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BANKING AND FINANCIAL CRISIS IN TURKEY FROM 1929 TO 2007

"Impact Which Does Not Kill You Makes You Stronger"

Mahmut Yardimcioglu, Karamanoglu Mehmetbey University
Gokhan Genc, Karamanoglu Mehmetbey University

ABSTRACT

Turkey is a country in which many crises are experienced in the fields of banking and financial system. Through this study, financial crises of Turkey sample are examined. Clear-cut information about crisis is given and their causes and effects are emphasized. Turkish financial system and banking almost became the least affected from 2007 mortgage crisis. Especially Europeans started to examine Turkish banking system which got stronger by learning from previous crises. Because Turkish banking system acknowledged its mistakes from previous crises, purged of them and the system became more resistant to crises. So it is possible to say that "Impact that doesn't kill makes you stronger". In this study, the crises Turkish banking system went through was demonstrated by a methodological examination.

INTRODUCTION

Since the Turkish Republic was established, it has faced banking and finance crisis due to both external developments in foreign countries and internal political and economical developments. Nation's weakly constituted finance and banking sectors whose shareholder's equity was inadequate were damaged in each crisis and suffered losses. The most recent crisis indicates that Turkey has been in a crossroads. Now it is impossible to solve the crisis with former political and economical policies. Moreover, we do not obtain the chance to suffer and overcome crisis on our own as it used to be. Considering the effect of the crisis on February 19 on foreign markets, we are obliged to solve the crisis we created and hinder the factors that form them as well. With globalization financial crisis may spread to other nations like a contagious sickness. In this study, it is aimed to examine the banking and finance crisis from 1929 to the very last crisis. Some of these crises were foreign-origin and affected banking and finance sectors considerably. After 90s, there has been a considerable rise in financial crisis due to progresses around the world and internal economical policies.

WORLD CRISIS OF 1929 AND ITS EFFECTS ON TURKISH BANKING SYSTEM

In 1923, during the settlement period of Turkish Republic, there were 31 banks (18 national, 13 foreign) active. Foreign banks compared to single-branched and economically weak national banks had a larger share in banking sector and possessed large portion of the credit market. In the period between 1923 and 1932 which is known as the first banking period of republican banking, considerable attention was paid to development of national banking. There had been a rise in the numbers of national banks. In 1928 there were 57 banks in the nation. In the period between 1924 and 1929, there had been a development of %50 percent in gross national product due to progresses in foreign trade and production increase in agriculture. The main features of economical policies executed in this period were balanced budget policy, tightening its stranglehold on the money supply, providing balance in balance of payment, maintaining asset of the national currency.

The 1929 World Crisis which had emerged from US and spread to the world had a serious effect on Turkish economic structure. Turkey, with experiencing opposition from terms of trade, faced great deficits in balance of payment, and TL's losing value. 1929 World Crisis had its effect especially on agriculture sector which produces for foreign trade. The banks establishing credits to this sector had difficulties, and some of them went bankrupt. In 1932-38 periods, ten banks went bankrupt containing Türk Ticaret ve Sanayi Bank, Karaman Çiftçi Bank, İstanbul Esnaf Bank, İstanbul Bank, Aksaray Halk bank, Karaman Milli Bank, Trabzon Bank, Karadeniz Bank, Kastamonu Bank, Kayseri Milli İktisat Bank. Besides, five banks which had been established in 1938-1940 were liquefied.

The most important reason for bankruptcies in this period was the loan holders could not pay these loans back because either product prices went down or the product amount was inadequate. Moreover the high interests of local banks compared to state banks had been a factor making payback of the credit harder. The most significant effects of 1929 World Crisis on banking system were the concentration on establishing state banks for financing industrial investments, reducing the numbers of local banks and increasing the government's regulatory and auditing role on banking.

In the 1930s policies have changed for economical development, a planned economic order had been initiated in the government's lead. Between 1933 and 1938 state banks had been established consecutively in parallelism with changes in main policies. In this period Sümerbank (1933), Belediyeler Bank (1933), Etibank (1935), Denizbank (1937), Halk Bank and Halk Sandıkları (1938) were established chronologically. One of the most important regulations about banking was made in this period. In 30.5.1933 2243 numbered "Law of Protecting Deposits" was enacted. In this law the concentration was audition and protection of deposit, yet since it contains decrees related to legal character of its owner, credit limits and audition of banks this law is considered by jurists to be the first Banks Law. Following this, Banks Law number 2999 was enacted with more decrees added to first law in June 1st, 1936. In this period Central Bank reduced rediscount rates from 8% to %5,5 in order to solve the problems caused by the inadequacy of shareholder's equity which limits the volume of credits. Banks who have a capital more than 4 million TL could benefit from this opportunity. Apart from this, banks had the obligation to deposit certain amount of their bank reserves to state bonds in order to help finance "First 5-Year Development Plan". As a result, while 1929 World Crisis caused Turkey to transfer to statism economical structure it also caused local banks to diminish by bankruptcies and state banking to flourish rapidly.

THE 1958 STABILITY PRECAUTIONS AND CRISIS IN BANKING SECTOR

In the first years of Demokrat Parti government, there had been a rapid development in the economy with the help of Marshall Aid. Investments grew as the credits for agriculture and trade sectors increased. Production increased considerably due to developments in foreign trade and construction sector. Mechanization in agriculture led to significant rise in cultivatable fields and this caused a relative prosperity.

Since the end of 1952, monetary based demand inflation increased gradually. Following the Korean War, with the opposition of world trade limits against the countries producing raw material and agricultural products, selling good to foreign markets became harder.

Imports grew rapidly whereas export dropped, and this led to external deficit in balance of payments. In this situation some of the exchange for the goods imported could not be transferred out by Central Bank. It became risky to sell goods to Turkey when the goods that came to customs was not paid for.

When import diminished as a result of exchange shortage, foreign trade was carried out by barter method. Shortage of goods appeared in the market, many fundamental necessity materials disappeared and black-marketeering became common. With good stocking there had been a rise in seeking speculation.

The continual relationship between Turkey and IMF first began in this period. Despite being founding member in 1947, Turkey did not have a serious relation with IMF until 1954. In 1954 IMF authorities came to Turkey and suggested stopping inflation-based growth policy and devaluation in order to cover deficits of external payments. However this suggestion was refused because of both the elections and strong opposition to 1946 devaluation by Menderes.

In 1956 inflation grew to 39% and national income decreased considerably. In 1958, with a very common idiom of those times; "government could not import a nail for a horseshoe". Because Central Bank could not perform exchange transfer, negotiations were held in Paris in 1957 in order to solve the loans problem which had occurred due to transfer delay. Turkey, IMF, USA and OECC came to an agreement about preparation of an economical stability package. According to this agreement, it was accepted to credit Turkey again and postpone the accumulated loans. Therefore stability precautions which would be known as "August 4th Decisions" began to be applied.

August 4th Decisions were regulated to set interior and exterior balance in Turkish economy. It was necessary to control inflation by limiting the expenses so as to set the interior balance. To set the exterior balance official dollar rate was raised from 2.8 kuruş to 9 TL. Therefore exchange rates were raised 221%. However, since premium was paid for export and premium was collected from import, active devaluation was below these ratios.

New rates were applied to all import goods, besides quotas were applied for obligatory import goods and extra taxes were collected for importing. On the other hand in export multiple rate, in other words different rates for different goods were applied. In response to measurements, new credit worthy of 250 million dollar was withdrawn from IMF and loan worthy of 600 million dollar was postponed. Despite all, 1958 stability measurement failed setting economical balances. Economy went through a recession, income distribution became worse, and political unrest prepared a basis for 1960 impact.

One of the most affected sectors from 1958 Stability Measurements was banking sector. As a result of these measurements 11 banks went bankrupt between 1959 and 1962, two banks united and nationalized. After 1950, in the expansion and inflation atmosphere, many banks had become active. Bank count which was 43 in 1944 including TCMB, had risen to 62(56 of them were national banks) in 1958.

Economical crisis experienced in the late 50s, caused problem for small-scaled local banks because of economical recession, reduction in deposits and the trust problem. And this caused many banks to go bankrupt. Following banks went bankrupt between 1959 and 1962: Konya İktisadi Milli Bank (1912-1959), Akseki Ticaret Bank (1927-1959), Akşehir Bank (1916-1960), Niğde Bank (1948-1960), Sanayi Bank (1958-1961), Bor Zürra ve Tüccar Bank (1922-1961), Esnaf Kredi Bank (1957-1961), Doğu Bank (1952-1961). Türkiye Eski Muharipler Bank (MUHA Bank)which was established in 1959 united with Subaylar Bank(Tümsu Bank) which was established in 1957 with the name of "Türkiye Birleşik Tasarruf ve Kredi Bank" but this bank did not last long either and went bankrupt in 1961. On the other hand Türk-Ekspres Bank (1953-1962) and Buğday Bank (1955-1962) united and nationalized with the name of Anadolu Bank.

In 1960 because of the crisis experienced in banking, in order to secure saver's rights a "Banks Liquidation Fund" was established under the control of TCMB. Banks had the obligation to deposit 0,5/1000 of their savings and trade deposits sum in their end of the term balance. With this, it was aimed to cover the deficits of the banks which received gradual liquidation decrees. In case fund could not cover this aim, it was decided that TCMB lent to the fund.

Banks Liquidation Fund was a sort of deposit insurance. This fund was transferred to "Savings account Assurance Fund" which was established to be managed and represented by TCMB. 1958 Stability Measurements and following banking crisis led to elimination of feeble local banks from the system.

JULY BANKING AND BANKING DISASTER

In the late 70s, financial liberalization movements all over the world also affected Turkey, as a result of this a new period in Turkish economy has begun with January 24th, 1980 decisions. With these decisions, economical liberalization, transition to liberal market economy and liberalism gained importance.

With January 24th decisions, following July 1st, 1980 all credit and deposit interests were released. With this application also known as "July Banking", the application of negative interests ended, deposits were begun to be rated positively; in other words deposit was given interest over inflation. Liberalization of interest with some exceptions led to a great increase in deposit interests and also credit interests. Because of the lack of control on interests and its effect on banking and banking, freedom of interest ended in 1983 and in 1987 the freedom of interest was accepted again

With July banking, limitations for establishing foreign banks and setting branches had been abolished and new trade banks were allowed. This period is also the period in which Turkish banks had internationalized.

With January 24th decisions, releasing the rate ratios resulted in lower consumption expenses and diversion of savings to banks and bankers. As a result of this situation, all industrial and trade enterprises from the smallest to the largest, could not sell the products they produced or negotiate. Companies had to work with great stocking cost. Companies working with insufficient capital and heavy credit burden could not put their sources in production process.

With the low consumption, the companies which have higher stocking cost gradually needed more working capital. For this they tried exporting; however exporting did not prove sufficient to create business capital. Therefore companies used credits even though rates of the credits were high.

Many companies had loans much higher than their shareholder's equity. So most of the credit limits in the banks were full. Holding banks dominating in the system tried to finance group companies, and were not willing to credit other companies. In this situation, companies in distress which could not receive credit from banks tried funds of the banker institutions which offers higher rates compared to banks. In this period with the release of the rates, banking institutions grew in number unchallenged by regulatory laws. Bankers developed immensely both in the field of capital market and external money market. In this period two new financial devices were introduced. First of these were "anonymous account" in which the identity of account owner was kept secret, the other was a sort of short term debentures; anonymous certificate of deposit. The aim of these devices was to divert the funds which are especially fed from smuggling market and whose origin is unknown into finance sector.

In a short period of time great funds had gathered into anonymous accounts. By some banks, anonymous certificate of deposits was made a means of exceeding interest rates which are decided by banks through negotiations. These banks transferred their certificates of deposits to capital market bankers and made these bankers sell them so they could give more interest than it was written on certificates. This situation became a topic of debate among the banks and in the future it caused some banks to be in distress or change their owners.

There were four main groups of banking institutions active in the market in that period:

- ♦ Independent Banking Institutions; these were the institutions that were previously active in the market and had a rapid development due to the conditions of the period. One of the most important of these, Banker Kastelli who became an idol for that time was just after ten greatest banks in the ranking. The other known institutions were “Mentaş” and “Bimtaş”.
- ♦ Banking Institutions established by banks in order to perform the operations banks cannot perform because of Banks Law; Such as Hisarbank’s “Eko Yatırım”, “Yatırım-Finansman A.Ş” established by 13 banks’ cooperation
- ♦ Non-bank-owner holdings’ banking Institutions; such as Transtürk Holding’s and Profilo Holding’s “Meban Menkul Değerler” and Eczacıbaşı Holding’s “Eczacıbaşı Yatırım Holding”
- ♦ Small banking institutions; to become a banker, it was sufficient to pay 450 TL worth filing fee and to have some document till September of 1981. Therefore many people got involved with this field, related to field or not. This bankers offered little insurance for savers yet they offered more interest. Grand bankers offered 60% interest whereas these offered 140% interest. For the money they collected, they usually gave out their personal cheques and notes payable.

Economical measurements applied since January 24th, 1980 led to bankruptcies of many enterprises which could not keep up with new conditions. Large portion of these were credit receivers form the bankers. When these enterprises could not pay back to the bankers, bankers also delayed payment of interest and capital to the savers. Since the high interest rates of bankers made application of government policies harder, the Council of Ministers negotiated on a bill and started to regulate this section.

Notifications and decrees enacted related to the law had some decision regulating the actions of banking institutions. In that way, bankers are separated into two groups as only brokers and lending market bankers. Moreover minimum capital amount required for banking had been elevated. Market bankers were banned from advertising and announcement. The announcement of contemporary Minister of Finance reading “People gambled” caused panic in the market. Especially small bankers went bankrupt affected by markets. Between December 1981 and April 1982, 198 companies in Ankara and 60 companies in İstanbul, İzmir, Adana and Antalya went bankrupt.

Savers who could not receive their money attacked bankers and offices. In this period 2 banker was murdered, 10 of them ran away, 5 of them were taken into custody, 5 was arrested and 12 were asked bankruptcy. These small bankers owed 75 billion TL to about 200000 savers.

Government who intervened lately began to liquidate bankers. In July 7th, 1982 a decree named "Banker Casualties Decree" was announced. In August 11th, 1983 "Banker Casualties Law" was enacted.

After the fall of the small bankers, it was time for greater bankers who cooperated with holdings and banks. The shortage in economy also affected large capital holders; they simply could not pay for capitals and interests of issued bonds. This situation led to bankruptcies of first class bankers and owner change of many companies and groups.

The most renowned banker of the day, Banker Kastelli, fell in one day when he could not receive a single payment from Hisarbank. Cevher Özden, also known as Banker Kastelli escaped abroad and his accounts were confiscated. Kastelli case led to minister resignations in that period. After the incident government had to abandon strict money policies. The most affected from this disaster were İstanbul Bank linked with Has Holding and Hisarbank linked with Çavuşoğlu-Kozanoğlu Group. These banks which were on the verge of bankruptcy transferred to Ziraat Bank along with Ortadoğu İktisat Bank (Odibank) which belongs to Çavuşoğlu-Kozanoğlu Group. Other great bankers followed the path of Kastelli. The institutions of these bankers who had difficulty in payment had also been liquidated. On September 19th, 1982 "Deposit Forming Funds" was established in order to pay capital and interests of bond and deposit certificates.

