation of information in the financial statements" with the objective of improving usefulness of the statement information for decision making. Former FASB chairman, Robert Herz has noted that "(w)e are trying to set the stage for what financial statements will look like across the globe for decades to come." [Stuart, 2008]. The guidelines in the FASB Staff Draft apply to all business entities, including non-public ones, which prepare financial statements in accordance with either IFRSs or US GAAP (specified pension plans are excluded) as well as to all financial statements.

The proposed changes in financial statement presentation are based on two key principles: cohesiveness and disaggregation. These principles, built on the objectives of financial reporting, were formulated utilizing feedback from users and advisory groups. The Cohesiveness Principle requires that the statements show a unified financial picture of a company's activities with associations between the various items clearly identifiable. The statements should complement each other as much as possible and the principle should be applied at the category level as opposed to the line-item level. The second key principle underlying the proposed changes, the Disaggregation Principle, is designed to assist financial statement analysis. The Principle emphasizes that resources should be separated by the activity for which each is used as well as by economic characteristics. Disaggregation should be by function, nature, and measurement base in the statements as a whole with liquidity and financial flexibility considered as part of disaggregation.

Non-financial executives should note that the FASB Staff Draft includes several changes to US GAAP which are designed to correspond to requirements already in place in *i*GAAP. Specifically, in the FASB Staff Draft, a complete set of financial statements consists of the Statement of Financial Position, the Statement of Comprehensive Income, the Statement of Cash Flows, and the Statement of Changes in Equity. Furthermore, executives should note that a minimum of one period of comparative information is required; however disclosures of additional period are allowed. Within each period, each statement has equal weight and prominence. This proposed authoritative definition of a complete set of financial statements converges US GAAP with the *i*GAAP. Table 1 presents a comparison of the current titles for specified US financial statements with the titles proposed in the FASB Staff Draft for a complete set of statements.

Table 1 Proposed Names for Complete Set of Financial Statements	
Current	**Proposed**
Balance Sheet	Statement of Financial Position
Income Statement Comprehensive Income Statement	Statement of Comprehensive Income
Statement of Cash Flows	Statement of Cash Flows
Retained Earnings Statement	Statement of Changes in Equity

While most non-financial executives can easily become comfortable with statement title changes, the structure and content changes may be more problematic. The majority of the current statements' structure and presentation will be drastically altered under the proposed formats; however, and this is important to note, the *same* information will be presented on each statement, just in a new format. As can be seen in Table 2 from the FASB's *Introduction and Summary of July 1, 2010, Staff Draft* (FASB Staff Draft), a proposed classification structure for the three basic financial statements (Statement of Comprehensive Income, Statement of Financial Position, and Statement of Cash Flows) provides that each will have the same sections, categories, and subcategories, all of which are required. The proposed statement of changes in equity is omitted from the table because its sections, categories, and subcategories will be different. While the categories and subcategories within the sections will be the same on all statements, the order of presentation will be determined by the company itself and must be the same on all three basic statements. The FASB Staff Draft requires totals/subtotals and, headings for all sections, categories, and subcategories, Furthermore, related information must be classified in the same section on each statement with a single measurement base used for each line item. In short, the balance sheet will no longer look like it balances, but it does; and the income statement will also sport a new look which, for most non-financial executives, will appear to become more complicated, but really isn't.

In general, a company utilizing the new classification scheme should separate its assets and liabilities according to the new presentation template for the statement of financial position. This classification approach will then be used for both the proposed statement of comprehensive income and the statement of cash flows. The preceding should result in a consistent relationship, at the line item level, among individual assets, liabilities, income, expense, and cash flow item, thus, complying with the Cohesiveness Principle.

The Business Section on each of the three basic financial statements reports items that are used by the company to create value in its everyday business activities (i.e., to produce goods or provide services which generate revenue) as well as other income producing activities. The

Business Section should divide transactions and events into two categories, Operating and Investing. The Operating Category includes items related to transactions with customers, suppliers, and employees. Examples of items, which according to the FASB Staff Draft should be included in this category, are Cash, Accounts Receivable, Plant Assets, Accounts Payable, Cost of Goods Sold, and Postemployment Benefit Service Cost.

Table 2 – Proposed Standardized Structure

Statement of financial position	Statement of comprehensive income	Statement of cash flows
Business section	**Business section**	**Business section**
Operating category	Operating category	Operating category
Operating finance subcategory	Operating finance subcategory	
Investing category	Investing category	Investing category
Financing section	**Financing section**	**Financing section**
Debt category	Debt category	
Equity category		
	Multi-category transaction section	**Multi-category transaction section**
Income tax section	**Income tax section**	**Income tax section**
Discontinued operation section	**Discontinued operation section**, net of tax	**Discontinued operation section**
	Other comprehensive income, net of tax	

Source: Introduction to and Summary of July 1, 2010. Staff Draft

Liabilities directly related to operating activities should be reported in a separate subcategory, Operating Finance, within the Operating Category. In general, this Sub-Category should include all liabilities and related assets that do not meet the definition of financing, that are initially long term, and that have a time value of money. Examples of items the FASB Staff Draft classifies in this sub-category include Net Pension Liability, Lease Liability, Expected Return on Plan Assets, and Postemployment Benefit Interest Costs. Cash flows associated with the Operating Category, including the Operating Finance Sub-Category, are considered Operating and classified as such under the proposed guidelines for the Statement of Cash Flows.

The second category in the Business Section, the Investing Category, reports those transactions/events that produce non-revenue income and that are unrelated to the company's day to day activities. Items classified in this category in the FASB Staff Draft include Short Term

Investments, Investments in Securities, Equity Method Investments, Interest Income, Equity Income, and Gains/Losses.

The Financing Section reports how the company finances its business activities; e.g., how the entity obtained capital and how the entity repaid capital. On the Statement of Financial Position, this Section is separated into two categories: Debt Category and Equity Category. However, neither the Statement of Comprehensive Income nor the Statement of Cash Flows subdivides this section. Included in the Debt Category are obligations involving a borrowing arrangement designed to raise/repay capital as well as the related revenues/expenses/cash flows. Examples from the FASB Staff Draft include Short Term Debt, Long Term Debt, Interest Payable, and Interest Expense. The Equity Category presents assets/liabilities that result from transactions with the owners of the company. The primary examples from the FASB Staff Draft are Common Stock and Preferred Stock, but the Category also includes all items currently included in Additional Paid in Capital. There is no "Treasury Category" in the Financing Section; these assets/liabilities which are being used as a substitute for cash should be classified in the Business Section under the proposed guidelines.

CURRENT VERSUS PROPOSED STATEMENT FORMATS

This section provides non-financial executives with a compare/contrast discussion and analysis of financial statements prepared utilizing current U.S. GAAP guidelines with those as they would appear under the proposed format. In order to assist the non-financial executive's journey through the statement maze, the proposed guidelines for each statement are briefly discussed and examples of current and proposed statements are presented.

The New Vision for the Balance Sheet: The Proposed Statement of Financial Position

Currently the Statement of Financial Position is commonly referred to as the Balance Sheet. Exhibit 1 presents a comparative balance sheet which has been prepared using existing US GAAP guidelines. As can be seen, the Balance Sheet is a formal presentation of the accounting equation. Assets, usually presented first, are generally shown in order of liquidity. Liabilities by due date, and equities, to the extent possible, by order of permanence are presented next with each section totaled as well as a grand total for the two sections together. Under the current format, the "balancing" of total assets with total liabilities and equity is both readily apparent and familiar to all users.

Exhibit 1

Current US GAAP Balance Sheet

	20x1	20x2		20x1	20x1
Assets			**Liabilities and Stockholders' Equity**		
Current			**Liabilities**		
Cash	$15,000	$32,000	**Current**		
Accounts Receivable (net)	44,000	69,000	Accounts Payable	$37,000	$58,000
Merchandise Inventory	36,000	45,000	Interest Payable	17,000	11,000
Prepaid Expenses	7,000	14,000	Notes Payable (Short-term)	52,000	67,000
Investment in Trading Securities	31,000	39,000	Income Taxes Payable	5,000	4,000
Total Current Assets	**133,000**	**199,000**	**Total Current Liabilities**	**111,000**	**140,000**
			Long Term		
Long-term Investment			Notes Payable	85,000	75,000
Investment in AFS Securities-Fair Value	120,000	95,000	Bonds Payable	250,000	225,000
Investments -Equity Method	64,000	99,000	Total Long Term Liabilities	335,000	300,000
Total Long Term Investments	184,000	194,000			
			Total Liabilities	**446,000**	**440,000**
Plant, Property and Equipment					
Building (net)	250,000	222,000	Stockholders Equity		
Equipment (net)	75,000	95,000	Common Stock	35,000	45,000
Land	60,000	60,000	Preferred Stock	22,000	22,000
Total Plant, Property and Equipment	385,000	377,000	APIC-Common Stock	129,000	158,000
Intangible Assets			Retained Earnings	105,000	162,000
Patent	35,000	32,000	Other Comprehensive Income Items	0	(25,000)
Total Intangible Assets	35,000	32,000	Total Stockholders' Equity	291,000	362,000
Total Assets	**$737,000**	**$802,000**	**Total Liabilities and Stockholders' Equity**	**$737,000**	**$802,000**

Under the proposed guidelines, this familiar "balancing" will be lost as assets, liabilities, and equity will no longer be presented in those specific, and familiar, groups. As discussed previously in this paper, the proposed format will report together items which are related by major activity (i.e., assets and liabilities related to the same activity will be reported and netted in the same section/category/sub-category). The classification of an item should be determined by the function of that item (i.e., how management uses the item) and, thus, is a way of disaggregating the information in the statements and highlighting the relationships among the items. Management's explanations of these classifications should be included in the notes.

Within the required standardized structure discussed previously, the specific sub-categories, to be determined by the company itself, should be the ones that, in its opinion, provide the most relevant information to users. Examples of potential sub-categories include short term vs. long term (determined using a fixed period of one year) or order of liquidity. Totals for assets and liabilities in each category as well as in each sub-category (if presented)

must be presented on the face of the statement. Classifications on the other financial statements are determined by classifications in the Statement of Financial Position. Under the proposed guidelines, cash equivalents will be a thing of the past and no longer part of cash, but rather will be classified as a short term investment.

Exhibit 2		
Proposed Statement of Financial Position		
	20x1	20x2
Business		
Operating		
Assets		
Cash	$15,000	$32,000
Accounts Receivable (net)	44,000	69,000
Merchandise Inventory	36,000	45,000
Prepaid Expenses	7,000	14,000
Investment in Trading Securities	31,000	39,000
Building (net)	250,000	222,000
Equipment (net)	75,000	95,000
Land	60,000	60,000
Patent	35,000	32,000
Total Operating Assets	**$553,000**	**$608,000**
Liabilities		
Accounts Payable	(37,000)	(58,000)
Notes Payable (Short-term)	(52,000)	(67,000)
Total Operating Liabilities	**(89,000)**	**(125,000)**
Net Operating Assets	**$464,000**	**$483,000**
Investing		
Investment in AFS Securities - Fair Value	120,000	95,000
Investments -Equity Method	64,000	99,000
Total Investing Assets	**$184,000**	**$194,000**
Net Business Assets	**$648,000**	**$677,000**
Income Tax		
Income Taxes Payable	5,000	4,000
Net Income Tax Liability	**5,000**	**4,000**
Financing		
Debt		
Interest Payable	17,000	11,000
Notes Payable	85,000	75,000
Bonds Payable	250,000	225,000
Total Debt	**$352,000**	**$311,000**
Equity		
Common Stock	35,000	45,000
Preferred Stock	22,000	22,000
APIC-Common Stock	129,000	158,000
Retained Earnings	105,000	162,000
Accumulated OCI	0	(25,000)
Total Equity	**$291,000**	**$362,000**
Total Financing	**$643,000**	**$673,000**
Total Assets	**$737,000**	**$802,000**
Total Liabilities	**$446,000**	**$440,000**

Exhibit 2 presents a statement of financial position prepared under the proposed guidelines. To the non-financial executive as well as many financial executives, at first glance the proposed statement appears to be a radical departure from the current balance sheet. However, appearances can be deceiving. All of the assets, liabilities, and equities currently reported on the Balance Sheet are still being reported on this proposed statement just not in their familiar, obviously balancing format. The difference is the classifications and arrangements of the items according to the proposed standardized structure which is purported to enhance disaggregation and cohesiveness.

As previously noted, the Business Section is first divided into two categories: Operating and Investing. The Operating Category includes those assets that contribute to the production of revenue and are listed generally in order of liquidity. The delineating of assets into current and non-current is no longer acceptable. As can be seen in Exhibit 2, this category includes many of the assets presently classified as Current Assets, Plant Assets, and Intangibles. The key is that these assets are used to produce revenue, the company's primary reason for being in business. Operating liabilities, in a separate subcategory within the Operating Category (aka Operating Finance Subcategory), generally reflect short term obligations that are associated with the production of revenue. The Investing Category, the second category in the Business Section, reports assets which produce non-revenue income and that are not related to the day to day activities of the company. These are primarily the assets that are presently classified in the long term investment section of the balance sheet; e.g., equity method investments; held to maturity investments. As can be seen, all section, categories, and subcategories must be totaled.

In the example in Exhibit 2, the income tax section is presented next. However, the order is determined by the individual company and this section may be presented later on the statement. Since income taxes are primarily a result of revenue or income producing activities, placement of the income tax section here presents these liabilities in close proximity to related assets and liabilities.

The Financing Section, which is the final section on the Statement of Financial Position in Exhibit 2, is subdivided into the Debt Category and the Equity Category and explains how an entity obtained its capital. All obligations not reported in the Operating Finance Subcategory are presented in the Debt Category and, in this example, are shown in order of due date. Liabilities are no longer *required* to be separated into Current Liabilities and Long Term Liabilities; however, a company may *elect* to have a Current Sub-Category and a Long-Term Sub-Category within the Financing Section if it so desires. Under the proposed guidelines, if such a presentation is elected, debt that is due within one year is current and debt due beyond the one year time horizon is long term. Utilization of the operating cycle is no longer a factor.

The Equity Category is essentially unchanged from the current presentation on the Balance Sheet which should provide non-financial executives with feeling of familiarity. Paid in capital is presented first followed by Additional Paid in Capital and Retained Earnings.

Accumulated Other Comprehensive Income, as is now the case, is the last item presented in the Equity Category.

As the non-financial executive can see, the Statement of Financial Position is no longer a “Balance” Sheet as the presentation no longer parallels the accounting equation. Total Assets and Total Liabilities are no longer required on the face of the Statement of Financial Position. Such totals are required to be disclosed, but a company has the option of making such disclosures in the footnotes. Regardless of the rearranged format,, *all* of the assets, liabilities, and equity currently being presented are still being disclosed, albeit in another arrangement.