Meban was the last banking institution which did not belong to a bank to be liquidated. Meban which was attacked by its panic customers following the Kastelli incident, asked help from Ministry of Finance. Payments of Meban were suspended until September 15th, 1982. Therefore the liquidation process of Meban started.

The golden era of banking which started January 24th, 1980 and lasted for two years had come to end with over 250 bankruptcies or tasfiyeler. Banking incident involved approximately 2,5 million savers and bankers mediated about 400 billion liras of savings. Among the bankers, only the bankers which certified themselves as borsa bankers; Çukurova Grubu'nun "Genborsa", Koç Group's "Koç Yatırım", 13 banks' cooperative "Yatırım Finansman A.Ş." ve Eczacıbaşı's "Eczacıbaşı Yatırım Holding Ortaklığı A.Ş." could survive.

Banking incident brought the attention of savers who were interested in traditional saving methods such as immovable or gold due to high interest rates without knowing the process of banking, and it also contributed to capital market that would be formed in the future.

THE 1983-84 BANKING CRISIS

In 1983-84 period Turkish banking had its third significant crisis and 6 national banks were deactivated. In 1983 Hisarbank, İstanbul Bank and Ortadoğu İktisat Bank which were on the verge of bankruptcy, were compulsorily transferred to Ziraat Bank. The activities of İşçi Kredi Bank established in 1954 were suspended in 1983. Emniyet Sandığı which was established in Ottoman period and one of the oldest banks in Turkey lost its tüzel identity and was transferred completely to Ziraat Bank. Baking rights of Türkiye Bağcılar Bank which was established in 1917 and belonged to Suat Sürmen group was abolished.

The problems which economic policies created on banking system continued after this period, Türkiye Öğretmenler Bank established in 1959 was converted into public bank and later (1992) it was transferred to Halk Bank with its actives and passives.

The impact of banker bankruptcies on banking system played an important role and non-returning credits increased due to high interests and these situations proved to be crucial in bank crisis in this period. Many banks turned to automation to lower staff costs after this crisis.

THE 1994 CRISIS

The crisis experienced in the early 1994 has a very different structure from the other ones; the most suitable one to be defined as bank crisis. The crisis which appeared quickly spread to non financial sector after affecting finance sector. In 94 crisis, three banks (TYT Bank, Impexbank, Marmara Bank) and three stock broker (Türkinvest, Çarmen, Pasifik) went bankrupt. Banking sector went out of the crisis by weakening itself and shareholder's equity and credits of the banks diminished. It would be wise to review the developments in previous years before examining the 94 crisis. With the decree number 32 enacted in1989 Exchange Regime was totally allowed. With the freedom decree brought, sending exchange and capital to abroad or receiving them were made easier. With the decree number 32 there had been significant developments in transition to convertibility. In April 4th, transition of Turkish Lira to convertibility and its validity in all countries was confirmed by IMF. By the way the efforts for creating financial markets in the country had gained speed. Firstly "Interbank's Money Market" was established by the lead of TCMB. Next, "Exchange and Effective Markets" was established in 1988. TCMB used open market operations as a means of monetary policy. In 1991 bidding system was begun to be used in open market operations. Except these "Istanbul Stock Exchange Market" was established in 1986 and grew rapidly.

In this period banking sector demonstrated a rapid growth, competition became larger, automation became more common, services and products were almost at the standards of Western banks. Besides, with trained banking staff, improving capital, money and exchange markets; banking went through a rapid growth trend. Since 1990s, Turkish banking concentrated on fund management and treasury operations, in order to have operations in markets home and abroad almost all banks set up operation rooms in which financial products could be bought or sold in electronic environment. For TL payments EFT system, for exchange payments SWIFT system made it easier to operate inter-banks considerably. In addition there was a great advance in individual banking, and ATMs and credit cards became very common. In that environment, banks got far away from non financial market operations and concentrated on state and consumer finance.

In parallelism with financial liberalism movements in the late 80s there has been a significant rise in short term capital entries with the rise in interests at home. Therefore international reserves increased. Central Bank, for the first time in history has utilized a monetary program since the beginning of 1990. This monetary program aimed to audit Central Bank's internal responsibilities and advances for treasury that takes place in active elements and also it aimed to audit Central Bank's total balance sheet. Program chose Central Bank Money as a target and aimed to audit it. This program which utilized open market and exchange operations as a means of monetary policy had been used successfully for six months, yet finally ended in Desert Storm Crisis when Iraq occupied Kuwait in 1990.

In the first three months of 1991, Operation Desert Storm affected markets in a negative manner, and considerable amount of TL and exchange deposit receded from banking system. When government change and general elections were added to these external situations, 1991 became a loss for the economy. This year sources of Central Bank are used densely for the cash needs of the public.

In years 1992 and 1993 expansive monetary policies kept their effects. TL is evaluated reel against exchanges; devaluation is kept same as inflation, even maybe lower than it. As the public's need for internal loan increased, interest were quite above inflation, finding cheap funds from abroad and investing them into cheap loan deeds became to be risk-free and attractive source of profit. For this reason banks opened their exchange open positions in the late 1993.

To the end of 1993, government banks found interests asked for Treasury auctions high and they started to cancel auctions for Treasury Bonds and State Bills. They preferred to turn to Central Bank's sources for finance needs of Treasury. In the beginning of 1994, state internal borrowing bills market almost disappeared. In this situation, the only resource for Treasury's finance needs was Central Bank's short term advances. In such an environment government made a second mistake but bringing withholding to the income from state internal borrowing bills. (This decision was cancelled in January, 1994)

High level of liquidity was formed as a result of cancellation of Treasury auction. As IMKB was quite shallow, the only area which this liquidity could turn to was exchange. The diversion of over liquidity to exchange market led to a sudden increase in exchange. The prevention of performing open market operations by government reflecting high interest rates as a reason, led to non absorption of liquidity from the market. For Central Bank, the only tool for rising demand for exchange was selling exchange.

The element that triggered 1994 crisis was rating institutions known as Standard & Poor's and Moody's degrading of Turkey. In that period the banks that opened their exchange positions highly started to convert liquidity they own to exchange for fear that they will have less opportunity for external borrowing. Central Bank tried to cover banks' demands with the only weapon it has; exchange sale. By the way it could sell only 2,5 trillion worth papers with 145% interest in seven irregular term Treasury auctions made in January. However in an auction in December 1993, Treasury could borrow 9 trillion in a year's term with an interest rate of 89%.

As the demand for exchange did not decrease, a devaluation of 13,6% had been made in January 26th, 1994. So Central Bank, American Dollar was announced to be 17250 TL. This also could not prevent the demand for exchange. During the crisis with the order of contemporary Prime minister, even public banks were forced to sell exchange. The usable exchange reserves of Central Bank gradually began to decrease to the lowest level. Interbank Money Market overnight interests which was 110%, was 200% in February, 400% in March and rose to 1000% before April 5th. The open positions of banks recessed to 4 billion dollar in March.

In April US Dollar gain assets against TL about 53%. In this stage, government policies lost its all reliability. By the way with the rumors of conversion of exchange savings accounts into TL, common people who were not involved in crisis to that moment began to attack banks to withdraw their exchanges. Then panic turned into a bank rush including TL accounts. This situation caused a serious loss in total assets of banking system.

There had been serious conflicts between banks and credit users from banks both because of high credit interests and payment demands. Crisis damaged the trust between banks and deposit owners and it also led to credit loss of the banks in the eyes of other banks and financial institutions abroad. In this period, one of the bankrupted banks did not fulfill its responsibility of 30 million dollar because of the swap operation and then abroad markets were not available for almost all Turkish banks. Banks could not borrow externally and could not perform simplest arbitrage operations.

To set the economic balance corrupted, and to lift the panic atmosphere from the markets, a new stability package was introduced. With stability measurements which will soon be named as "April 5th decree" included some measurements rather than structural solutions. With April 5th decree, first exchange rate was released. US dollar which was about 24000 TL reached 40000 TL in a single day. The asset difference between Central Bank rates and market rates had been greater; determination of Exchange of Central Bank was meaningless. With April 5th decree, Central Bank transferred to realist Exchange application. Daily exchanges was started to be determined for Central Bank based on exchange sale rates at 15:00 3 month periods and exchange sale rates of ten banks which have the highest compulsory exchange effective transfers and sales.

The other measurements which came along with the April 5th decree can be listed as :

- ♦ Savings account upper limit was extended. When this measurement proved to be insufficient to prevent bank panic, unlimited state insurance was applied to all saving accounts.
- ♦ Public expenses and investments were lowered.
- ♦ Fee, salary and minimum price were limited.
- ♦ Special tax was enacted for one time only.

- It was planned to concentrate on privatization
- Disponibility rates were rearranged.
- The authorization for treasury of using advance was reduced. (from %15 to %12)
- Super treasury bonds which bring %50 net interest at the end of three-month terms were released.

Following April 5th decree, when Central Bank reduced interests for TL, some banks steered to Exchange in panic. In the mean time TYT bank, Marmara Bank and Impexbank whose financial constitution had weakened considerably, were confiscated and these banks were liquefied in the following stages.

With the crisis, IMKB index has shown significant decline, amount of operations in stock exchange had decreased and index was able to catch up with its pre-crisis level in a very long time. The decrease that began in the second half of January in stock exchange index had continued until the end of the month, and the index declined to 13,864 on January 28th. The decline of the index affected the intermediary institutions negatively. In this period, three intermediary institutions; Türkinvest, Pasifik Menkul Kıymetler and Çarşı Menkul Kıymetler went bankrupt.

Meanwhile the crisis in finance sector spread to real sector too and including the leading firms of Turkey, many institutions began reduce their worker staff. In the following months, when the things started to go smoothly, some of these workers were to be re-employed with half of their salaries.

The crisis which Turkey went through in 1994 was a conception lead by international hot money. Economic policies which were applied after 1989 have followed a path that has a hot money catalyzing nature. IMKB's income supplying on world markets, incomes supplied by exported state internal borrowing bills over world average on dollar base and suppression on rate of Exchange had increased the flow of hot money heading Turkey. While foreign capital motives in the form of credits which were provided from capital markets and portfolio investment to the country was 1,1 billion dollars in 1990, it was 5,2 billion dollars in 1992, and it reached 7,6 billion dollars in 1993.

The fact that the economy was in vicious circle because of its compulsion for internal borrowing in order to pay the loan interests of the state caused by high interest policies, and the fact that the export was not growing as expected, also the tendency to provide source by external borrowing, high credit interests discouraging the production and investment actions lead to crisis environment gradually. With the gradual decline of production, markets turned into a rant concentrated structure. Economy, was concentrated on interest, market, and exchange triangle, the dimension of production had been neglected continually.

The measurement package also known as April 5th decree did not bring any serious measurement in structural change, saved the day by offering short term solutions, it provided base for a more serious crisis in years 2000-2001 because of amassed problems. After the end of 1994 previous policies were readopted, banks began gaining profit from open positions, the rant economy was maintained by leaving the burden of real economy finance to the public banks.

THE EFFECT OF ASIAN AND RUSSIAN CRISIS

The unlimited guarantee to saving account after the 1994 crisis could only halt the problems in banking system for a while. The moral risk rate increased during the period until 2000 in banking system. Many middle and small scaled banks under unlimited state insurance began accumulating exchange and TL with the interests that they could not handle. A. İhsan Karacan states this situation in his book called “Banking and Crisis” as: “From the aspects of banking system, a system in which the passive responsibility was on state and the active on owners and managers or in other words a system in which the loss is collective and the profit is individual, creates a structure vulnerable to risk and dangerous.”

The relative facilitation of the bank establishment permission along with the unlimited guarantee on savings account had been an element increasing the vulnerability of the financial system.

In the period 1998-1999 rumors had been dominant in baking sector. Banks could not perform their basic tasks due to continual rumors. Operations in TL and exchange markets were done between 5 or ten banks. Small banks which could not obtain source from markets tried to create source by paying more interests to deposit than they could possibly handle.

Asian and Russian crisis in this period affected Turkey in a negative manner. Crisis which appeared in Thailand in the second half of 1997 and spread to many Asian countries, showed its affect both directly and indirectly. While Asian countries’ gaining competitive advantage and increasing exports by devaluating created a direct effect, rival countries’ decreasing exports created an indirect effect. In 1998 Turkey had a reduced export to these countries whereas there had been an increase in import. Another effect of crisis was a decrease in foreign trade capacity of countries due to deceleration in the expansion speed of the world. On the other hand the unrest created by crisis in especially ascending markets increased Turkey’s loan costs from international markets and led to curtailment of terms. Asian crisis from the aspect of non financial sector affected iron-steel sector most. Asian countries which created a demand for 40% of global production in the rapid growth period were the most significant market for Turkish producers. Asian crisis led foreign investors to quit from stock markets ant that was the effect of Asian crisis on Turkey finance markets. The money quitted reached to 313 million dollars in October, 1997. the quitted money between October, 1997 and January 1998 was estimated to be 565,3 million dollars. This amount can be considered to be small compared to forthcoming crisis. Rate and interest exchange policies applied by Central Bank had a considerable effect on this. High exchange reserves also created an advantage in crisis. Other than these the low globalization level of Turkey compared to other countries led to prevention of this country during the crisis.

Turkish economy which had overcome the effects of Asian crisis was affected from Russian crisis more in August, 1998. Russian Federation was the second country we exported after Germany in 1997. Russian crisis had negative effects both on non financial and financial sectors. Official export to Russia was 2 billion dollars, trade in the form of bag trade was 8,8 billion dollars in 1996, 5,8 billion dollars in 1997 and decreased to 3,5 billion dollars in November, 1998. Today bag trade is in a trivial level.

In the first half of 1998 there was a capital entry of 7,8 billion dollars yet with the Russian crisis appeared in August, capital exits started from Turkey as a result of its geographical situation. In the last quarter of 1998 capital exit of 10,5 billion dollars was observed. 7 billion dollars of this amount was formed by exchange transfers of individuals settled abroad. This situation on one hand led to diminishing of banking and finance sectors and on the other hand led to an increase in non financial interests as a result of need for high loan for public section.

After August international and domestic finance possibilities began to diminish on the aspect of investments. Banks recalled some of the credits they gave to firms. In the meantime despite the crisis public banks did not stop crediting, and they managed to delay the effects of crisis on non financial sector. Private sector banks' avoiding taking risks and concentrating on financing the state and consumer led public banks to take the whole burden of non financial finance. However this situation led to corruption of public banks' asset quality and public banks' taking on debts in increasing amounts created a basis for prerequisites of 2001 crisis.

The most affected sectors from the crisis were textile and leather trade sectors. The decrease in German markets affected textile and leather export negatively. Considering the fact that sales in leather confection were to Russia, Russian crisis had more effect on this sector.

In this period application of economic program by Central Bank in order to reduce high chronic inflation was begun to be debated. In the frame of Closer Inspection Agreement with IMF since the second half of 1998, a three year program was suggested to set economic balance again and lower the inflation permanently. This Closer Inspection Agreement would serve as a bridge to financially supported stand-by agreement. In the program, especially banking sector was concentrated on, the importance of auditing the sector, strengthening the capitals of banks and limitation of open positions were emphasized.

In 1998 political developments resulting in the fall of Mesut Yılmaz administration in October-November Period, Financial Beginning Application in 30th, September, and political tension with Syria were other developments affecting financial markets. Following the Russian crisis, Brazil crisis decreased loan possibilities of Turkish banks from abroad. Syndication markets could only be opened in the middle of 1999. Especially small and middle scaled banks tried to create source by concentrating ob TL and exchange deposits. With the unlimited guarantee to savings, many banks had taken interest burden more than they can handle. Public bill interests reached 147% in November whereas overnight interests reached 80%. Deposit interests of banks increased considerably in parallelism with these progresses. 20-25% of interests were pronounced for dollar.

Serious problems started to occur in the financial structure of a lot of bank as a result of inefficient usage of these gathered resources and providing indirect finance for the group companies. As a result of this while Interbank, Bank Ekspres and Türk Ticaret Bank were transferred to TSMF in the first step, Yaşarbank, Esbank, Egebank, Sümerbank and Yurtbank were added to these at the end of 1999. And Birleşik Yatırım Bank's activity was terminated.

In this period, such factors as cool-headedness of generals of economy especially authorized of TCMB and their efforts of providing liquidity necessity of the markets, support of public banks on non financial economy prevented the further effects of crisis.

THE LIQUIDITY CRISIS IN 2000

Turkish economy started the year 1999 in quite a bad performance in the aspect of macro-economic balances. The Brazilian crisis at the turn of the year increased the tension in domestic markets. Following the early general elections, the coalition government made up by DSP, MHP and ANAP came to power with a strong parliament support in the administration of Bülent Ecevit on 28th, June.

The government started to apply a dense program suggesting change in laws for the solution of problems. In the first step, new Bank Law, which could not be enacted for a long while, was enacted. One of the innovations brought by this new law was the foundation of an independent observing and auditing institution, in administrative and financial aspect. Besides identification of credit was expanded to cover participations, audition was brought in consolidated basis, the relation between indirect credit and shareholders equity was reduced, intervention methods for the problematic banks' activity was altered, individual responsibilities of shareholders and administrators were increased. With the other changes in Banks Law and Legislation the general banking legislation was adapted to Basel Committee advices and the European Union. Banking law was rearranged in December.

Turkey experienced two vast earthquake disasters in 1999. Earthquakes led to many casualties and considerable material damage affected public's morale and economic activities in a negative way. A new tax was enacted to compensate for a portion of the damage caused by earthquake.

While the economic growth was -6,1, at the end of 1991 GNP diminished 9%, income per individual went back to 2878 dollars from 3213. Inflation was 63% in wholesale, and 69% in consumer prices at the end of the year. In this period, the ratio of public sector deficit over national income (except for the deficit of public banks) reached 15% by braking record. Turkey living with a chronic inflation for about 30 years saw this situation to be unsustainable. It became inevitable to apply a new economic program to decrease the inflation affecting the economic performance of Turkey seriously, causing great gaps in income distribution and the relations of the nation with the outer world in a negative manner. To achieve this, by preparing a program 17^{th} stand-by agreement was signed to reduce the inflation.

Within the frame of the agreement signed with IMF, the consumer inflation would be reduced to 25% in 2000, 12% in 2001 and 7% at the end of 2002. Besides it was aimed to reduce the non financial interest rates exceeding 50% to reasonable levels and to provide more efficient and just distribution of sources by increasing the growth potential of economy. "Reducing The Inflation Program" announced by Central Bank would be executed on three main elements;

By applying a strict financial policy increasing the remains of interest, achieving structural reforms and fastening the pace of privatization, income policies compatible with inflation targets, rate and money policies focused on reducing the inflation.

Exchange rate policy which would be applied throughout the term was divided into two terms. The first of these was 18 month period covering January 2000 and June 2001. In this first month, rate increase compatible with 20% inflation target in wholesale prices; and in the second 18 month period, gradually expanding band application would be executed. Exchange portfolio application which had been sustained as 1 US dollar+0.77 EURO since the beginning of 1999 would be maintained and Central Bank would announce the rates as portfolio in advance in 2000 in three month periods. Central bank would use exchange market, open market and interbank market operations along with compulsory insurance amount and disponibility rates as main money and rate policy tools. Central Bank set a limit for "Net Internal Assets" which is a main expense for balance. Besides "Net International Reserves" had been limited to minimum level to which reserves could decrease.

Reflection of rate policy on liquidity situation would be fulfilled as Central Bank's purchase of all exchanges in the price Bank has decided in advance, in other words would be fulfilled as giving TL instead of exchange whenever wanted. Creating TL in the markets would only be performed through exchange purchase by Central Bank.

Therefore, with this application expansion in Net Internal Assets would be prevented. To achieve this goal maximum value for Net Internal Asset was fixed to 1200 trillion which was the end of the term value for 1999.

Declaration of the program had a positive effect on markets. Since the beginning of 2000 there had been a faster decline in the interests more than expected. Annual united domestic borrowing interest rates of Treasury which had been 106% on average in 1999 had declined to 37% in January, 2000. While there had been operations in Turkish Republic Central Bank TL Interbank market for about 69, 75-70% overnight, in the second market it was 105-150% overnight; in the first week of January these rates declined to 20-38% and 25-40%.

Rapid decline in interests led to serious problems in struggle with inflation. The decrease in consumer credit interests by banks, led to an increase in consumption demands which were delayed due to high interests. The sources gathered by banks had been diverted into rapid consumption finance. With the revival in the markets there had been fewer declines in inflation than expected.

Demand for the luxurious goods especially automobiles led to a boom in import and contemporary operations deficit in the middle of the term got greater. Contemporary operations deficit which had been 1,3 billion dollars in1999, reached out to 9,8 billion dollars at the ends of 2000.

At the end of October, with vitalization brought by the increase in consumption in domestic markets and import, led to an expansion for about 6,5 – 7 %. The inflation rate declined to %40 from %69. Remain of the interest increased in record. The inflationist suppression created by budget deficits was reduced. Structural regulations were maintained despite the delays. Reforms which could not be achieved for years were at last executed. The re-establishment of banking sector was maintained by "Banking Regulation and Auditing Institution in August. The privatizations performed despite the delays; moreover more income than last 15 years was yielded in this particular year. Except Cari operations deficit there had been no obvious reason for crisis.

In general, banks had the tendency to close open positions for the reasons of closing accounts and adjusting balance. Thus in autumn months there is a rise for exchange demand compared to other months. Besides, foreign investors that operate in stock, convert their yielded income into exchange by going to profit realization in order to close account. For these reasons it is estimated that the exchange demand that rises to the end of the years to be 2 billion dollars.

Because of additional conditions there had been more demand along with the normal in 2000. One of these was the impression that the political authority did not adopt this program adequately. All the responsibility was seemed to be burdened on the shoulders of the Treasury and Central Bank's bureaucrats. Foreign investors changed their positive opinions about Turkey because of progresses in Argentina which applied a similar program to Turkey in this period. The foreign investors that see Turkey more risky compared to first months, started to quit because they refrained from the nation's risk and for this reason the demand for exchange started to increase more than normal.

In the same period regulations about banks started to accelerate suddenly. This led banks to close their open positions earlier. Banks tried to increase their liquidity in order to purchase exchange in these conditions. As the amount of TL was stabilized on markets, demand on liquidity caused an increase in TL interests. This increase in the interests created a distress for the banks that uses treasury bonds for repo operations. The banks that possess huge amount of treasury bond and that had to fund these with market interests began to have losses. Since the rumors that banks in interbank market would be involved in TMSF constitution had risen banks lowered or abolished the limit of cooperation. Operations in the market began to be performed between few great banks. Private banks preferred to sell money with high interest to public banks which were consistent buyer from the markets and which they consider as less risky. Small or middle scaled banks were less affected from this situation.

The positive performance of the program in the first half the year and trust environment provided accelerated capital entry from abroad both treasury and private sector originated. While in the first nine months of 1999 there had been a net entry of 1.7 billion dollars, this amount reached

6 billion dollars in the same period of 2000. In the long term capital movements, while the quit of exchange was 500 million dollars in the first nine months of 1999, there was an entry of 3 billion dollars in the same period of 2000. The credits provided by banks was 1.5 billion dollars whereas was an entry of 3 billion dollars in the same period of 2000. As a result of these official reserves increased 2.9 billion dollars. The exchange entry in the markets increased TL liquidity. Some banks opened exchange positions as they could and besides they invested on long-term TL actives (Treasury bonds, state bills) by borrowing short-term TL. Interest risk of banks that have no protection measurement against changes in interest rates has risen significantly compared to previous years.

In November, foreign investors and foreign investment funds that have Turkish bills in their portfolios were disturbed by recent progresses accelerated their quit from the country by selling their present treasury bonds in their hands. The risks of the banks that had a large amount of treasury bonds and that used these to finance them with over-night repo operations has increased significantly due to rise in the interests. Because of speculative rumors these banks which could not find funds from both internal and external markets had difficulties.

Overnight repo interests reached to 250% on 22nd November which is named the Black Wednesday. The stock decreased to 10.033 score with a loss of 12 %. Central Bank sold exchange of 1.5 billion dollars. Also CB gave 380 trillion TL to market with repo bidding. Despite Central Bank which did not want any distractions from “Net Internal Assets” targets resisted for giving additional liquidity had to provide additional liquidity to market by having a loss of 1,5 quadrillions.

Crisis continued after November and on the 4th, December interests reached to record level. Overnight interests reached to 2000%. Stock market had a stunning decrease and closed in 7329 points. With the agreement done with IMF 7,5 billion dollar provided additional reserves eased the market a little. However, Cıngıllıoğlu Group’s who had great amount of public bills and who was affected from the crisis severely Demirbank was confiscated. Besides, banking permission of Park Yatırım Bank was terminated. Central Bank had to sell exchange of 6 billion dollars.

Generally November crisis was interpreted to be a liquidity crisis by economists. The delay of governments on reforms and its negative effects on market expectations was said to be the reason for crisis. Some economists suggested that crisis was inevitable result of IMF program based on state controlled exchange.

IMF Vice President Stanley Fisher emphasized that there had been a attack to exchange crisis as a result of panic derived from current deficit expansion created by exchange rate peg and suggested that giving liquidity to markets would make the crisis greater instead of solving it. Some foreign economists claimed that the true reason for the crisis was the banks in bad condition. No matter how November crisis seems to be calmed down, the unrest it created on markets would lead to a worse crisis in the second month of 2001. Yet to write the history of 2001 crisis, it is compulsory to wait for it to end.

CONCLUSION

Turkish Republic faces the gravest economical and political crisis since its foundation. After 80s, an artificial expansion was experienced with economical policies encouraging hot money motives. There had been no significant investment on production and we observe an expansion in banking sector whose primary objective is to create sources for non-financial sector. The banking system which transferred the hot money coming from abroad by the attraction of high reel interest and high speculative funds to Turkey; basically started to finance the state which got under effect of short-term loan. Stock market, by getting rid of its functions such as providing fund for the companies and diverting savings to economy, started to work like a casino. It is quite normal that banking and finance sector which is accustomed to live with inflation and speculative funds and which have no links left with non financial economy is quite vulnerable to crisis. Thus this sector which had an artificial growth with the recent crises started to fade like a balloon.

In the last twenty years, the sources borrowed from aboard are the highest in Turkish history yet national income demonstrated the slightest development rate. The sources provided from abroad were mostly spent to consumption, a portion of them were spent to substructure works such as highway. So to say these could not be spent on production. Nation turned to become a trade nation by abandoning its aim to be an industrial nation. The facilities of 500 great companies which have great influence on Turkish economy were built between 1960 and 1980. No large-capacity investments have been done since then.

Turkey now stands in the crossroads. Now, it is impossible to achieve a growth with artificial expansions. It is vital to apply expansion strategies based on production. Otherwise we would face crisis in time. It is observed that programmers prepared by foreign organizations serving their profits did not help Turkey's problems to be solved any. The thing to do from now on is applying an expansion program supported by every section of the society and in a certain plan and targets based on Nation's facts. To execute such a program there is a need for reliable political authority. Turkey needs serious structural changes in fields like education, policy and bureaucracy along with economy. If these are not fulfilled, 21st century will be wasted and lost century.

Crisis which emerged in the middle of July, 2007 from USA and spread all over the world led to a decline of 4.6 trillion dollars in top 31 stock markets of the world. The crisis showed its greatest effect on banking and finance sectors. Turkish banking and finance sectors which are not affected from the crisis yet are highly trusted. In crisis in November, 2000 and economical crisis in 2001, 21 banks were confiscated by Savings Accounts Insurance Fund. (TMSF) Following these crisis and shrinkage in sector, Turkish banks who have accelerated their growth rate had a stronger stance against crises.

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IMPACT OF INTERNET FINANCIAL REPORTING ON EMERGING MARKETS

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ABSTRACT

Application of information technology to gain a competitive advantage is well known and often used by business firms in developed countries. A fairly recent technological development is use of the Internet to provide corporate financial information, that is, Internet financial reporting. The research question posited by this study is: Do investors value emerging market firms that attempt to reduce information asymmetry by using information technology? This study uses the efficient market hypothesis to test the effects of two economic events on the market returns of emerging markets firms that engage in Internet financial reporting. At the macro-economic level, the event date is defined as the date the country deregulated the telecommunications industry granting commercial access to Internet providers. At the micro-economic level, the event date is based on the firm's announcement of the launching of its website. This study offers empirical evidence of the longitudinal effects of Internet technology i.e., timely dissemination of financial information, on emerging markets. The analysis reveals positive dispersions in market price and volume around the event dates. Market performance of securities listed on emerging market stock exchanges does improve after commercialization of the Internet.

INTRODUCTION

The use of information technology for competitive advantage is well known and often applied by business firms. Using stock data for firms listed on the emerging market stock exchanges in Brazil, India, Indonesia, Russia, and South Africa, this study provides empirical evidence as to the positive dispersions in price and volume regarding the economic event of investments in the Internet. We show that in spite of operating in highly volatile capital markets, some emerging market firms attempt to distinguish themselves in the 1990s by investing in Internet technology. Our study contributes to prior disclosure literature by providing evidence regarding the integrity and speed of adjustment (efficiency) of emerging markets to the new (value relevant) qualitative information that is released electronically by public firms.

Internet financial reporting refers to the use of a company's website to distribute information about the financial performance of the corporations. Use of Internet financial reporting is effectually a method of marketing a company to shareholders and investors (Poon et al. 2003). According to Wagenhofer (2003), Internet financial reporting has at least two major economic effects. First, the Internet alters information processing costs and with it the demand and supply of financial information in capital markets. Second, Internet financial reporting creates a demand for standardization; this led to development of XBRL (Wagenhofer 2003).