The New Vision for the Income Statement: The Proposed Statement of Comprehensive Income

The Statement of Comprehensive Income has been the subject of a separate joint project of FASB and IASB with changes to both US GAAP and *i*GAAP already implemented. As a result, the FASB Staff Draft provides only general guidance regarding this statement as many of the changes necessary for harmonization have already been incorporated into current US GAAP. Under the proposal, the Statement of Comprehensive Income presents information about changes in the company’s net assets (e.g., equity) during a period from transactions other than those with the company’s owners. The format proposed in the Staff Draft for this statement combines the current Income Statement (see Exhibit 3) with the current Statement of Comprehensive Income (see Exhibit 4), thus using the single statement approach to the reporting of comprehensive income. This format is also acceptable under current U.S. GAAP.

As can be seen in Exhibit 3, the current accepted format of the Income Statement divides revenues and expenses into Operating and Non-Operating categories with Extraordinary Items and Discontinued Operations presented separately. Revenues and expenses are currently separately reported on the Income Statement with relevant subtotals (e.g., gross profit) also presented if applicable. Current US GAAP requires intra-period tax allocation on the face of the Income Statement.

Exhibit 3 Current US GAAP Income Statement		
Sales		$2,153,000
Cost of Goods Sold		1,070,000
Gross Profit on Sales		1,083,000
Selling Expenses	570,000	
Administrative Expenses	363,000	933,000
Income from Continuing Operations		150,000
Other Revenues and Expenses		
Interest Revenue	3,000	
Interest Expense	(23,000)	
Income From Securities - Equity Method	42,000	
Unrealized Holding Gain on Trading Securities	8,000	30,000
Income Before Income Tax		180,000
Income Tax Expense		62,000
Net Income Before Extraordinary Loss		118,000
Earthquake Loss (net of tax of $5000)		(26,000)
Net Income		**$92,000**

The current format of the Statement of Comprehensive Income, shown in Exhibit 4, separates the non-owner changes to equity into Net Income and Other Comprehensive Income Items. This separation is also required under the currently acceptable single-statement approach combining the Income Statement and the Statement of Comprehensive Income

Exhibit 4 Current US GAAP Statement of Comprehensive Income		
Net Income		$92,000
Other Comprehensive Income Items		
Unrealized Loss - Available For Sale Securities (Net)		(25,000)
Comprehensive Income		**$67,000**

Exhibit 5 shows a Statement of Comprehensive Income prepared under the proposed guidelines. As can be seen, the statement is divided into two sections: Net Income and Other Comprehensive Income with a subtotal for Net Income required to be presented on the face of the statement. Revenues and expenses should be classified into the same categories and in the same order as those on the Statement of Financial Position. Related items on the two statements must be classified in the same manner on both, again to emphasize the cohesiveness among the statements. Within each category, revenues and expenses should be disaggregated first by function (e.g., selling goods, providing services) and then those functional amounts should be disaggregated by nature (e.g., salaries, rent, depreciation) either in the statement itself or in the notes. (The example in Exhibit 5 assumes disaggregation by nature is presented in the footnotes.)

Each revenue or expense reported on the Statement of Comprehensive Income, whether part of net income or as another comprehensive income item, must be clearly identified as to whether it relates to an operating, an investing, or a financing activity. This identification is achieved primarily by classifying the item in one of the required sections or categories (Business-Operating, Business-Investing, or Financing). As can be seen in Exhibit 5, this approach still reports revenues and expenses in a manner similar to the current format as the proposed Business-Operating Category retains the majority of revenues and expenses presently classified as operating while the revenues and expenses currently reported as non-operating items are divided between the investing and financing sections.

Intra-period tax allocation continues as in the past with the tax effects of key items reported with the associated item. A change that non-financial executives should note is the elimination of the extraordinary items classification. This approach is both a modification to US GAAP and a simultaneous convergence with *i*GAAP. Other Comprehensive Income Items, net of tax, will be reported in the final section on this statement in a manner similar to current presentation guidelines. Key subtotals must be presented for each section as well as any category or sub-category with the final figure on the statement being Comprehensive Income. Companies will no longer be allowed to present a Statement of Comprehensive Income separate from the Income Statement as those two current statements are combined under the proposed guidelines. No specific name has been identified for this statement although the IASB refers to this statement as the "Statement of Profit or Loss and Other Comprehensive Income". This title, however, is merely suggested - not required. In contrast, the FASB Staff Draft uses the name "Statement of Comprehensive Income."

The "New Vision" for the Statement of Cash Flows

The Statement of Cash Flows as presented in the FASB Staff Draft differs little from the Cash Flow Statement prepared under current US GAAP. This statement still explains how cash changed over a period by reconciling beginning and ending cash as reported on the Statement of Financial Position; again cash equivalents are no longer allowed and are now reported as investments. The objective of this statement remains the same: to provide a meaningful summary of how the company got its cash and how it spent its cash during a particular period. Accordingly, the majority of non-financial executives should be comfortable with the proposed version of this statement.

Exhibit 5			
Proposed Statement of Comprehensive Income			
Business			
Operating			
Sales			$2,153,000
Cost of Goods Sold			1,070,000
Gross Profit on Sales			1,083,000
Selling Expenses		$570,000	
Administrative Expenses		363,000	
Unusual Earthquake Loss		31,000	964,000
Total Operating Income			**119,000**
Investing			
Interest Revenue		3,000	
Income From Securities - Equity Method		42,000	
Unrealized Holding Gain on Trading Securities		8,000	
Total Investment Income			53,000
Total Business Income			**172,000**
Financing			
Interest Expense		23,000	
Total Financing Expense			**23,000**
Income From Continuing Operations before Taxes			149,000
Income Tax Expense			57,000
Net Income			**92,000**
Other Comprehensive Income			
Unrealized Loss - Available for Sale Securities (Net)		(25,000)	
Total Other Comprehensive Income			(25,000)
Total Comprehensive Income			**$67,000**

Today, most companies prepare their Statement of Cash Flows utilizing the currently acceptable Indirect Approach as shown in Exhibit 6. This is true even though the FASB recommends the Direct Approach. The Indirect Approach converts accrual net income as reported on the income statement to Cash Provided by Operating Activities by adjusting for all reported non-cash revenues and expenses. The categories on the current Statement (Operating, Investing, and Financing), which represent the three main areas of company activities, are also the ones utilized in the FASB Staff Draft for all financial statements. The Statement of Cash Flows is the statement least changed by the proposed guidelines; however, several frequently encountered cash flows will be classified in a different category from where they are currently being classified. For example, cash flows relating to plant assets are classified in the Operating Category in the Business Section under the proposed guidelines rather than in under Investing

Activities as seen in Exhibit 6. Both the current and the proposed approaches require the reconciliation of beginning and ending cash balances as reported on the Statement of Financial Position/Balance Sheet.

Exhibit 6 Statement of Cash Flows - 20x2 (Current US GAAP)			
Cash flow from Operating Activities			
Net income		$92,000	
Adjustments to reconcile net income			
Increase in Investment in Trading Securities		(8,000)	
Income from securities - Equity Method		(35,000)	
Extraordinary Loss - Earthquake Loss		31,000	
Depreciation Expense		36,000	
Amortization - Patent		3,000	
Increase in Accounts Receivable		(25,000)	
Increase in Merchandise Inventory		(9,000)	
Increase in Prepaid Expenses		(7,000)	
Increase in Accounts Payable		21,000	
Decrease in Income Taxes Payable		(1,000)	
Decrease in Interest Payable		(6,000)	
Increase in ST Notes Payable		15,000	
Cash provided by Operating Activities			$107,000
Cash Flow from investing Acitivies			
Purchase of Equipment		(59,000)	
Cash Used by Investing Activities			(59,000)
Cash Flow From Financing Activities			
Payment on Long Term Notes		(10,000)	
Issuance of Common Stock		39,000	
Dividends Paid		(35,000)	
Payment on Bonds Payable		(25,000)	
Cash Provided by Financing Activities			(31,000)
Net Increase in cash			17,000
Beginning Cash			15,000
Ending Cash			$32,000

Exhibit 7		
Proposed Statement of Cash Flows 20x2		
Business		
Operating		
Cash Collected from Customers	$2,128,000	
Cash Received on ST- Note	15,000	
Cash Paid for Inventory	(1,058,000)	
Cash Paid for Wages	(250,000)	
Cash Paid for Operating Expenses	(651,000)	
Purchase of Equipment	(59,000)	
Net Cash Flows from Operating Activities		**$125,000**
Investing		
Cash Received for Interest	3,000	
Cash Received for Dividends	7,000	
Net Cash Flows from Investing Activities		**10,000**
Net Cash Flows from Business Activities		**135,000**
Financing		
Cash received from Sale of Common Stock	39,000	
Cash paid for dividends	(35,000)	
Cash paid on long term notes	(10,000)	
Cash Paid for Interest	(29,000)	
Cash Paid for Bonds	(25,000)	
Net Cash Flows from Financing Activities		**(60,000)**
Income Tax		
Cash paid for Income Taxes		**(58,000)**
Increase in Cash		17,000
Beginning Cash		15,000
Ending Cash		**$32,000**

In a major change, the proposed guidelines require the use of the direct method for preparing the Statement of Cash Flows (see Exhibit 7) as well as the presentation of the reconciliation of operating income to operating cash flows. Class flows are to be classified in a manner consistent with how the related items/transactions are classified on the other financial statements, in particular the Statement of Financial Position. Significant non-cash activities are required to be included in the body of the Statement of Cash Flows rather than in the notes. As discussed previously and as shown in Exhibit 7, cash flows associated with plant assets (e.g., purchase of equipment), which are currently classified as Investing Activities would, under the proposed guidelines, be reported in the Operating Category in the Business Section. In addition, several cash flows currently reported in the Operating Activity category such as cash received for

interest and for dividends as well as cash flows related to trading securities, would be reported in the Investing Category of the Business Section. Other cash flows that are re-classified under the proposed guidelines include cash payments for interest and income taxes. Cash paid for interest is currently reported in Operating Activities, but reported in the Financing Section under the FASB Staff Draft. Furthermore, income taxes paid will be reported in its own separate section consistent with the reporting of taxes on the other statements. Even with these few tweaks to classification on this statement, non-financial executives should be able to make the transition to this statement with minimal trouble.

The New Vision for an Additional Proposed Statement and the Footnotes: Statement of Changes in Equity

Current US GAAP requires that a company explain all changes in paid in capital, retained earnings, and other equity items during a period by reconciling beginning balances in each item with the ending balances. However, these disclosures are generally provided in the footnotes or as a supporting schedule in those footnotes. (The Statement of Retained Earnings in Exhibit 8 shows an example of these disclosures for one such equity item.)

Exhibit 8 Statement of Retained Earnings (Current US GAAP)	
Beginning Retained Earnings	$105,000
Net income	92,000
Dividends	(35,000)
Ending Retained Earnings	**$162,000**

Under the proposed guidelines, such disclosures should be presented in a separate Statement of Changes in Equity that has equal prominence with the other three financial statements. Exhibit 8 illustrates this new financial statement. This financial statement is the only statement under the proposed guidelines that does *not* utilize the Standardized Structure required in the other statements (i.e., Business Section, Financing Section, etc.). Although this statement would be required under the FASB Staff Draft, the non-financial executive is already familiar with the content and, more than likely, with the format as this information has already been included in financial reports. Only the placement and prominence has changed.

Exhibit 9						
Proposed Statement of Changes in Equity						
	Common Stock	Preferred Stock	APIC Common Stock	Accum. Other Comp Income Items	Retained Earnings	Total Equity
Balance as of 1/1/20x2	$35,000	$22,000	$129,000	$0	$105,000	$291,000
Comprehensive Income						
Net Income					92,000	92,000
Other Comprehensive Income				(25,000)		(25,000)
Total Comprehensive Income				(25,000)	197,000	358,000
Transactions with Owners						
Issuance of Common Stock	10,000	0	29,000			39,000
Dividends Paid					(35,000)	(35,000)
Balance as of 12/31/20x2	$45,000	$22,000	$158,000	($25,000)	$162,000	$362,000

Footnotes are still required for full disclosure purposes with new as well as expanded disclosures to be provided in addition to currently required disclosures. For example, the proposed guidelines require a company to analyze the changes in all asset and liabilities by reconciling beginning and ending balances. This disclosure is important in understanding how and why a company's financial position changed over a period. However, descriptions of the basis for classifying assets and liabilities into categories will no longer be necessary. Furthermore, companies will be required to explain each individual change relating to cash transactions, non-cash transactions, accounting allocations, write downs/impairment losses, acquisitions/ dispositions, and other remeasurements. Disclosures must include a note identifying remeasurement amounts recognized on the Statement of Comprehensive Income as well as a narrative putting each of those amounts into context. These disclosures are designed to help users including non-financial executives to understand the information reported in the statements by providing essential background and details; i.e., disaggregation.

SUMMARY

The proposed changes to financial statement presentation are nothing short of a complete reconfiguration of current financial statements. The proposed format for financial statements in the FASB Staff Draft alters the presentation of financial position, results of operations, and cash flows by all entities – both in the U.S. and globally – in an attempt to develop a common presentation approach. In essence, the current balance sheet and income statements would be reformatted to conform to the three categories contained in the cash flow statement. The proposal increases the disaggregation in the financial statements in an attempt to provide

additional information to users and to, perhaps, increase insight to non-financial executives into the inner workings of financial reporting. Furthermore, the proposed guidelines could improve standardization in presentation to enhance the articulation and flow among the financial statements. This could potentially allow non-financial executives to more readily see and understand the relationships among the major areas of business activity with the resulting increase in cohesiveness.

The new vision for financial statement presentation will mark a dramatic change for non-financial executives. What they have spent years learning will have to be relearned. If the proposed changes become reality, the challenge will be to minimize the learning curve. What is certain is that non-financial executives need to carefully examine the FASB Staff Draft and analyze the benefits and costs that the proposals would have on their company. What is equally important is that non-financial executives, as well as other users, take every opportunity to comment and make their voices heard by the rule making bodies.

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WORLD-CLASS STRATEGY EXECUTION THROUGH 'ON THE JOB' LEADERSHIP DEVELOPMENT

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ABSTRACT

This article describes an approach to leadership development in firms that relies mostly on "on-the-job" training. Because strategy execution has come to be a critical issue for CEOs, real leadership that can be cultivated "on-the-job" in a complex, novel and ambiguous problem solving environment. Using the recommended nine step approach based on our leadership development framework, we provide some practical considerations gleaned from extensive case study field experience to help move an organization toward achieving world class strategy execution.