Brown and Warner (1980) state that event studies provide a direct test of market efficiency; their assumptions are that the event will be either reflected in traded asset prices or in trading volume, if the corporate news announcement is deemed value-relevant to their investors. The authors that a major concern in event studies is that they tend to assess the extent to which security prices perform around the time of the economic event as abnormal. They also state that nonzero abnormal security returns that persist after a particular type of event are inconsistent with the efficient market hypothesis that security prices adjust quickly in order to fully reflect new information (Brown and Warner 1980).

In this study, we analyze two economic events to assess the impact of information technology in Brazil, India, Indonesia, Russia, and South Africa. The first event regards the effect of the Internet at the macro-economic level. The purpose of the first event analysis is to measure the total market response to the introduction of a new communications medium that resulted from reforms made to the telecommunications sector. The second event regards use of the Internet at the micro-economic level. The purpose of the second event analysis is to measure the market performance of those firms that have invested in the new technology. The firms with websites send a strong signal to the government of their endorsement of the privatization initiative.

This study uses valuation methodologies from prior literature to measure security price performances relative to the two event dates, i.e. the Mean Returns, the Market, and the Market Adjusted Returns models (Megginson 1997; Brown and Warner 1980). Each methodology was applied to publicly listed firms in Brazil, India, Indonesia, Russia, and South Africa that commercialized the Internet and announced the existence of their websites during the sampling period of 1991 to 2001. These five securities markets are, arguably, the most important and volatile emerging markets in the world and are often clustered into the same market indices by virtue of their systematic risks (Posner 1998; International Finance Corporation Annuals 1992-1999; Standard & Poor's Emerging Market Factbook (S&P EMF) 2000).

This study proceeds as follows. The next section briefly describes the research environment. Following this section, the research questions are formulated based on the conceptual model of the Internet as a reporting medium. Next, the theoretical development of the hypotheses is presented, followed by a section on the research methodology. Results are then described. The final section presents the conclusions and the limitations of the study, and suggests opportunities for future research.

RESEARCH ENVIRONMENT

The key objective of this event study is to determine whether any value enhancing benefits accrue for those emerging market firms that invest in Internet technology. Bhattacharya et al. (2000) state that event studies are used to measure the impact of an economic phenomenon on firm value. The economic event that motivates this study is the liberalization of the telecommunications sector in Brazil, India, Indonesia, Russia, and South Africa. In the 1990s, Brazil, India, Indonesia, Russia, and South Africa issued equity of $1 billion or more and BARRA rated these markets as highly volatile (Posner 1998). The research question posits whether investors attach any incremental value to consistent and accurate electronic disclosure by website firms in their attempt to alleviate some of the uncertainty attributed to investments in highly speculative markets. If the website is perceived as value enhancing by global investors, then the expectation is a positive response in abnormal returns.

Financial reporting issues, such as information integrity, associated with traditional paper reporting are equally relevant when companies use their website for reporting. Companies around the globe are making increased use of Internet financial reporting (Khlifi 2007, Pervan 2006, Oyelere et al. 2003, CTM 2003). Research has examined determinants of Internet financial reporting and how management might implement controls to ensure Internet financial reporting integrity (DiNapoli 2007, Khlifi 2007, Debreceny et al. 2002, PKF 2002).

Ismail et al. (2007) identify potential problems associated with Internet financial reporting. These problems are particularly troublesome if reporting objectives are not well designed, if the data is improperly formatted, if the system is flawed, and if the users are unable to use the data. They conclude that companies should carefully plan before implementing Internet financial reporting (Ismail et al. 2007). Bonson and Escobar (2006) examine how the European Union (EU) has developed a series of norms with the objective of increasing the transparency of both companies and the financial markets via distribution of company information on the Internet. Their study focuses on how incorporation of countries of Eastern Europe into the EU affects the transparency of the markets.

Once financial information is available on the Internet, it can be used in myriad ways, from traditional analyses to state-of-the-art. For example, Bovee et al. (2005) describe the development and applications of Financial Reporting and Auditing Agent with Net Knowledge (FRAANK). FRAANK is used to assimilate accounting numbers with other financial information publicly available on the Internet and calculates key financial ratios and other financial-analysis indicators. Coupland (2006) offers an analysis of Internet-based financial and corporate social responsibility (CSR) reports, and raises questions regarding prominence given CSR issues due to physical positioning or language used.

EMERGING MARKETS

The term "emerging market" implies a stock market that is in transition, increasing in size, activity, or level of sophistication (International Finance Corporation Annuals (IFC) 1992-1999; Standard & Poor's Emerging Market Factbook (S&P EMF) 1999-2000). A stock market is classified as emerging if it is located in a low or middle-income economy, as defined by the World Bank, and its *"investable"* market capitalization is low relative to its most recent Gross National Product per capita (S&P EMF 2000). In the Standard & Poor's Emerging Market Database, the first test of a stock's "investability" is determining whether the market is open to foreign institutions. Standard & Poor's determine the extent to which foreigners can buy and sell shares on local exchanges and repatriate capital, capital gains, and dividend income without undue constraint. Standard & Poor's also examines company statutes that could for impose limits on foreign ownership that may be more restrictive than national law.

Table 1 shows that the sample countries have created an enabling environment for investments in the Internet. Column 3 in Table 1 shows that South Africa was ranked 17th in terms of total market capitalization in 1997, demonstrating a drastic decline in total market capitalization from its 1st place ranking in 1990. Brazil experienced a similar decline in market rank in total market capitalization to 18th in 1997 from its prior 3rd place rank in 1990. The volatility in market capitalization was attributed to some extent to such macroeconomic factors as inflation and currency devaluation that were impeding the operating performance of some of the listed firms. For India, Indonesia, and Russia, Column 4 reports Gross National Product per capita as systematically below that of Brazil and South Africa during most of the 1990s.

The conclusions reached in this study concerning Brazil, India, Indonesia, Russia, and South Africa could be generalized to other emerging markets in Africa, Asia, Eastern Europe, and Latin America with similar characteristics such as low liquidity and restrictions on foreign investors.

THE INTERNET IN EMERGING MARKETS

This event study looks for a positive market response to the introduction of the new electronic stimulus. The assumption is that any firm disseminating its information electronically to its investors has already altered its assets structure by making substantial investments in information technology (IT). The Internet represents a tangible benefit from those IT investments, with electronic reporting made available as the main communication process.

The Internet is not the sole catalyst that will propel these five countries in this study into the global market. In this study, it is the communications medium that is leading to a reduction in information asymmetry in securities markets, which are characterized by low liquidity. Each of the markets in this study is already in some stage of Internet development, but none have achieved the level of Internet penetration experienced in the United States.

TABLE I
Investment Restrictions and Investor Information by Country Chronological Time Series 1990-2000

TIME PERIOD	COUNTRY	MARKET RANKING	GNP PER CAPITA $	MARKET BARRIERS TO ENTRY AND EXIT: RESTRICTIONS ON FOREIGN INVESTORS	REPATRIATION OF INCOME	REPATRIATION OF CAPITAL	WITHHOLDING TAX: INTEREST	DIVIDENDS	LONG TERM CAPITAL GAINS	QUALITY OF INFORMATION: INVESTOR (h) PROTECTION	ACCOUNTING STANDARDS
1990-1991	Brazil	3	2,810	None	None	None	15%	15%	15%	Good	Adequate
	India	10	310	Authorized Investors	Some	Some	10%	10%	10%	Good	Good
	Indonesia	11	680	Some	Some	Some	20%	20%	20%	Adequate	Poor
	Russia	n.a.	2,820	Closed	Closed	Closed	32%	32%	n.a.	Poor	Poor
	South Africa	1	2,830	None	None	None	0%	15%	0%	Good	Good
1992-1994	Brazil	15	3,020	None	None	None	15%	15%	0%	Good/69.9	Adequate
	India	22	290	Authorized Investors	None	None	20%	20%	20%	Adequate/28.0	Adequate
	Indonesia	27	730	Some	Some	Some	15%	15%	15%	Adequate/63.4	Poor
	Russia	35	2,350	Closed	Closed	Closed	32%	32%	32%	Poor/n.a.	Poor
	South Africa	11	2,900	None	None	None	0%	15%	0%	Adequate/n.a.	Good
1995-1996	Brazil	17	3,640	None	None	None	15%	0%	0%	68.5	Adequate
	India	20	340	Authorized Investors	None	None	20%	20%	10%	16.8	Adequate
	Indonesia	25	980	Some	Some	Some	20%	20%	1%	56.3	Poor
	Russia	33	2,240	None	None	None	15%	15%	20%	n.a.	Poor
	South Africa	16	3,160	None	None	None	0%	0%	0%	22.4	Good
1997-1998	Brazil	18	4,790	None	None	None	15%	0%	0%	69.7	Adequate
	India	21	370	Authorized Investors	None	None	20%	20%	10%	47.3	Adequate
	Indonesia	38	1,110	Some	Some	Some	20%	20%	0%	63.5	Poor
	Russia	36	2,680	None	None	None	0%	10%	n.a.	n.a.	Poor
	South Africa	17	3,210	None	None	None	0%	0%	0%	47.4	Good
1999-2000	Brazil	19	4,630	None	None	None	15%	0%	0%	64.0	Adequate
	India	23	440	Authorized Investors	None	None	20%	20%	10%	43.6	Adequate
	Indonesia	33	640	Some	Some	Some	20%	20%	0%	58.6	Poor
	Russia	29	2,260	None	None	None	0%	10%	n.a.	n.a.	Poor
	South Africa	18	3,310	None	None	None	0%	0%	0%	25.5	Good

Notes:
a. None = Foreign investors have free entry and exit privileges to purchase stocks.
b. Some = Foreigners are required to register with the Central Bank to ensure repatriation rights.
c. Foreigners approved by the Central Bank may buy stocks.
d. Closed = Closed to foreign investors. e. Good = International acceptable quality. f. Adequate = Local market quality.
g. Poor = Require reform. h. Operational Risk Benchmark = IFC quantified the data -100 points scale.

If the emerging stock markets are truly efficient as defined by Fama (1970), then firms that voluntarily develop websites send a costly signal to investors that future reporting will be timelier than in the past and, if that signal is deemed credible, the market should respond. The prediction is that both local and global stock markets will reward those emerging market stock companies that engage in electronic reporting over their non-website competitors, because website firms are attempting to reduce information asymmetry between investors and themselves with the expectation of monetary rewards.

THEORETICAL DEVELOPMENT OF THE HYPOTHESES

Prior disclosure literature shows that the quality of supplemental voluntary printed disclosures is associated with a lower cost of capital for manufacturing firms in the United States (Botosan 1997). Table 2 reports the results from prior studies, on the impact of the Internet as a reporting medium various countries which suggest that investors prefer timely and accurate financial information that is electronically disseminated, over printed material for decision making (Ashbaugh et al. 1999; Deller et al. 1999; Financial Accounting Standards Board [FASB] 2000; Marston and Leow 1998; and Westarp et al. 1998).

Table 2: Internet Financial Reporting Studies

STUDY	PUBLICATION DATE	RESEARCH FOCUS	GEOGRAPHICAL REGION	RESEARCH FINDINGS
Financial Accounting Standards Board (FASB)	2000	Financial disclosure on the Internet	United States	Financial reporting on web by U.S. firms around 1997. Legal hazards of excerpted financial data, hyperlinks, and transcriptions.
International Accounting Standards Board (IASB) (Lymer, Debrecency, Gray, and Rahman)	1999	Annual financial on the Internet	Australia, Brazil, Canada, France, Japan, Norway, South Africa, United Kingdom, and United States,	22 countries, U.S. and U.K. dominate 660 sample firms, 86% of firms have websites, and information content of website.
Ashbaugh, Johnstone, and Warfield	1999	Financial information contained on website	United States	Investors valued timely disseminated accurate information by website firms

Table 2: Internet Financial Reporting Studies				
STUDY	PUBLICATION DATE	RESEARCH FOCUS	GEOGRAPHICAL REGION	RESEARCH FINDINGS
Deller, Stubenrath, and Weber	1999	World wide web, shareholder structure, and network effects	United States, United Kingdom, and Germany	Financial disclosure is more prevalent in the United States where the Internet is pervasive and private investors dominate the stock market
Marston and Leow	1998	Firm characteristics and electronic disclosure	United Kingdom	Firm size and financial services sector had significant impact on quality of electronic disclosure
Westarp, Ordelheid, Stubenrath, Bukman, and Konig	1998	Internet disclosure and GAAP	United States, United Kingdom, and Germany	Selective electronic disclosure

A study by Lymer et al. (1999) of 660 companies from 22 countries shows that 62% of the firms had websites that disclosed financial information. Driven by the market demand for more business information, Lymer et al.'s (1999) descriptive statistics show that more than 70% of the listed firms in Canada, Germany, Sweden, the U.K. and the U.S. use the Web and 52% of the firms in Chile have websites. Lymer et al.'s (1999) study provides evidence that publicly traded firms are using the Internet to disclose relevant information about their operations to foreign investors and creditors. However, prior literature has not examined the impact of electronic reporting on firm value. We predict that emerging market firms with websites will continue to incur the incremental costs of voluntary electronic disclosure as long as they are signaling value-relevant information to investors and creditors.

The current study posits that the market response to a company announcing that it is establishing a website could be empirically measured ex-post by examining daily abnormal returns using a short-event window. This study suggests that if the magnitude of the residuals from abnormal returns surrounding the event window exceeds that which occurs during the non-event estimation period, then the market has assigned some incremental value to that information. This incremental value serves as the incentive that motivates managers to establish a website. Our prediction is that the incremental value of this signal should be more apparent in emerging market firms with ownership structures that exhibit greater information asymmetry than comparable firms in developed markets.

The efficient market hypothesis (EMH) is one of the theoretical axioms supporting prior disclosure literature that forms the basis for this study (Fama et al.1969; Fama 1970). The EMH posits that stock markets react to new (value relevant) information that is disclosed by public companies through variations in either the stock price, or in trading volume. Prior literature has analyzed abnormal performance indices for publicly traded firms in developed countries, providing evidence of a spike in abnormal returns during the event window of announced earnings (Ball and Brown 1968). The EMH leads to the premise for Hypothesis One, which examines the overall market response to the release of new information by the government that it has allowed the telecommunications sector to permit commercialization of the Internet:

H1: The market performance of securities listed on emerging market stock exchanges is higher in the post-event period following commercialization of the Internet.

This study also questions if any value-enhancing benefits accrue for the emerging market stock companies that voluntary engage in electronic disclosure. For example, does the Internet matter for those firms with concentrated ownership structures that are also listed on emerging market exchanges? In addition, do market incentives exist which motivate manages of these firms to take action to reduce information asymmetry between their firms and external stakeholders? If so, is the Internet the reporting medium being used to communicate the manager's response (acceptance) of the market incentive? Alternatively, are these managers merely mimicking the behavior of listed firms on stock exchanges in developed nations? Prior literature shows that the benefits of voluntary management forecast disclosure increase when private information exists (Baginski et al. 2002).