Key Words: leadership development; strategy execution; execution traits and values; uniting leadership development across the firm

INTRODUCTION

Strategy execution has become an increased priority among CEOs since the recognition in more recent years that disciplined strategy execution is associated with a host of favorable organizational outcomes as well as improved firm performance (Bigler, 2009). Though a priority, strategy execution can also be a dilemma and headache if not sufficiently committed to and developed. Support for the importance but evasive nature of strategy execution was found in recent research by the Conference Board. Rudis, (2008) reports that in the Conference Board 2007 CEO Challenge study, it was found that Excellence in Strategy Execution is the No. 1 challenge of ten key dilemmas their sample of CEOs face while Consistent Execution of Strategy by Top Management is the No. 3. In addition, recent McKinsey work on "healthy organizations" defines this phrase as "… the ability of your organization to align, execute, and renew itself faster than your competitors can…." (Keller and Price, 2011). Furthermore, the 2009 Institute for Corporate Productivity Leadership Competencies Pulse Survey found that of all the leadership competencies surveyed, strategy execution was the greatest discrepancy in terms of what respondents stated their firms were doing compared with what they should be doing. This

suggests that while CEOs recognize the importance of strategy execution, successfully and consistently maintaining an effective strategy still eludes many organizations.

Given the prevalence of these dilemmas, expanding the leadership capability within an organization may be one plausible option to successfully implement and maintain an effective strategy. Leadership is vital to world-class strategy execution and world-class strategy execution can in turn serve as the "laboratory" for home grown, on the job efforts for leadership development. Utilizing a world class approach involves optimizing the most suitable strategy for mid-sized to large organizations and can result in a host of benefits around leadership development. These benefits include minimizing down time at off- site training events, customizing leadership development content to be firm specific, working on the firm's specific goals to extend its leadership development efforts, utilizing resulting intellectual property as a source of sustainable competitive advantage, and increasing efficiency of processes so that delay lags related to learning are minimized.

World-class strategy execution skill is a goal many firms strive to attain but find difficult to realize, especially if the acquired skills are expected to contribute to the firm's sustainable competitive advantage (Bigler, 2001; Bigler and Norris, 2004). Those firms which successfully gain the skill of world-class strategy execution through leadership development attain a valuable firm specific resource that would be difficult to imitate in the short to mid- term. This level of performance is the hardest source of advantage for a competitor to match because it arises from true leadership of strategy within the organization by operating at a "root cause level" of analyses and action. Operating at the symptoms level of analyses can cause more problems than it solves. Quality decisions derive from operating at the root cause level and this idea is reiterated in Montgomery (2008) who provides related arguments for the importance of true leadership to strategy execution.

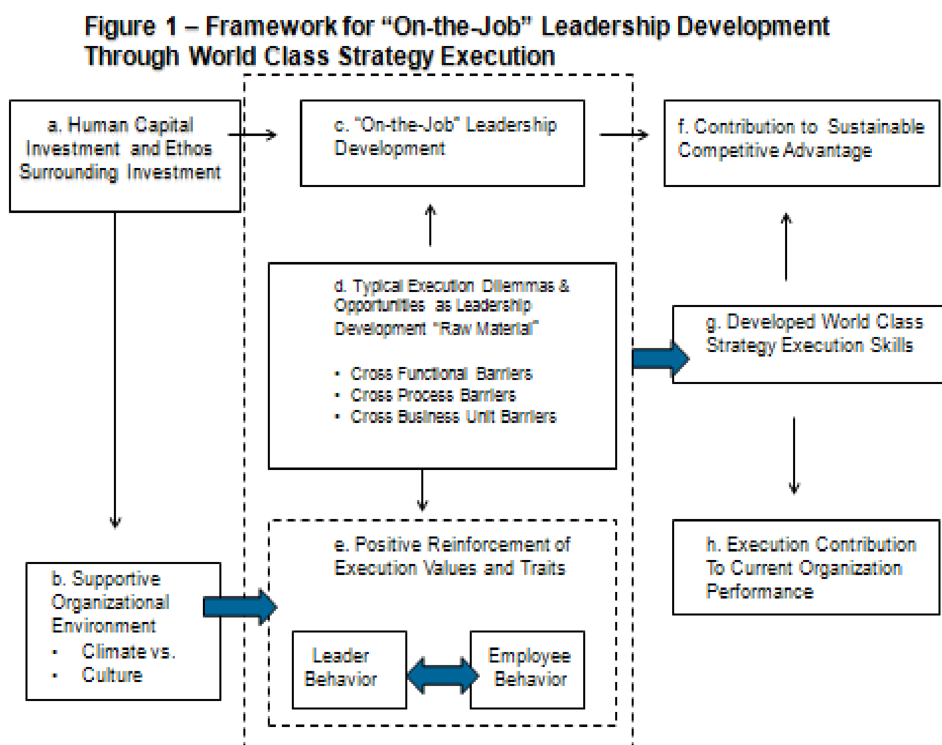
Even though previous research suggests the great significance and desirability of world-class strategy execution (Bigler, 2009), many established firms seem incapable of *sustaining* it. Those organizations which move steadfastly toward the goal of world class strategy execution will increase the probability of being rewarded with sustainable competitive advantage and by extension a "premium" stock price (Kaplan and Norton, 2008). The process of creating and sustaining a competitive advantage and executing world class strategy begins however with the leadership capability that is developed with an organization based on the value that they place on their human assets. It is through the expansion of human capital within an appropriately supportive organizational context that leaders are developed 'on the job' who can capably enact world class strategy execution.

INVESTING IN HUMAN CAPITAL: A LEADERSHIP DEVELOPMENT FRAMEWORK

In the last twenty years, the value that organizations have placed on human capital has increased tremendously, across a variety of occupations as well as across a variety of industries. In dynamic work environments, managers are increasingly realizing that employees need to be more actively engaged in their work and exhibit creativity in order for the organization as a whole to remain competitive (Mumford, Scott, Gaddis, & Strange, 2002). The importance of employees generating novel and appropriate products, processes, and approaches in their jobs is not only an end unto itself but also constitutes activities which may ultimately impact firm performance and survival (Nystrom, 1990; Kanter, 1988).

This newly realized premium placed on human capital emphasizes the critical role that the human resources (HR) function within an organization plays in accomplishing an organization's strategy. HR professionals on behalf of the wider organization need to lead the charge in nurturing their human capital in an appropriately supportive organizational context in order to foster an overall positive effect on leadership development. Figure 1 below presents a consolidated leadership development framework which includes relevant case study variables that have been observed during twenty five years of field experience by one of the authors.

Figure 1 – Framework for "On-the-Job" Leadership Development Through World Class Strategy Execution



As HR professionals, it is imperative to lead organization wide initiatives based in an appropriately supportive organizational context (Panels a and b of Figure 1). To facilitate this, HR primarily must adopt the important role of promoting organizational strategic imperatives, especially in regards to fostering leadership development through investing in their human capital to achieve sustainable competitive advantage (Panel f).

Many leadership theories propose specific behaviors that make effective leadership possible; behavioral styles (Lindell & Rosenvqist, 1992), and transformational or charismatic leadership (Bass & Avolio, 1994; Klein & House, 1995) among others. These theories focus on specific behavioral patterns and their implications for leadership behavior (Panel e). Alternatively, leadership can also be framed as an asset based on possessing an effective skillset rather than enacting specific behaviors. According to Ackerman (1992), skills are developed capabilities that emerge over time as a function of education and experience (Panels c, d and g). By this rationale, acquiring leadership skills in order to improve leader performance is attainable by many individuals and can emerge through education and experience (Mumford, Zaccaro, Harding, Jacobs, & Fleishman, 2000).

Organizations need leaders who can manage resources, direct day to day activity, and drive an organization into the future through innovation. Leadership involves problem solving but the problems leaders face involve more complex social problem solving unlike typical routine problems (Mumford et al., 2000). The problems leaders might encounter differs from more routine ones given that complexity, change and conflict are typical of organizations and almost always result in ill-defined problems (Mumford and Connelly, 1991). Ill-defined problems lack a single solution path so problems can be addressed in a variety of ways (Runco, 1994) and are by nature inherently more complex. The complexity of leader problem solving may also be increased by a number of other factors including having little clarity about the information relevant to the problem. Further, leadership problems may be more novel and less routine (Nutt, 1984). Overall, leadership problems can be characterized as complex, novel, and often fraught with information ambiguity especially given that leaders problem solve in a real world context where they often do not have the luxury of generating solutions over long periods of time and with little other demands (Lord and Maher, 1990). These constraints especially make it imperative that in today's innovation climate leaders address complex problems with creative solutions.

World-class strategy execution with its associated dilemmas is such a leadership problem and opportunity. A naïve observer might believe that strategy execution is linear, straight forward and composed mainly of project management post strategy formulation. Project management, while an important tool, in no way fully reflects the reality of strategy execution as the classic "messy problem" (panel d). Utilizing a skills based approach to organizational leadership involves cultivating integral cognitive and motivational capabilities to solve complex, messy problems (Mumford et al. 2000). By investing in the development human capital through skill based, 'on the job' training, organizations can put themselves directly on a trajectory toward

world-class strategy execution skill attainment (panel g). Further, developing these skills will contribute to the firm's current performance (panel h) through operating process improvements as well as improved customer satisfaction.

THE IMPORTANCE OF WORLD-CLASS STRATEGY EXECUTION IN DEVELOPING WORLD-CLASS LEADERS: CORROBORATING EVIDENCE FROM THE FIELD

Achieving world-class strategy execution by an established firm means being able to match or exceed the flexibility, innovation, and return rate of a new entrant in the same industry (Johns and Bigler, 1998). The ability to achieve this status rests on four essential foundations; speed, internal alignment, innovation, and executive behavior (Bigler, 2009; Bigler and Norris 2004). These concepts are discussed in greater detail in Table 1.

Table 1: Essential Foundations of World Class Strategy

Essential Foundations of World Class Strategy	Descriptions
Speed	Understanding the firm's market rhythm, which is the tempo of the market as determined by the buying patterns of customers
Internal Alignment	Aligning executive, operating, and support processes with the market rhythm, creating cyclic, recurring timing rather than calendar-based timing for all processes
Innovation	Maintaining a portfolio of innovation and growth initiatives with various objectives and in various stages of completion
Executive Behavior	Evaluating executive efficiency (speed at which initiatives are successfully launched), productivity (rate at which initiatives achieve their targeted return), and effectiveness (growth rate of the market value of the firm)

The importance of this concept lies in our main premise that only world-class leaders can guide an organization toward world-class strategy execution as they are willing to work in the trenches alongside their firm's cross-unit and cross-process teams. Further, these leaders have the courage to accept responsibility if things go wrong, so that both they and their organizations can learn. They prioritize, lead the charge, and set an example of discipline and fairness. This view of the importance of leadership to world class strategy execution has been long established over many years from many different research sources (e.g. Collins, 2001; Anand, Collis and Hood, 2008; Kaplan and Norton, 2008; Bigler, 2009). This type of leadership development is also thought to occur most frequently during organizational dilemmas and opportunities *that are cross functional, cross process and cross business unit in nature.*

By nature then, this type of leadership cannot be developed most effectively in a classroom and does not necessarily align with conventional ways of developing leadership. In support of this view, we draw heavily from the extensive field experience of one of the authors who distilled his findings into nine practical steps to developing on the job leadership. Over a ten year period between 2000 and 2011, ten companies served as detailed case studies which provided great practical insight into leadership development and its importance in achieving world-class strategy execution.

Nine Steps to Developing World Class 'On-the-Job' Leadership

The following nine-step process highlights the leadership qualities and skills necessary for achieving world-class execution and offers a way of assessing individual behaviors against these criteria and further developing leaders. A detailed discussion of the nine step process follows.

Step 1: Select people with positive execution values and traits.

Individuals with positive execution values and traits often have intrinsic motivation to complete things and take pride in authentic work. They are also geared to the real tempo of the business. Many years of observation and experience have helped to pinpoint both positive and negative key values and traits highlighted in Table 2 which can enhance or impede world-class strategy execution. Leadership at world-class status can happen when most people in a firm exhibit behaviors on the positive side of the execution values and traits.

Table 2: Execution values and traits

Positive execution values and traits	Negative execution values and traits
1. Has a keen need to achieve closure by completing projects and assignments	1. Performance anxiety does not allow completing projects and assignments, and too many new starts fill the void.
2. Has an acute desire for individual excellence, but a good team player.	2. Is a rank opportunist.
3. Enjoys serving and delighting both internal and external customers.	3. Enjoys primarily the social aspects of work.
4. Has an intense personal drive for integrity, ethics, magnanimity and craftsmanship.	4. Has a personal drive only for a paycheck, and is constantly looking for opportunities outside the firm. Mercenary.
5. Views self as an apprentice in an ever-learning mode.	5. Is arrogant and has an inflated sense of personal value to the firm.
6. Has respect for the dignity and confirmation of the individual in all situations.	6. Spreads rumors; is overly political; violates fairness, justice, equity and ethics trying to elevate

Table 2: Execution values and traits	
Positive execution values and traits	Negative execution values and traits
	self.
7. Is resilient to and accepts the need for direct and sometimes curt communications.	7. Needs high emotional maintenance; feelings and ego are bruised easily.
8. Is able to think in mission-driven terms and changes concepts and behaviors when the mission changes.	8. Has a one-track mind, behavior and attitude; is one-dimensional and the keeper of outdated tradition.
9. Is able to leave a personal comfort zone and view it as a learning opportunity.	9. Is resistant to change and keeper of the status quo; cherishes a culture of comfort.
10. Has a real desire and propensity to teach and coach.	10. Has a real desire and propensity to micro-manage.
11. Is comfortable with being accountable.	11. Manages to shirk all opportunities for accountability.
12. Can admit mistakes and learn from them.	12. Views losing face as the worst thing imaginable.
13. Is appropriately "street wise," but a sense of nobility persists. "Those to whom much is given, much will be expected" is the key worldview.	13. Is a corporate bully and gangster. "It's all about me" is the key worldview.

While there is no clear existing evidence as to what percentage of workers in any geographic area or across specific industries exhibit most or all of these value and traits, we feel that there are sufficient numbers of such people in most firms and will gladly commit to and sustain developing world-class strategy execution skill.

Step 2: Align the positive execution values and traits in five key areas of business operations.

This five phase step involves utilizing a different set of employee assessment factors at each phase.

Phase 1–Align positive execution values and traits with current background and skills for the job.

This phase aligns and compares the skills of a new hire or incumbent employee with the positive execution values and traits shown in Table 2. While the required background and skills may vary by organizational level, the execution values and traits will be the same for each employee. Figure 2 contains a staff evaluation matrix for initial assessment.

Figure 2 – Aligning execution values and traits with current background and skills for the job

Execution values and traits	Background and skills for the job: Yes	Background and skills for the job: No
Yes	Hire or keep at almost any cost	Train and develop
No	Caution: Depends on deficiency level in execution values and traits	Do not hire/ Counsel out

Phase 2: Align positive execution values and traits with core competencies at appropriate levels of mastery.