Our prediction is a positive reaction to corporate news of a website, a non-financial market event, because global investors and creditors value manager's efforts to reduce information asymmetry in the market. This suggests that we are specifically testing for a non-zero or positive abnormal returns during the event period, implying that the market participants value the information. Brown and Warner (1980) state that positive abnormal returns signal a good news response to the economic event as opposed to negative abnormal performance or bad news. If the economic event results in an unconditional abnormal performance equal to zero, then the null hypothesis of no abnormal sample security returns is realized (Brown and Warner 1980). For the study, the prediction of a good news response to the micro-economic event leads to Hypothesis Two:

H2: The market responds positively to emerging market firms that announce the launching of a website.

RESEARCH METHODOLOGY

Research methodology includes two sections. The first reports on the analysis of the country level event, using monthly mean differences. The second reports on the analysis of the firm level event, using daily abnormal returns.

MONTHLY MEAN DIFFERENCES TEST – COUNTRY LEVEL EVENT

To test the first hypothesis, the Wilcoxon Signed Rank test, a non-parametric test rank order statistical test measuring the volatility of means returns, was calculated and is presented in a format following a methodology proposed by Bhattacharya et al. (2000) and Corrado (1989). A two-tailed test at the 5% percent level was used to rank the order of the absolute value of equal and value weighted returns for each firm (i) (Bhattacharya et al. 2000 and Corrado 1989). Table 3 presents the monthly event periods (-36, + 36 months, -24, + 24 months, and -12, +12 months) for phase 1 of the study. The mean differences in returns are examined relative to the null hypothesis for each firm (i) in specific country (c).

Table 3: Longitudinal Event Time Line (1991 - 2001)

ANALYSIS	DATA LEVEL	ECONOMIC EVENT& PREDICTION	RETURNS ESTIMATION INTERVAL	EVENT WINDOWS	EVENT PERIOD
Phase 1	Country	Commercialization	Monthly	(-36,+36 months)	1991-1997
	specific	of the Internet	Returns	(-24, +24 months)	
		Hypothesis One		(-12, +12 months)	
		Positive differences			
Phase 2	Firm	Launch of Website	Daily	(-10, +10 days)	1998-2001
	specific	and Investor Relations	Abnormal	(-15, +15 days)	
		Hypothesis Two	Returns		
		Positive differences			

To reject the null hypothesis, the differences in mean returns during the pre-and post-event windows should not equal zero. The one-tailed test at the 2.5% percent level examines Hypothesis One, indicating that the magnitude of the parameter should be significantly higher in the post-event periods. For this study, the Wilcoxon Signed-Rank test is used because it is more analogous to the parametric Correlated or Related sample t-test; it takes into account the magnitude as well as the direction of the difference for each pair.

The z test statistics are as follows, for each firm (i) in country (c) for event period (t):

$$z = \frac{T - \mu_T}{\sigma_T}$$ Formula (1)

where $$\mu_T = \frac{n_1(n_1 + n_2 + 1)}{2}$$

and the standard deviation (σ_T) is calculated below for the entire event period

$$\sigma_T^{\ 2} = \frac{n_1 n_2 (n_1 + n_2 + 1)}{12}$$

The rejection regions for specified levels of α are:

Reject H_0 if $z \neq z_{\alpha/2}$, for $\alpha = 0.050$
Reject H_1 if $z < z_{\alpha}$, for $\alpha/2 = 0.025$

DAILY ABNORMAL RETURNS – FIRM LEVEL EVENT

In the second phase of the study, two event windows (-10, +10 days and - 15, + 15 days) are used to examine the impact of the Internet on daily returns for those firms listed on the emerging market stock returns in Brazil, India, Indonesia, Russia, and South Africa. A 260-day (-60 to +200) estimation period leading up to these event windows is defined around the corporate news announcements of the Internet launch dates for each firm. The use of a benchmark pre-Internet window allows us to establish a baseline of normal market behavior for these firms following a methodology proposed in other event studies (Brown and Warner 1985). It also allows for the use of these sample firms as their own control group, since it has proven difficult for us to obtain data on a matched group of emerging market non-web firms. The post-Internet period is defined as the event window after the corporate news announcement of the launch date for the website.

We propose Abnormal Returns (ϵ_{ict}) as the performance measure of the market valuation models, as opposed to Botosan's (1997) cost of capital, as the variable of interest because stock returns (R_{ict}) for firm (i) in country (c) at time (t) serve as an independent measure of the market's response to the event. Prior literature shows that when an event occurs whose impact may be highly significant to the welfare of the firms, there should be an economic reaction by the market (Fama 1970). The performance measures show that any deviations from the expected return are interpreted as Abnormal Returns (ϵ_{ict}). The expectation is that Abnormal Returns should equal zero ($E\ (\epsilon_{ict}) =$ 0) and provide evidence of an efficient market (Brown and Warner 1980).

The Market Model ($R_{ict} = a_{ict} + B_{ict}R_{mct} + \epsilon_{ict}$) and the Market Adjusted Returns Model ($R_{ict} = R_{fct} + [R_{mct} - R_{fct}]B_{ict} + \epsilon_{ict}$) are used to calculate the Cumulative Abnormal Average Residuals effect ($CAR_{ict} = CAR_{ict-1} + AAR_{ict}$) on the stock returns for those emerging market firms in the pre-Internet and post-Internet periods following the methodology proposed by Brown and Warner (1980).

Brown and Warner (1980) suggest that one could also use the Cumulative Abnormal Average Residual method to investigate abnormal performance when there is incomplete information about the event date. This method is appropriate for this study since the event date is defined as a random variable. The method calculates the Cumulative Abnormal Average Residuals in the pre-event window (CAR_{ict-1}) plus the current value of the Average Residuals (AAR_{ict}) in order to determine if they are systematically different from zero.

The decision by firm management to establish a website signal that the firm is trying to distinguish itself from non-website firms is examined in Hypothesis Two. Under the signaling hypothesis, this event should have informational value and affect security prices (Beaver 1998). To the extent that the firm's investment in information technology results in the electronic disclosure of financial statements, the economic consequences of the investment action should positively alter stock prices, as reflected in the residual error terms of the post-Internet period. Formulae for this analysis are shown below:

$R_{ict} = \quad a_{ict} + B_{ict}R_{mct} + \epsilon_{ict}$	Formula (2)
$R_{ict} = \quad R_{fct} + [R_{mct} - R_{fct}]B_{ict} + \epsilon_{ict}$	Formula (3)
$\epsilon_{ict} = \qquad - E(R_{ict} \mid \rule{1em}{0.4pt})$	Formula (4)
$E\ (\epsilon_{ict}) = \qquad 0$	Formula (5)
$CAR_{ict} = CAR_{ict-1} + AAR_{ict}$	Formula (6)
$E\ (CAR_{ict}) = \quad 0$	Formula (7)

The rejection regions for specified levels of α are:

Reject H_0 if $z \neq z_{\text{ب}/2}$, for BOL97\f"Symbol"\s12 = 0.050
Reject H_2 if $z < z_{\text{ب}}$, for $\alpha/2 = 0.025$

SAMPLE DATA

The country level data on the telecommunications industry, Internet, and stock market statistics for Brazil, India, Indonesia, Russia, and South Africa were obtained from the International Telecommunications Union Annuals (ITU 1994-2002) and the Emerging Stock Markets Factbook

(IFC 1992-1999). The first phase of the study examines the effects of commercialization of the Internet in emerging markets. The sampling period for this analysis was from 1991 to 1997. This phase of the study provides empirical evidence that an enabling information technology infrastructure exists in Brazil, India, Indonesia, Russia, and South Africa, which is necessary to support investments in web technology at the firm level. The event date (MMYY) is the Internet access day for each country (ITU Annuals 1994-2002). Monthly returns are used to measure the market performance in the pre-Internet and post-Internet periods. The event estimation windows for this analysis are (-36, +36 months), (-24, + 24 months), and (-12, +12 months).

Table 4 reports some descriptive statistics on the stock exchanges in Brazil, India, Indonesia, Russia, and South Africa using mean market data for the pre-Internet and post-Internet periods. The data represents the total number of firms listed in each country during the pre- and post- event periods. The results are reported in U.S. dollars reflecting ESMF foreign currency, devaluation, and inflationary adjustments.

Table 4: Market Performance Statistics of Listed Firms
Mean Monthly Market Data (U.S. $)
Sampling Period 1991 to 1997

PANEL A – Pre-Internet Period																					
			t -36							**t -24**							**t -12**				
COUNTRY	Total Firms	Market Capital.	Value Traded	Days Traded	S.D.	Turn-	S.D.	Total Firms	Market Capitalization	Value Traded	Days	S.D.•	Turn	S.D.	Total Firms	Market Capitalli	Value Traded	Days	S.D.	Turn	S.D.
Brazil	573	31,753.2	768.5	20.0	1.00	2.8	1.14	569	55,072.7	1,891.5	20.6	0.92	3.7	0.56	556	74,959.8	3,317.4	20.5	1.25	5.0	1.12
India	2,590	66,169.3	2,129.0	15.8	3.44	3.7	2.06	2,828	66,533.7	1,313.3	18.3	2.22	2.0	0.58	3,475	104,331.7	2,424.4	18.4	3.20	2.6	1.04
Indonesia	139	7,955.1	260.4	20.7	1.97	3.3	0.79	153	12,423.4	394.9	20.4	1.16	3.2	1.34	170	25,802.4	957.4	20.4	1.38	3.8	0.81
Russia	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
South Africa	-	-	-	-	-	-	-	683	103,536.6	341.1	21.0		0.0		664	134,885.6	822.6	21.2	1.34	0.6	0.12
PANEL B: Post-Internet Period																					
			t +12							**t +24**							**t +36**				
Brazil	542	151,194.0	8,396.7	20.5	1.25	5.8	1.30	543	152,329.2	6,487.8	20.4	1.35	4.3	0.51	548	191,720.8	9,757.8	20.8	1.29	5.2	0.80
India	4,671	135,616.0	1,760.9	19.2	1.95	1.3	0.47	5,549	144,955.9	6,477.1	19.9	1.93	4.4	2.70	5,898	138,162.8	11,163.8	19.8	1.75	8.0	2.13
Indonesia	209	44,058.1	943.1	20.6	1.24	2.2	0.51	234	65,331.0	1,767.6	20.6	1.93	2.7	0.46	252	87,847.7	3,314.5	20.6	1.78	3.8	0.64
Russia	-	-	-	-	-	-	-	100	15,632.5	143.9	20.0	1.87	0.8	0.64	97	53,867.7	560.7	20.8	1.30	1.1	0.35
South Africa	637	189,828.3	1,261.7	20.8	1.96	0.7	0.16	642	249,180.9	1,557.4	20.8	1.54	0.6	0.11	633	256,168.5	2,250.0	20.9	1.38	0.9	0.11

Notes:

a. Data source - Emerging Stock Markets Factbook and Standard & Poor Emerging Markets Database.
b. Country Internet Access Dates - Brazil Jan 94, India Aug 94, Indonesia May 94, Russia Jun 94, and South Africa Jan 94.
c. Russia - Information available Jun 96, t+24 represents 5 months data, t+36 represents 12 months data.
d. South Africa - Information available Dec 92, t+24 represents 1 month data, thereafter 12 months data.
* + Market Capital. = Market Capitalization; Turn = turnover ratio; **SD = standard Deviation; ***Days = days traded;

Over the entire pre-and post-event periods, the mean level of market liquidity appears to have been more stable in Brazil, at an average turnover ratio of 4.5x, relative to India, Indonesia, Russia, and South Africa. Although a late comer to the investment indices, the mean market capitalization has been consistently higher in South Africa in comparison to the other countries, from a low of \$103.5 million in the pre-Internet period (*t-24*) for the 683 listings, to more than doubling in the post-Internet period (*t+24*) to \$249.2 million for a mean number of 642 listed stocks. The stock exchanges in India report the largest increase in new, small firm listings based on a mean market capitalization of \$138.2 million for 5,898 firms in the post-Internet period (t+36), from an initial level of \$66.2 million for 2,590 listings in the pre-Internet period (t-36). Although Russia's stock exchange is rather embryonic, the turnover ratio at 1.1x in the post-Internet period (*t+36*) outperformed South Africa's market.

Firm level data were obtained from the Emerging Stock Markets Factbook (IFC 1992-1999), the Global Researcher Worldscope (Global 2006), and Standard and Poor's Emerging Markets (Standard and Pooor's 2000) databases. The second phase of the event study measures the impact of the web on the market performance of listed firms. Eventus Software was used for the second phase of this study. The sampling period was from 1998 to 2001. The event date (DDMMYY) was obtained using an electronic survey and the Global database. This date represents the date that knowledge of the firm 's website was either announced by the firm or disclosed by a third party intermediary (Global). The event windows for testing Hypothesis Two are (-10, +10 days) and (-15, +15 days).

RESULTS

Results include two parts. The first concerns commercialization of the Internet in emerging markets. The second involves impact of corporate websites on emerging markets.

COMMERCIALIZATION OF THE INTERNET IN EMERGING MARKETS

Panel A of Table 5 reports the results from using equally weighted stock returns to test mean differences in the event periods. There are 11,992 firm-month observations in the portfolio. The z-statistics are significantly positive for India, Indonesia, and South Africa in the event window (*t+12*) – (*t-12*), leading to a rejection of the null hypothesis of equal means. Thus, Hypothesis 1 is accepted that the market performance of securities listed on emerging market stock exchanges is higher in the post-event period following commercialization of the Internet, with regard to India, Indonesia, and South Africa. For example, regarding India, the z-statistics are significantly positive in the pre-Internet period *(t-12) - (t-24)* which persists for 2 years through to the post-Internet period *(t+24) - (t+12)*, most likely due to the significant increase in the number of firms trading in India during these periods. An analysis of value weighted mean returns yielded the same results as the analysis of equal weighted mean returns.

Table 5: Test of Mean Differences in Price and Volume Mean Monthly Returns and Trading Volume (U.s. $)

COUNTRY	Internet Access Date	Total Firms	PRE - INTERNET PERIOD			POST - INTERNET PERIOD			MEAN DIFFERENCES IN EVENT PERIODS z- statistics				
			t -36	t -24	t -12	*t +12*	*t +24*	*t +36*	*(t-24) - (t-36)*	*(t-12) - (t-24)*	*(t+12) - (t-12)*	*(t+24) - (t+12)*	*(t+36) - (t+24)*
Panel a - Equal Weighted Mean Returns													
Brazil	Jan-94	55	2.571	1.057	2.437	2.732	2.319	1.365	2.307**	0.644	0.366	6.357**	4.688**
India	Aug-94	45	1.044	0.990	1.051	0.964	0.983	0.993	3.753**	7.930**	11.367**	2.426**	0.116
Indonesia	May-94	23	0.970	0.999	1.025	0.975	1.001	0.998	2.565**	1.208	3.688**	2.689**	0.258
Russia	Jun-94	25	-	-	-	-	-	1.072	-	-	-	-	-
South Africa	Jan-94	59	-	-	1.061	1.013	1.034	0.971	-	-	4.924**	1.808	12.140**
Panel B - Mean Trading Volume													
Brazil	Jan-94	55	733.925	795.238	1,505.471	1,367.904	1,699.092	1,891.581	5.453**	8.552**	4.403**	0.623	2.463**
India	Aug-94	45	1.280	1.009	1.634	0.753	2.745	8.819	5.727**	7.330**	14.763**	6.882**	11.736**
Indonesia	May-94	23	2.392	3.958	6.528	7.014	11.453	18.289	3.665**	6.666**	0.777	6.118**	4.017**
Russia	Jun-94	25	-	-	-	-	-	38.250	-	-	-	-	-
South Africa	Jan-94	59	-	-	1.451	2.432	2.236	3.395	-	-	8.010**	3.922**	13.533**

Note: z- statistics based on the Wilcoxon Signed Rank Test at two-tailed significance levels 0.05** or less for the mean differences in event periods.