Core competencies are those skill sets that give the firm sustainable competitive advantage and thus are strategically valuable resources for a firm (Collis and Montgomery, 2008). These competencies share four important attributes; they are inimitable and allow firms to outperform their competitors, they are unique and differentiate a firm as offering superior value, they allow for charging a premium or maintaining price points in a falling market and they are the foundation for market expansion for successful products and services. The gradations of these competencies[1] differ for varying levels of mastery (e.g. novice, craftsman, and expert) but all job classifications are expected to develop skills *in these same competencies*. Figure 3 provides guidelines for making staff decisions based on these factors.

Figure 3 – Aligning execution values and traits with core competencies at appropriate level of mastery

Execution values and traits	Core competencies with appropriate level of mastery: Yes	Core competencies with appropriate level of mastery: No
Yes	Hire or keep at almost any cost	Train and develop to appropriate levels of mastery
No	Caution: Depends on level of deficiency in execution values and traits	Do not hire/ Counsel out

Phase 3: Align positive execution values and traits with ongoing and initiative work.

Ongoing work is that which keeps the firm running on a day-to-day basis while initiative work involves key new thrusts that are expected to directly increase the market value of the firm or significantly increase the performance of an internal support unit. These two kinds of work are equally important, but their leadership and execution requirements differ. Ongoing work requires a close-in, day-to-day rhythm and line-of-sight supervision and leadership where people can see and understand each other in real time. Initiative work requires a longer leash and requires an entrepreneurial approach where an 8-to-5 workday is typically a barrier as initiative work happens when it must. Initiative teams work until they exhaust themselves and then take a break. As such, imposing the tempo of routine on-going work on initiative teams fosters frustration. The positive execution of values and traits form an important foundation for both types of work, as shown in Figure 4.

Figure 4 – Aligning execution values and traits with ongoing and initiative work

Execution values and traits	Ongoing work	Initiative work
Yes	Hire or keep at almost any cost	Hire or keep at almost any cost
No	Do not hire/ Counsel out	Do not hire/ Counsel out

Phase 4: Align positive execution values and traits with the ability to create an appropriately timed confidence and success platform.

This phase assesses whether firm leaders can manage the constant tension between appropriate growth and innovation and *current* financial requirements (e.g. earnings, costs, revenue, stock price). Creating the right confidence and success platform for the workforce is key in this phase. Also, a world-class leader supports the organizational confidence gained from its present successes, but is also able to change the platform as conditions change[2]. Figure 5 explains the assessment criteria for this phase.

Figure 5 – Aligning execution values and traits with ability to create an appropriately timed confidence and success platform

Execution values and traits	Ability to create an appropriately timed confidence and success platform: Yes	Ability to create an appropriately timed confidence and success platform: No
Yes	Hire or keep at almost any cost	Train and develop
No	Do not hire/ Counsel out	Do not hire/ Counsel out

Phase 5–Align positive execution values and traits with success as defined by driver and end result measures.

The fifth phase is critical for leadership development and world-class strategy execution and aligns those who possess the requisite positive execution values and traits with the tools to achieve success as defined by driver and end-result measures. Driver measures (e.g. process cycle time, amount of rework in a process and process cost) are *lead* process measures that end in *lagged* eventual end results (e.g. revenue, earnings, inventory levels, ROI, stock price)[3]. The matrix in Figure 6 depicts these relationships.

Figure 6 – Aligning execution values and traits with driver and end result measures

Execution values and traits	Yes — Driver measures	No — End result measures
Yes	Hire or keep at almost any cost, and improve with line mentoring	Hire or keep at almost any cost, and improve with line mentoring
No	Do not hire/ Counsel out	Do not hire/ Counsel out

At this point in the nine step process, the people who make the cut throughout the five phases of Step 2 form the backbone of a company that is well on its way to world-class strategy execution and sustainable competitive advantage. The presence of these people within the organization also ensures that a cadre of true leadership talent exists at all levels of the organization.

Step 3: Make sure everyone is adding value for internal and external customers.

World-class strategy execution is all about truly implementing superior value for both external and internal customers, rather than simply planning to do it. Adding superior value for customers happen when the results shown in Table 2 occur in such a way that they are unmatchable by competitors. Possessing positive execution values and traits predisposes people toward a real passion for delivering superior value to both internal and external customers.

Table 3: The Results of Superior Value for Internal and External Customers

Superior Value for External Customers Yields for Them:	Superior Value for Internal Customers Yields for Them:
Increased revenue	Increased productivity
Lower costs	Lower costs
Avoidance of working/fixed capital	Avoidance of adding resources
Shortened response times to their customers	Shortened response times to their customers
Lower risk	Fewer mistakes
Increased sustainability of above factors	Increased motivation in people

Step 4: Employ an appropriate form of an initiative management process with associated disciplines.

This step is an important part of world-class leadership development. Managers at every level within the firm must learn to appropriately use processes to generate, commit to, implement and realize planned performance at world-class speed so initiatives that drive the performance of a unit or directly increase the market value of the firm are realized (Bigler and Norris, 2004). The only relevant cross unit differences will be the process initiatives that are specific to each unit[4].

Step 5: Everyone develops and uses an appropriate growth and innovation roadmap.

Every unit in the organization must have a common way of depicting and accomplishing innovation and growth. In today's environment, a firm that does not embrace an innovation and growth roadmap is typically on a path to stagnation or outright failure (Land, 1986; Land and Jarman, 1992). While these functions are usually focused on external customers, units that serve internal customers can also think, plan and implement in these terms. With all units focusing on a common goal, the firm can grow together and learn from the process. To avoid chaos and draining resources during a given planning cycle, senior management must set parameters to judge initiatives[5].

Step 6: Develop an appropriate gain-making and gain-sharing system.

This incentive compensation step might seem out of the ordinary but it remains an important consideration. Gain-making and gain-sharing programs serve as forms of incentive compensation which allow employees who are responsible for the gains to share in the gains. Years of industry experience shows that successful leadership development can be achieved by hiring for the requisite positive execution values and traits while also using an above market pay strategy (a rate of 10 to 25 percent above) that involves incentive compensation. One form of incentive pay that has been found to be very effective is some form of "phantom equity[6]". Limiting other forms of variable pay, including stock options and other stock purchase programs, is recommended. This also excludes stock purchase programs available to all at a discount to market since these are not based on performance.

A key issue is whether this practice should be publicly transparent by posting performance share awards or strictly private. We suggest that it be strictly private unless a firm is attempting to reform a "good 'ole boy" image in which case transparency is preferable. The internal market for selling and buying performance shares should also be kept private based on personal experience. If a true meritocracy exists, one where the ingredients for world-class

strategy execution are apparent, then each person will have the trust that "… those who contribute more will be rewarded appropriately and with fairness and justice".

Step 7: Develop an appropriate recognition and promotion system.

Recognition of individuals, teams and units should be appropriate. Years of industry experience has shown that the best recognition occurs in private, with public praise appropriate only in some instances. Motivating the workforce through grandiose recognition of wins and successes by a few employees usually has exactly the opposite effect on morale. Much that goes along with developing world class strategy involves difficult initial work that will in many cases only bear fruit in the future. Many of the short term achievements often happen quickly if some teams are simply lucky. Knowing this then, it is important to avoid overly glorifying those who may have inherited relatively easy end result measure improvements because another cross unit team did the more difficult driver improvement work and was called onto other tasks. The result of such over glorification for short term achievements by a few individuals is often cynicism and mistrust by other unit teams.

Similarly, the promotion process should be organic to the needs of the business. A firm that has world-class execution skills will grow and make room for great people in good times and in lean times those who have a shared destiny with the firm will be willing to wait until the good times return. Firms whose execution skills are less developed and whose strategies are not robust will exit the competitive space when times get bad. This cyclical reality is familiar to firms who have world class execution skill because of their experience with the market rhythm. With marginal firms retreating, the supply-demand balance will be improved for those firms still in the game and herald in a new round of growth and promotion potential.

Step 8: Use a one-on-one monthly personal communication process to facilitate real communication, performance reviews and learning.

A process of one-on-one communication ties the entire leadership development process together. Individuals should have private, one on one, monthly meetings with their bosses to review the pertinent measures. This time should also be used to discuss the status of the initiative management process, movement on the growth and innovation roadmap, barriers and plans for their removal, changes in job aspirations, and needs for further subject matter training. These meetings should likely last less than an hour, with the last few minutes reserved for setting out future deliverables. Nothing short of an emergency should interrupt these meetings as they are extremely integral to the leadership development process.

Step 9: Develop an appropriate process to continually improve the leadership development process.

Using the outlined approach and process should result in automatic improvements. It is equally important however to self-audit at all levels within the organization, create a business case for any viable suggestions and present it to management for consideration. The business case should include why the change should be undertaken, its value relative to any costs, and its time to implementation. Every few months, all suggestions should be ranked in terms of benefit and cost, and implementation should be approved or denied based on the merits of the business case. This feedback loop is integral to improving the overall process of on the job leadership and provides the organization with an opportunity to conduct an internal audit and make the necessary process changes.

CONCLUSION

The idea that leadership development can take the form of 'on-the-job training' has been reinforced by first hand experiences derived from ten case study firms ranging from business units of large multi-national firms to mid-sized companies to major new venture start-ups. This point of view and the value that it brings to organizations in terms of sustainable competitive advantage has been practically derived over time using years of industry experience, but corroborated by recent relevant academic research in the leadership development area.

The experience of these firms showed the relative ineffectiveness of utilizing off-site leadership development. One main issue was the loss of investment in training whenever leadership development candidates left the organization. Another issue was the internal conflict that ensued whenever "high-potentials" were thought of as being elitist by others in the organization. This separation among employees only intensified when it appeared that those who received the off-site training opportunity returned with an increased elitist attitude. Absent the required positive execution values and traits in these individuals, arrogance often ensued post training in the "students" and cynicism resulted among those not allowed to attend off site training. Further, after many conventional leadership development programs the completion of "action assignments" and the required accompanying report were only given a modest effort as the focus shifted back to regular organizational priorities. In many ways these leadership development programs became synonymous with a sort of 'vacation' for those who had the opportunity to attend while those who were unable to attend often thought that the relatively high costs were a waste of resources.

Overall then, the approach outlined in this article addresses these problem areas that are typical to many conventional leadership development programs. Utilizing an on the job approach to developing leaders who can capably execute world class strategy will help a firm avoid the pitfalls associated with typical off site leadership development.

To maintain focus on the goal at hand, organizations must keep several considerations at the forefront. All parties within an organization who are actively engaged in strategy execution should be immersed in the on-the-job leadership development approach together. Similarly, it is

imperative to make clear to those engaged in this form of leadership development that there are no separate action assignments. Leaders will consistently make use of the same tools discussed in this article when they engage in the "job" of world-class strategy execution. Finally, organizations need to ensure that engaging in this kind of leadership development is not viewed as a vacation. Doing this will ensure that those who are privileged enough to be exposed to this kind of training do not take it for granted. Indeed, incumbents who possess the positive execution values and traits and are given this on the job leadership opportunity will know that they are involved with the some of the most vital work of the firm.

Once the system has been incorporated into the organization and people begin to use it, this nine-step approach to leadership development is easier and more effective than many conventional approaches. While the initial period requires hard work in terms of developing a common organizational language, in use and over time it will become a self-correcting process. Its overall benefits are numerous and advantageous to everyone in the firm. Firms will also benefit from the real time learning that occurs during this process, and an added benefit is that the entire firm develops a unified way of communicating.

By embracing the ethos that employees are an organization's most valuable asset, providing a culture of development toward sustainable competitive advantage, and utilizing the corresponding systematic, holistic and practical approach to leadership development outlined on the Nine Step Process, a firm can greatly enhance its chances of developing leaders throughout the organization who can communicate, learn and work together in order to execute strategy and drive results together.

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In alphabetical order and both authors contributed equally

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ENDNOTES

1 An important caveat worth mentioning here is that true core competency frameworks must never be confused with quick-fix management fads. Developing true core competencies requires keen thinking and foresight to define the specific core competency categories that will endure as the firm grows and changes. To work well, these frameworks require senior management to stay the course through the assessment of

individual levels of mastery for each competency. As an example, if an employee is still a novice during assessment, they remain at that level until they have truly earned the next level of mastery as a craftsman.

2 For example, a unit in turnaround mode fighting a tough market may experience organic confidence and success that is typified by tough, gut wrenching actions that inspire them to win the day. Asset loss and reduction in size may occur, but if the turnaround is done well, it becomes the platform for new future rounds of growth. Early on, the leader must ably convert the platform from turnaround to growth. If inappropriately stuck in one approach, the unit's growth and effectiveness when the strategic focus shifts may be stunted.

3 A rule of thumb in operations excellence disciplines is that working primarily on and/or only on end result or lagged measures is related to working on symptoms and not root causes. A more suitable approach involves working on the lead measures first where the cross functional and cross process barriers and issues can be seen clearly and removed. This route will more likely be taken by a firm if they have honestly committed to taking on strategy execution disciplines. It is here where true, courageous leadership is needed as many times the root-cause barriers include complex and emotionally charged issues.

4 As an example, the initiatives of shop floor managers and department managers will be narrower in scope than those of senior executives, who put enterprise-wide initiatives into play. But when everyone uses the same initiative prioritizing mechanism, reinforces the same process disciplines (cycle time, rework and cost), measures ongoing internal and external customer satisfaction and loyalty, and uses the same lead and lag measures to monitor progress, continuous improvement can produce huge dividends. Everyone is able to use the same language to communicate and learn as they drive their initiatives to achieve world-class performance.

5 When current financial performance needs to be optimized, the parameters would be narrow, serving as a governor on growth and innovation. In other periods, when success and confidence have been gained and the firm has excess cash flow, the field can be widened. Because leaders at all levels of the organization are operating with the same tools, they understand the reasons for planning cycle decisions. This shared understanding almost always results in appropriate expectations grounded in reality rather than inflated expectations, dissatisfaction and decreased motivation.

6 Phantom equity involves a system where all participating managers are granted a certain number of performance shares *depending on level of mastery with respect to the core competencies*. The initial value of one performance share is established by dividing the current or desired baseline free cash flow by the total number of planned performance shares. Every six months the value of the performance shares is recalculated. After this time, if the value has increased, performance shareholders can sell their shares to others in the firm in exchange for cash. The internal cost to administer this kind of program is small relative to the benefits of the total system. At the end of the year, additional performance shares can be awarded for performance above threshold contribution, and some performance shares can be granted for achievements that reflect performance above and beyond the call of duty. As people are promoted and increase mastery in the core competencies, their baseline number of awarded performance shares is adjusted upward.

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