The mean differences in trading volume are reported in Panel B of Table 5. The volume differences are significantly positive at the 0.05 level on the event date *(t+12) - (t-12)* for Brazil, India, and South Africa, leading to a rejection of the null hypothesis. Thus, the analysis of mean trading volume corroborates the analysis of mean returns.

THE IMPACT OF CORPORATE WEBSITES ON EMERGING MARKETS

Table 6 reports the results from using the Market Model to calculate Daily Abnormal Returns in the event period. The same results were obtained, but not shown in the table, from the Market Adjusted Returns Model. The t-statistics are significantly positive at the 0.05 level, rejecting the null hypothesis that the residual error term is equal to zero. Thus, Hypothesis 2 is accepted that the market responds positively to emerging market firms that announce the launching of a website. As expected, positive abnormal returns are realized at the 0.025 significance level (for $\alpha = 0.05/2$), signaling a good news market response to the corporate news announcement of the launch of a website.

Table 6: Market Model Daily Abnormal Returns Composite Firm Level Data					
Panel A: n = 151					
DATE	AVERAGE ABNORMAL RETURN	MEDIAN ABNORMAL RETURN	*t-statistics*	POSITIVE: NEGATIVE	SIGN TEST *z-statistics*
Window -15					
-14	*-0.05*	*0.00*	*-0.09*	*76:75*	*0.65*
-13	*0.04*	*0.01*	*0.07*	*77:74*	*0.82*
-12	*-0.37*	*-0.10*	*-0.71*	*71:80*	*-0.16*
-11	*0.48*	*0.03*	*0.91*	*77:74*	*0.82*
Window -10	*0.21*	*-0.20*	*0.40*	*68:83*	*-0.65*
-9	*0.06*	*-0.15*	*0.11*	*67:84*	*-0.81*
-8	*0.16*	*-0.01*	*0.31*	*75:76*	*0.49*
-7	*-0.01*	*0.01*	*-0.03*	*79:72*	*1.14*
-6	*-0.49*	*-0.50*	*-0.93*	*57:94*	*-2.44****
-5	*-0.09*	*-0.26*	*-0.17*	*62:89*	*-1.63**
-4	*0.46*	*0.14*	*0.88*	*78:73*	*0.98*
-3	*0.05*	*-0.04*	*0.10*	*72:79*	*0.00*
-2	*0.61*	*0.15*	*1.16*	*81:70*	*1.47**
-1	*0.68*	*0.15*	*1.28**	*82:69*	*1.63**
Event Day 0	*1.02*	*-0.17*	*1.94***	*69:82*	*-0.49*
+1	*-0.03*	*-0.26*	*-0.06*	*65:86*	*-1.14*
+2	*-0.64*	*-0.29*	*-1.22*	*68:83*	*-0.65*
+3	*0.35*	*0.30*	*0.66*	*86:65*	*2.28***
+4	*-0.32*	*-0.18*	*-0.61*	*73:78*	*0.17*
+5	*0.21*	*-0.13*	*0.40*	*74:77*	*0.33*
+6	*0.69*	*0.27*	*1.32**	*82:69*	*1.63**
+7	*-0.29*	*-0.16*	*-0.55*	*70:81*	*-0.32*
+8	*0.12*	*0.02*	*0.23*	*80:71*	*1.31**
+9	*0.27*	*-0.06*	*0.52*	*70:81*	*-0.32*

Table 6: Market Model Daily Abnormal Returns Composite Firm Level Data					
Window +10	*-0.05*	*-0.07*	*-0.10*	*70:81*	*-0.32*
+11	*0.66*	*0.15*	*1.25*	*82:69*	*1.63**
+12	*1.42*	*-0.04*	*2.70****	*73:78*	*0.17*
+13	*0.91*	*0.06*	*1.73***	*79:72*	*1.14*
+14	*1.22*	*-0.10*	*2.31***	*72:79*	*0.00*
Window +15	*0.86*	*0.11*	*1.63**	*84:67*	*1.96***
Panel B: n = 151					
EVENT WINDOWS	*CUMULATIVE* AVERAGE ABNORMAL RETURNS	*MEDIAN* CUMULATIVE ABNORMAL RETURNS	*t-statistics*	*POSITIVE:* NEGATIVE	SIGN TEST *z-statistics*
(-10,+10)	*2.98*	*2.88*	*1.23*	*89:62*	*2.77****
(-15,+15)	*8.58*	*4.00*	*2.92****	*87:64*	*2.45****

Notes:
*a. Significance levels 0.01***, 0.05**, and 0.10*; b. Abnormal Returns used value-weighted index;*
c. Sign test based on one-tailed test.

In Table 7, the Market Model method is used to report the t-statistics on the sample data that has been disaggregated by country. The t-statistics are significantly positive for Indonesia and South Africa in each of the event windows (-10, +10 days) and (-15, +15 days), a strong indication of a good news market response to the economic event. This suggests that for listed firms in Indonesia and South Africa, a significant market response resulted from the Web announcement. The t-value for India in the event window (-15, +15 days) is positive and significant supporting a lag in the market response to the news event.

Hypothesis 2 that predicts positive returns in the post-event window is rejected for Brazil and Russia in both event periods due to their significantly negative results. The magnitude of the t-values show a general trend of declining levels of significant negative abnormal returns being realized in each subsequent event window for Brazil and Russia. However, since the cut-off date for this study is set at 31 days, further analysis beyond that period could conflict with other confounding market events.

In Brazil and Russia, the residual error terms were significantly negative throughout the event periods, thus causing a rejection of the second null hypothesis. One of the factors contributing to this negative reaction may be that many of the websites in Brazil and Russia only display information in Portuguese and Russian, respectively. The language obstacles create some difficulties when trying to manipulate these websites.

Table 7: Market Model Daily Abnormal Returns					
COUNTRY	n	EVENT WINDOW	t-value	t statistics	MEAN DIFFERENCES
Brazil	44	(-10,10)	-7.776	0.000***	-0.0013
	44	(-15,15)	-1.790	0.074*	-0.0003
India	42	(-10,10)	-3.579	0.000***	-0.0003
	42	(-15,15)	13.967	0.000***	0.0015
Indonesia	22	(-10,10)	16.467	0.000***	0.0033
	22	(-15,15)	69.060	0.000***	0.2496
Russia	8	(-10,10)	-15.926	0.000***	-0.0076
	8	(-15,15)	-2.404	0.016**	-0.0006
South Africa	35	(-10,10)	17.951	0.000***	0.0015
	35	(-15,15)	12.123	0.000***	0.0013

Notes:
a. One - sample t-test of null hypothesis, test value = 0.
b. Significance levels 0.01***, 0.05**, and 0.10* based on two-tailed test.

In a low liquidity market characterized by high information asymmetry, prior literature predicts a lag in the market response to new information (Bhattacharya et al. 2000). This was true for India, which registered significantly positive abnormal returns in the event window (-15, +15 days). Bhattacharya et al. (2000) also state that an economy may be information inefficient, and that prices may be left with no announcement stimuli against which to respond. The corporate news announcement of an emerging market firm launching a website, a technology induced stimulus, could possibly fit this analogy. In countries where individuals are economically marginalized, use of the Internet as a communications medium may be value-relevant to a subgroup of investors who are attempting to diversify their portfolios.

SUMMARY AND CONCLUSIONS

This study contributes to prior literature on the Internet by providing empirical evidence of the longitudinal effects of the Internet technology on emerging markets. It demonstrates that in markets that suffer from low liquidity, firms that invest in Internet technology are able to use the electronic medium to attract foreign investors, analysts, and creditors who might not have otherwise consider the emerging market securities within their portfolios. As predicted for the first hypothesis, the market performance of securities listed on emerging market stock exchanges is higher in the post-event period following commercialization of the Internet, with regard to India, Indonesia, and South Africa.

Some disparities were observed in the hypothesized effects accruing from a firm launching a website in second phase of the study. As predicted by the second hypothesis, managers of website firms will incur the costs of electronically disclosing private information to potential investors as long as their wealth is increased. The incremental price effect is the pecuniary payoff sought by these managers. The value of the website firms in India, Indonesia, and South Africa appears to be incrementally enhanced due to their investments in Web technology. The magnitude of the price effects was more significant for website firms in Indonesia and South Africa than for those in India. These price dispersions could be driven by such country specific factors as the existence of an extractive iron ore-mining sector in South Africa that attracts more foreign investors' interest than the agricultural sectors in India.

In many ways, this study could serve as a benchmark for future studies on Internet financial reporting that might replicate these phenomena in other emerging markets. The findings from this study could assist analysts seeking new markets for investments in order to balance some of their portfolio's risk. It is also of interest to policymakers because the Internet and website firms show support at the micro-level for a national policy on privatization.

Some caveats to these markets should be considered when reaching these conclusions. They are characterized by low liquidity and business practices suggest that the protection of foreign investors may be minimal. This study shows that there is a lag in the speed of adjustment of these emerging markets to new information. This lag in response cannot be interpreted that these markets are less efficient than developed markets because these markets are bombarded by different macroeconomic factors than those that exist in for example, either the United States or United Kingdom. If these markets are truly inefficient in the theoretical context of the Efficient Market Hypothesis, then well-informed investors could institute a profitable trading strategy. However, this may not be practicable due to limited foreign investments in emerging markets' firms.

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INTERNATIONAL BUSINESS SPECIALIZATIONS OF ACCOUNTING, FINANCE AND MARKETING PROFESSORS, 1994-2003

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ABSTRACT

This study investigates the extent of international business specializations within the teaching and research interests of professors at over 800 U.S. colleges and universities in three disciplines, namely, accounting, finance, and marketing. It is facilitated by focusing on two groups of educators. The first group consists of named/titled professors as per the Hasselback faculty directories for the three disciplines during the academic years 1994-1995, 2000-2001, and 2002-2003. The second group consists of randomly selected instructors in each of the three fields from the three academic years. By and large, no clear upward trends in international business specializations within the teaching and research interests are detected over the study period for either group of professors in any of the three fields. In relative terms, the finance and marketing educators are found to specialize in international areas of their fields far more than the accounting educators. With respect to the teaching and research interests of named finance professors in the international finance area, the evidence shows some unmistakable declining patterns over the study period. Similar declining trends are also observed for the international marketing specializations of the randomly selected marketing professors. The findings do reveal a bright spot in that the teaching and research interests of the randomly selected finance professors in the international finance area peaked in 2002-2003, the latest year covered by the study.

JEL Classifications: M19, M39, M49, G00
Key words: International Business, Business Professors, Teaching and research interests

INTRODUCTION

This paper investigates the teaching and research interests of professors of accounting, finance and marketing at U.S. colleges and universities pertaining to their specializations in multinational business. The stimulus for this study stems from several interconnected factors. First and foremost, the business environment has exhibited strong trends toward globalization in almost every aspect in the last 25 years. The internationalization of financial markets and the resulting 24-hour marketplace for numerous financial assets just serves as one glaring example of business globalization. Even in some fields where one could not have imagined a global market place and therefore, an existence of global competition just 5 years ago, such a possibility has become a reality. The markets for medical care, surgeries as well as post-operative recovery have also now become worldwide. In a newly emerging field called "Medical Tourism," patients from all of over the globe consider India and Thailand, among others, as viable alternatives to many highly developed and well established medical care locations.

Second, according to Kedia, Harveston and Bhagat (2001), "As businesses confront increasing international challenges, the need for developing managers who can understand and effectively meet the demands of the global marketplace becomes critical. While the responsibility of developing such international managers of tomorrow may lie in different sectors of the economy, we suggest that business schools have a special role in inculcating appropriate global mindset, knowledge base, and skills." Indeed, U.S. colleges and universities have accepted the challenge of training their students to enter and embrace the global market arena, and accordingly, more and more schools have created opportunities for students to choose international business as a major or a minor. By June 2005, of the 430 AACSB accredited U.S. schools, 81 were offering undergraduate degrees in international business (IB) and 48 were offering graduate degrees in IB. Third, presently 28 schools have been designated as Centers of International Business Education and Research (CIBERs) (see Scherer, et al., 2003). Fourth, numerous business administration colleges have created centers or institutes or divisions of international/multinational/global business to form alliances with multinational business organizations, or state and local world trade centers, etc. Fifth, the text books used in most required or core courses in business schools began addressing the globalization of business issues in the late 1970s or early 1980s. Now, even the textbooks of the elective courses, such as risk and insurance for example, have started integrating "International Perspectives" in as many chapters as feasible (see Trieschmann, et al., 2005). Given the issues raised above, it is understandable that business and government entities expect U.S. educators to play a vital role in preparing students to function and flourish in a global business environment. If so, one could logically ask the following two questions:

What percentage of business faculty in the U.S. are willing to teach courses in the international areas in their disciplines; and

What percentage of business faculty in the U.S. are willing to conduct research in the international areas of their disciplines.

This study attempts to answer these questions for three business disciplines, namely, accounting, finance, and marketing. We examine the data of three academic years, 1994-1995, 2000-2001, and 2002-2003 to meet the task at hand. To meet these objectives, we investigate the IB specializations within the teaching and research interests of two groups of business faculty. The first group consists of all the named or titled professors, including the endowed professors in each field, during each academic year as per the Hasselback faculty directories. Named professors' teaching and research interests are examined because they are generally the highest ranked academicians, and are considered to be the most renowned, most accomplished and elite educators in their fields. Moreover, one could argue that some of them set the tone and the direction for research in most fields. However, to fully satisfy the goal of this study, we felt that we should also consider the business faculty at large and not just the "experts" of each discipline. Accordingly, the second group is made up of randomly selected instructors from each field, for each of the academic years studied. By utilizing a random selection process, we believe that we are likely to achieve proportions of different academic ranks, different levels of experiences, different levels expertise, and different age groups representing the underlying population of faculty. As a result, we could expect findings to reflect the true levels of IB specializations of professors in each of the three disciplines within the margins of sampling errors.

In the next section, the relevant previous research is briefly reviewed. The methodology and the data underlying this study are discussed in the third section. The findings of the investigation are presented in the fourth section. A brief summary makes up the final section.

PREVIOUS RESEARCH

The body of literature on business globalization and international business education is extremely large and rich as well as diverse. Scores of articles have been published on the subjects such as the internationalization of the business curriculum or even specific courses (see for example, Aggarwal,1989; Beamish,1989; Tung and Miller, 1990; White and Griffith, 1998; Yeoh, 2001; Sanyal, 2004; Zimmer, Koening and Greene, 2004; Laughton, 2005; and Danford, 2006; among others). White and Griffith (1998) compared 21 top U.S. graduate level IB programs with the help of telephone interviews and publicly available secondary data. They also consulted well-known scholars of IB education to ascertain the opportunities available for improving the curriculum of graduate level IB education in the U.S.

The literature search on the subject of IB education within doctoral degree programs identified several published studies in the last 20 years. Nehrt's survey (1987) of 53 largest U.S. doctoral programs found that an overwhelming percentage of doctoral students (85%) were not trained in IB courses. In many respects, Nehrt's disappointment with the progress of internationalization of U.S. doctoral programs was also expressed by Kuhne (1990). Kuhne's survey identified only a handful of doctoral business programs which offered an opportunity to major or minor in IB. In a 1997 volume edited by Cavusgil and Horn on internationalizing doctoral education in business, a survey of doctoral program directors by Myers and Omura was included. Myers and Omura expressed the view that the doctoral faculty did not embrace the challenge of blending international aspects and dimensions of the subjects they were teaching, possibly because of their lack of international expertise. More recently, Webb and Allen (2005) reported the findings of their survey of AACSB accredited doctoral programs. They concluded that "The majority of the doctoral business programs, for the responding schools, have no specific approach to internationalizing the curriculum" (2005).

In a 1994 paper, Kwok, Arpan and Folks presented the findings of their AIB (Academy of International Business) supported global survey to examine the status and trends in the IB education. The survey attempted to answer six sets of crucial questions concerning the internationalization of business education (pp. 607-608). Two of the questions they addressed are relevant to the present study. In one of their inquiries, they were trying to ascertain if different functional areas of business had accomplished different levels of internationalization. In the other, they were attempting to determine the level of IB expertise of business faculty. Various issues examined in their well prepared study and their findings were reported with the help of ten tables. Their findings are of utmost interest to the subject at hand. According to these findings, at all three levels (Bachelor's, Master's and Doctoral) of business degree programs, accounting courses had the least level of IB content infusion and marketing had the highest level of IB infusion. They also the specialized IB courses offered in each business discipline at each of the three degree level programs. Once again, the accounting discipline lagged considerably behind marketing and finance. The authors note that before curriculum internationalization can begin, faculty internationalization needs to take place. In their words, "Quite simply, if the faculty has little interest in knowledge about international business, an internationalized curriculum is not likely to be implemented" (p. 614). The present study is an attempt to extend the work of Kwok, Arpan and Folks (1994). The goal of this study is to measure the level of interest in international business of faculty from three academic departments of business colleges in the 10-year period following the publication of the Kwok, Arpan and Folks paper.

Since the present paper investigates the extent of IB specialization within the teaching and research interests of named professors as well as randomly selected instructors from the three business disciplines, the literature concerning named professors was also reviewed. Of the 3 disciplines, most published papers can be found related to the named professorships in accounting. Studies by Bloom, Fuglister and Meier (1996); Tang and Griffith (1997/1998); and Meier and Kamath (2004) are the recent examples of studies of profiles of and/or trends in named professorships of accounting. Both published studies of named marketing chairs are by Kamath, Meier and Rao, one from 2004 and the other from 2006. In the 2006 paper, they examined the named marketing professorships from the academic years 1994-1995, 1996-1997, 2000-2001 and 2002-2003. With respect to the finance departments, there are two published papers; one by

Metwalli and Tang (2001); and one by Kamath and Meier (2006). In the 2006 paper, Kamath and Meier analyzed the multidimensional characteristics of named professorships in finance in the U.S. from five academic years. Their study examined the characteristic profiles of named professors of finance; the characteristics of colleges and universities which provided the named professorships; and the trends exhibited in those profiles over the study period.

METHODOLOGY

Faculty Guides/Directories compiled by Professor James R. Hasselback were the primary sources of information for this study. For example, to extract the relevant data of 2002-2003, *Prentice Hall 2002-2003 Accounting Faculty Directory, Prentice Hall Finance Faculty Directory 2002-2003*, and *Prentice Hall Marketing Faculty Directory 2002-2003* were used for accounting, finance, and marketing, respectively. As noted earlier, this study examines the international area specializations over three academic years, namely, 1994-1995, 2000-2001, and 2002-2003. For the academic year1994-1995, the marketing and finance guides were published by John Wiley & Sons, Inc.

Each of the nine faculty directories which include information on faculty from over 800 colleges and universities were compiled by information provided by the faculty themselves or by their department chairpersons. These directories include all the information provided by a certain date prior to the academic year covered. For example, only the information received by April 27, 2002 is included in the 2002-2003 marketing directory. This source included faculty members' names, their academic/administrative ranks, schools where they were employed and from when, schools which granted them their highest degrees and when, their highest degrees, their teaching interests, and their research interests, among other information. In case of the named professors, named chairs, or endowed professors, the exact titles of such designations are also provided. The last academic year data examined in this investigation is 2002-2003 because that is the latest year of publication for the marketing discipline.

For accounting, Hasselback directories include 26 different areas of teaching/research specializations with international accounting being one of the choices. Each participant is allowed to list up to four (4) areas of specializations. In the case of accounting, teaching and research specializations are not separated. Instead, the specializations are combined as "teaching/research interests." For finance and marketing however, the teaching and research interests are separated. For finance, there are seven (7) different areas of teaching interests, including one for international finance. To indicate research specializations, the finance directories offer a total of 28 different areas. Three of these areas concern international finance, namely, international corporate finance, international financial markets, and international investments. Marketing offers nine (9) different choices to convey teaching interests including one titled "international/multinational/global marketing." Of the 28 different research specializations for marketing, three are concerned with international marketing. The three areas are international marketing strategy, international marketing management, and international comparative marketing.

To meet our primary goal of investigating the teaching and research interests of professors at U.S. colleges and universities in the three business disciplines pertaining to multinational business specialization, we examine two groups of professors. First, we investigate the teaching and research interests of named professors in each discipline over the study period. During 2002-2003, we found 526 named professors of accounting, 375 named professors of finance and 195 named professors of marketing as per the Hasselback directories. Moreover, we observed that the named professors in all three fields were primarily senior full professors with an average service of 20-25 years after receiving their highest degrees. Specifically, in 2002-2003, the percent of named chairs that held the rank of full professors were 79 in accounting, 90 in finance, and 88 in marketing.

We firmly believe that one should definitely examine the international business specializations of the most distinguished faculty members of each discipline to gauge the trends in those disciplines. Yet, given the discussion of the previous paragraph, we conjecture that to fully understand the international focus or specializations of instructors in any field, we had to expand our study to include instructors of all ranks, experience levels, ages, etc. in the particular field. Moreover, we surmised that to get unbiased estimates of the extent of international specialization, we had to investigate large random samples of instructors in each field. In accounting, for example, the alphabetically listed individual faculty member information in the 2002-2003 Hasselback directory is covered over 164 pages (pp. 209-372). Each page includes the relevant information on about 68 to 76 individuals. From each page we took a random sample of 4 individuals who teach at U.S. colleges and universities. Thus, our resulting random sample of accounting instructors for 2002-2003 was 656. In effect, our random sample was approximately 1 in 18 of the total population of faculty in each business discipline as per Hasselback guides, for each study year. The randomness of the sample enables us to investigate the teaching and research specializations of instructors of all academic ranks specifically concerning international business. For the three academic years studied, the randomly selected faculty totaled 1,826 from accounting, 917 from finance, and 752 from marketing. The comparable numbers of named professors in this study totaled 1,441 from accounting, 921 from finance, and 496 from marketing.

FINDINGS

Specializations of Named Professors

The findings of this study are presented with the help of 7 tables. We begin with the teaching and research specializations of named professors. The teaching/research specializations of named accounting professors in the U.S. specifically relating to international accounting are contained in Table 1. The tabulations include three academic years, starting in 1994 and ending in 2003. Over this period, the number of named professorships in accounting increased from 443 to 526. However, the number of named professors specializing in international accounting barely increased. The exhibit indicates that the percent of accounting named professors specializing in international accounting has at best remained around seven (7) over the 10-year period.

Table 1. International Specializations of Named Professors of Accounting, 1994-2003

Item	1994-1995		2000-2001		2002-2003	
	Number	% of 433	Number	% of 462	Number	% of 518
Total Named Professors	443	--	472	--	526	--
Professors Expressing their Teaching/Research Interest in International Accounting	31	7.16	32	6.92	35	6.76
Teaching/Research Interest not noted	10	--	10	--	8	--
Teaching/Research Interests noted	433	100	462	100	518	100

One drawback of relying on the Hasselback directories for faculty data is the incidence of missing data, particularly concerning teaching and research interests. The non-response bias of the survey methodology affects the reported information in these guides. In accounting, the data is unreported for a very small percent of the faculty and therefore, our findings are not adversely affected. For example, for the 2002-2003 year, out of 526 named professors, the teaching/research interest data was missing for only eight (8). Yet, we calculate and show the percentages based on 518 since the teaching/research interests were available for 518 as shown in Table 1. For finance and marketing, the number of individuals for whom the relevant data is unreported turns out to be greater.

The international specializations of named professors of finance are shown in Table 2. The upper segment of the table contains the information on teaching specializations in international finance and the bottom segment contains information on the three different research specializations in the area of international finance. While the number of named professors of finance increased by over 60 percent between 1994 and 2002, the number expressing a teaching interest in international finance increased by only 40 percent. Thus, the percentage of named professors with teaching interest in international finance shows a small, yet, a steady and a noticeable drop. It is worth noting that the percent of named professors of finance expressing a teaching interest in international finance in each of the three years of this study are more than double the percent of accounting named professors showing a teaching interest in international accounting.

The trend observed in all three research specializations involving international finance are counter intuitive given the overwhelming shift to globalization of business. For all three sub-areas of international finance, the table shows declining percentages over the period investigated. The entries in the third row from the bottom of Table 2 and of Table 3 should be interpreted with caution. Often, those professors with research interest in one of the three areas noted also express an interest in one or both of the remaining areas. Therefore, in 2002-2003, 61 distinctly different named professors of finance had not indicated research specializations in international finance.

Table 2. International Specializations of Named Professors of Finance, 1994-2003

Item	1994-1995		2000-2001		2002-2003	
	Number	% of 169	Number	% of 247	Number	% of 300
Total Named Professors	234	--	312	--	375	--
Professors Expressing Teaching Interest in International Finance	30	17.75	38	15.38	42	14
Teaching Interests not noted	65	--	65	--	75	--
Teaching Interests noted	169	100	247	100	300	100
	Number	% of 148	Number	% of 215	Number	% of 255
Professors Expressing Research Interest in International Corporate Finance	14	9.46	16	7.44	14	5.49
Professors Expressing Research Interest in International Financial Markets	22	14.86	26	12.09	28	10.98
Professors Expressing Research Interest in International Investments	12	8.11	17	7.91	19	7.45
Total Number of Professors with Research Interests in any of the above three areas	48	32.43	59	27.44	61	23.92
Research Interests not noted	86	--	97	--	120	--
Research Interests noted	148	100	215	100	255	100

Table 3 presents the international specializations of named professors of marketing. Once again, the information on teaching specializations is exhibited in the upper portion of the table. In marketing, there is no evidence of a clear trend with respect to teaching interest in global marketing. On average, about one in nine named professors of marketing had an interest in teaching global marketing. This average percentage of preference for marketing is higher than that expressed by accounting named professors and lower than that expressed by finance named professors. The research interests of marketing named professors in the three international marketing areas also do not exhibit a clear trend over the study period.

Table 3. International Specializations of Named Professors of Marketing, 1994-2003						
Item	1994-1995		2000-2001		2002-2003	
	Number	% of 95	Number	% of 116	Number	% of 144
Total Named Professors	143	--	158	--	195	--
Professors Expressing Teaching Interest in International/ Multinational/Global Marketing	9	9.47	13	11.21	16	11.11
Teaching Interests not noted	48	--	42	--	51	--
Teaching Interests noted	95	100	116	100	144	100
	Number	% of 84	Number	% of 108	Number	% of 136
Professors Expressing Research Interest in International Marketing Strategy	12	14.29	13	12.04	17	12.5
Professors Expressing Research Interest in International Marketing Management	8	9.52	9	8.33	11	8.09
Professors Expressing Research Interest in International Comparative Marketing	1	1.19	4	3.7	6	4.41
Total Number of Professors with Research Interests in any of the above three areas	21	25	26	24.07	34	25
Research Interests not noted	59	--	50	--	59	--
Research Interests noted	84	100	108	100	136	100

The Best and the Brightest

Each year, *Business Week* magazine publishes a report on business schools highlighting its list of the top 30 business schools. In this detailed report, *Business Week* also includes a list of top 10 schools for developing specialized skills, such as, finance skills, marketing skills, global scope, technology and general management. Since the present study has so far focused on international specializations of named professors in three disciplines of business, we now turn our attention to the elite list which *Business Week* describes as the rankings of the schools according to recruiters which turn out the "best and brightest." In this paper, we examine the schools where the named professors of accounting, finance and marketing were employed in 2002-2003 to determine how many of the named professors were at schools which were deemed to be graduating the best of future business men and women with global business credentials as per *Business Week* (2002). Our findings are presented in Table 4. The table reveals that the largest number of named professors at the ten elite schools was in finance, but the largest percentage of named professors at these schools belonged to marketing.

	Table 4. Named Professors at Schools Listed by *Business Week* (2002) which Turn Out the Best and the Brightest in Global Scope 2002-2003			
		Accounting	Finance	Marketing
1	Total Named Professors During the 2002-2003 Academic Year	526	375	195
2	Number of Named Professors at Schools in the *Business Week* Top 10 List	33	71	49
3	2 as a % of 1	6.27%	18.93%	25.13%

Specializations of Randomly Selected Professors

Next, we turn our focus on international specializations of randomly selected samples of professors from three business disciplines. Our findings are summarized in Tables 5, 6, and 7. As explained in the methodology section, the random sample in each discipline is about 1 in 18 full time instructors for each year of study. By and large, the tabulated findings contain the same kind of information presented in Tables 1, 2, and 3 for named professors. The only additional information in Tables 5 through 7 concerns the academic ranks of the randomly selected professors.

In Table 5, the international specializations of randomly selected accounting professors at U.S. schools are reported. The random selection does give rise to a more balanced distribution of different rank professors than the named professor population as evident from the Table 5 data. In all three years, full professors make up less than 30 percent of the sample. The teaching/research interests of the randomly selected professors of accounting are however, not markedly different from those of named professors of accounting. Once again, less than seven (7) percent of these professors had expressed an interest in teaching and/or conducting research in international accounting. While no trend is apparent from the tabulated results, it is clear that the percentage of accounting professors wanting to teach or conduct research in international accounting did not increase over the 10-year study period.

International specializations of randomly selected finance professors are summarized in Table 6. The academic rank distribution of our samples indicates a more balanced pattern. This table shows that about 40 percent of the finance educators were full professors as compared to the 90 percent full professors in the case of the named professors of finance. With respect to the teaching interest in international finance, once again a clear trend cannot be detected. Yet, two important conclusions emerge from a thorough examination of the results. First, the average percentage of randomly selected finance professors expressing a teaching interest in international finance is 15.78 which is almost identical to the average of 15.71 percentage observed for named professors of finance over the study period. Second, our findings for the randomly selected finance professors do not exhibit the clearly noticeable declining trend observed in the teaching interests of named professors of finance regarding international finance.

Table 5. International Specializations of Randomly Selected Sample of Accounting Professors, 1994-2003						
Item	1994-1995		2000-2001		2002-2003	
	Number	% of 558	Number	% of 612	Number	% of 660
Total Professors selected for random sample	558	100	612	100	656	100
Full Professors	150	26.88	179	29.25	194	29.57
Associate Professors	176	31.54	200	32.68	216	32.93
Assistant Professors	156	27.96	170	27.78	166	25.3
Other Rank[a]	76	13.62	63	10.29	80	12.2
Professors Expressing their Teaching/Research Interest in International Accounting	36	6.74	34	5.69	39	
		(% of 534)		(% of 598)		(% of 637)
Teaching/Research Interest not noted	24	--	14	--	23	--
Teaching/Research Interests noted	534	100	598	100	637	100

[a]: Other rank includes instructors, lecturers, senior lecturers, term professors, visiting professors, and visiting scholars.

With respect to the research interests in international finance, our random samples do not exhibit clear patterns. We do not know if the lower percentages obtained in 2000-2001 for both the teaching as well as the research interests are sample specific. What is clear is that the largest percentages reported for teaching interest or for that matter, research interest in any of the three areas of international finance are in the latest year of the study. Moreover, the latest year information on randomly selected professors of finance displays higher percentages than named professors of finance regarding international specializations.

The evidence concerning the international specializations of randomly selected marketing professors is summarized in Table 7. On average, the marketing sample constituencies are 40 percent full professors, 29 percent associate professors and 27.5 percent assistant professors. With respect to the teaching interest in global marketing, an unmistakable downward trend can be detected over the period examined. And yet, the percentages of randomly selected professors of marketing expressing an interest in teaching global marketing are found to be significantly higher than the corresponding percentages for the named professors of marketing. The findings concerning the sampled marketing professors' research interests in the three international marketing subjects do not reveal a clear pattern. The most distinguishing aspect of the findings in Table 7 is that the highest percentages of professors with research interests in all three fields of international marketing are found in the earliest year of the study. Thus, the randomly sampled marketing educators were more inclined to teach international marketing courses as well as engage in research in that area in 1994-1995 than they were in 2002-2003.

Table 6. International Specializations of Randomly Selected Sample of Finance Professors, 1994-2003						
Item	1994-1995		2000-2001		2002-2003	
	Number	% of 254	Number	% of 323	Number	% of 340
Total Random Professors	254	100	323	100	340	100
Full Professors	99	38.98	132	40.87	132	38.52
Associate Professors	73	28.74	88	27.24	99	29.12
Assistant Professors	77	30.32	92	28.48	92	27.06
Other Rank[a]	7	2.76	11	3.41	17	5
Professors Expressing Teaching Interest in International Finance	23	15.44	31	13.96	45	17.93
		(% of 149)		(% of 222)		(% of 251)
Teaching Interests not noted	107	--	101	--	89	--
Teaching Interests noted	149	100	222	100	251	100
	Number	% of 127	Number	% of 189	Number	% of 219
Professors Expressing Research Interest in International Corporate Finance	10	7.87	8	4.23	28	12.79
Professors Expressing Research Interest in International Financial Markets	15	11.81	18	9.52	33	15.07
Professors Expressing Research Interest in International Investments	8	6.3	11	5.82	24	10.96
Total Number of Professors with Research Interests in any of the above three areas	33	25.98	37	19.58	85	38.81
Research Interests not noted	129	--	134	--	121	--
Research Interests noted	127	100	189	100	219	100
[a]: Other rank includes instructors, lecturers, senior lecturers, term professors, visiting professors, and visiting scholars.						

The reported findings answer the set of questions underlying this inquiry. Now we attempt to evaluate whether these findings could be supported by evidence presented by previous studies. The Kwok, Arpan and Folks survey of IB education in the early 1990s noted that the internationalization of business faculty is essential before the curriculum of business schools can be internationalized (1994). They present evidence on the extent of the IB content infusion into the core areas and specialized IB courses offered in each area and clearly pointed out that accounting lagged far behind finance and marketing. For example, they reported that 81 percent of the respondents were offering specialized international functional courses in marketing at the bachelors level. The comparable figures for accounting and finance were 28 percent and 72 percent, respectively. At the doctoral level, the comparable percentages were 65, 25, and 76 for marketing, accounting and finance, respectively. In this respect, our findings concerning the international specializations of both groups of accounting faculty being considerably lower than finance and marketing faculty are consistent. It should also be pointed out that the academic accounting field depends largely on the accounting guidelines and standards as well as corporate, tax and security laws which tend to be nationally based rather than internationally. This might partially help explain why the globalization of business has not impacted the international specializations of accounting faculty.

Table 7. International Specializations of Randomly Selected Sample of Marketing Professors, 1994-2003

Item	1994-1995		2000-2001		2002-2003	
	Number	% of 224	Number	% of 256	Number	% of 272
Total Random Professors	224	100	256	100	272	100
Full Professors	83	37.05	102	39.84	118	43.38
Associate Professors	67	29.91	82	32.03	68	25
Assistant Professors	64	28.57	68	26.57	75	27.57
Other Rank[a]	10	4.47	4	1.56	11	4.05
Professors Expressing Teaching Interest in International/ Multinational/Global Marketing	32	22.07	37	19.07	30	15.08
		(% of 145)		(% of 194)		(% of 199)
Teaching Interests not noted	79	--	62	--	73	--
Teaching Interests noted	145	100	194	100	199	100
	Number	% of 115	Number	% of 178	Number	% of 189
Professors Expressing Research Interest in International Marketing Strategy	23	20	23	12.92	29	15.34
Professors Expressing Research Interest in International Marketing Management	27	23.48	13	7.3	15	7.94
Professors Expressing Research Interest in International Comparative Marketing	11	9.56	12	6.74	7	3.7
Research Interests not noted	109	--	78	--	83	--
Research Interests noted	115	100	178	100	189	100

a: Other rank includes instructors, lecturers, senior lecturers, term professors, visiting professors, and visiting scholars.

Our findings for the marketing named professors do not exhibit any clear trend. However, the findings on randomly selected marketing professors suggest that both the teaching as well as the research interests in international marketing had peaked in 1994-1995. Kwok, Arpan and Folks (1994) report that by the early 1990s, marketing was the discipline "that had the greatest infusion of international material" at all levels of business education. It is plausible that the academic marketing departments began their efforts to internationalize their courses and offerings much before other departments and consequently, reached their intended goals sometime during the 1990s. This conjecture can help explain our findings reported in Tables 3 and 7.

The functional area of finance had not quite achieved what marketing had by the early 1990s in terms of the internationalization (see Kwok, Arpan, and Folks, 1994). However, it is important to note that further integration of global financial markets has continued from the early 1990s to today. Moreover, worldwide crisis of almost any nature often tend to translate into international financial crisis. Such crisis in turn can reshape the research interests of finance faculty to a large extent and teaching interests to a smaller extent.

Finally, since the globalization of business has progressed at a rapid pace over the last 10 to 15 years, one could have expected to witness an upward trend in the international specializations of business faculty. The evidence uncovered in this study is at odds with such an expectation. We believe that the teaching and research interests of university professors are rather fluid and therefore they may not exactly follow business trends. The business trends lead academic research in certain areas of business disciplines but lag in some others. These complexities make it very difficult to predict the directions of teaching and research interests of faculty from one year to another in one specific area.

SUMMARY

The objective of this study was to examine the extent of the international business specializations of accounting, finance, and marketing professors in U.S. colleges and universities within their teaching and research interests. Specifically, this paper presented the findings of an investigation aimed at ascertaining the percentage of business faculty who wanted to either teach or conduct research in the international areas of their disciplines. The primary sources of information were the Hasselback faculty directories for the academic years 1994-1995, 2000-2001, and 2002-2003. For each of the three years, the study focused on two samples of professors. The first sample consisted of all the named professors in each field as per the Hasselback guides. The study included 1,441 accounting, 921 finance, and 496marketing named professors over the three years examined. The second group consisted of randomly selected instructors in each of the three fields. The overall sample sizes of randomly selected instructors were 1,826 from accounting, 917 from finance, and 752 from marketing. These samples represented about 5.55 percent of the faculty populations in the three academic years as per the Hasselback guides.

Even though, the globalization of business has taken place at a rapid pace over the last 10 to 15 years, this investigation did not find evidence of clear upward trends in the international business specializations within teaching and research interests of either group of faculty in any of the three disciplines over the period under consideration. The study revealed that the percentage of accounting faculty, whether named professors or randomly selected professors, with an interest in the international accounting area for teaching or for conducting research remained more or less steady at or below 7 percent. This percentage of accounting faculty wanting to specialize in international accounting was found to be considerably lower than the comparable percentages found for finance as well as marketing. The evidence clearly demonstrates that the named finance professors' interests in both teaching as well as for conducting research in the international finance area declined over the 10- year study period. Comparable declining patterns were also evident in the international marketing specializations of randomly selected marketing professors. In the case of randomly selected finance educators, this study found that their teaching as well as research interests in the international finance area peaked in 2002-2003.

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THE HISTORICAL ROOTS OF CHINESE CULTURAL VALUES AND MANAGERIAL PRACTICES

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ABSTRACT

To understand current Chinese culture and managerial practices requires an appreciation and understanding of important Chinese historical figures and philosophical orientations. Important historical figures such as Confucius and Mencius, Sun Tzu and Sun Pin, Lao Tzu, and others are discussed, along with cultural values such as guanxi, dao, dé, li, and ren. This paper provides insight into the major figures and philosophies which have shaped current Chinese cultural values and provides a deeper understanding of why the Chinese have adopted their unique management style.

INTRODUCTION

China's recent and impressive economic gains have captured the attention of the world. With the world's fastest growing economy and largest population, China is poised to change the landscape of global business. China has become the fourth largest economy in the world in a very short time. This economic gain is driven in part by an impressive expansion of China's manufacturing base and export abilities; both of which are expected to continue to increase in the coming years and to outperform its large competitor, India (Black 2007; Wu 2007; Lee, Rao, and Shephers 2007). With China's economic growth comes an increased need to better understand the strategic thinking of the Chinese. The last few years have seen an increased interest in understanding the business and managerial practices of the Chinese (Quer, Claver & Rienda 2007). In the hope of either capitalizing on China's growth, or being able to defend against its economic threat, many in the West and beyond have taken a much greater interest in China. One area of particular interest is a better understanding of Chinese culture and management system.

In order to truly understand another culture, it is necessary to explore the sources of the values of that culture. A deeper understanding of a culture is achieved when one explores the historical antecedents of the beliefs and values of the people comprising the culture. While much literature is devoted to current business practices and cultural do's and don'ts, this information provides only a superficial understanding and limited ability to work with people in the targeted culture. For example, while it is useful to understand that the Chinese place their family name first and given name second, a deeper understanding and appreciation of the importance of family and collectivist orientation can be gained by examining the sources of those cultural practices. Wong

(2005) has proposed that management researchers have failed to appreciate the importance of history in explaining the management practices of the Chinese. This paper attempts to provide a better understanding of Chinese culture and management practices by exploring the most important historical figures and philosophies of Chinese culture.

Some of the more common characteristics of Chinese management and organization are: centralized control, collectivism, harmony, authoritarian and paternalistic leadership, flexible strategies, family-staffed businesses, and strong organizational networks and business connections. These characteristics are practiced both in China and overseas by the Chinese Diaspora. All of these practices can be traced to important historical figures and schools of thought beginning with the very early rules and philosophers of China.

LAO TZU AND THE SAGE KINGS

Early Chinese civilization saw the rise of great leaders. Two important figures in this early period were the Sage Kings of High Antiquity, Yao, and Shun. In particular, Yao is seen as a model of effective and morally perfect leadership. He is credited with many improvements including the establishment of a calendar useful for the planting of crops and the creation of harmony among the villages. Yao's rule was wise and humanistic. When great floods devastated China, Yao suffered along with his people. He developed a social and political structure that helped to unite the Chinese people. Instead of selecting his son to succeed him, Yao chose Shun, a common man who possessed the virtue necessary to rule a nation. Collectivist concerns were more important to Yao than a lasting family legacy. Yao spent thirty years training Shun how to rule his people, and Shun ruled with virtue. Confucius would later use Yao and Shun as models of leaders who possessed great wisdom. As stated in the *Analects*, or the sayings of Confucius, "How majestic they were - Yao and Shun reigned over the world but did not rule it" (Ames and Rosemont 1998). These historical figures of China are studied for their effective use of wisdom, humanism, and perseverance in the practice of leadership.

Later, in early Chinese history, the mystic, Lao Tzu developed the philosophical and spiritual orientation of Daoism. Lao Tzu proposed that the universe was ruled by the Great Unity, commonly known as Yin and Yang. Yin and Yang do not represent the struggle between good and evil, in fact, both Yin and Yang represent goodness. Evil develops when there is an imbalance between Yin and Yang. A central element of the Daoist belief system is that nature exists in harmony, and mankind should also strive for harmony and balance. The *dao*, or the "way," according to Lao Tzu, was an unexplainable force that maintained balance. Tao Tzu taught that humankind should seek to live in harmony with nature and among themselves. They should strive for balance in their lives and resist doing anything that goes against the *dao*. Tao Tzu and his book, *The Dao de Ching*, have been fundamental in shaping generations of philosophical, political, and religious thinking in China. His influence is particularly significant in the importance of harmony and the maintenance of good relationships among people. The role of the leader is to provide a paternalistic and nurturing environment. The mystical figure, Lao Tzu, was a profound believer in the inherent goodness of humankind and promoted the benefits of harmonious personal relationships.

CONFUCIUS AND MENCIUS

It can be argued that the greatest influence on Chinese culture and managerial practices, however, can be traced to Confucius and his value system that emphasized the importance of hard work, loyalty, dedication, learning, and social order. For thousand of years, up until the fall of the imperial system in China in the early 1900's, Chinese school children would raise their hands in respect to Confucius at the start of the school day. The children would recite the saying of Confucius until they were permanently recorded into memory. With the fall of the imperial system of governance in China, Confucian teachings were eliminated; however, the ideals espoused by Confucius never left the Chinese people (Lin and Chi 2007). Recently Confucianism has been reintroduced to the Chinese educational system (McGregor 2007; Mooney 2007; Osnos 2007). Confucian values require that an individual first honor one's duty to family and society. The individual is not seen as important as the group. Individual needs are sacrificed in order that group needs can be realized. Weiming (1998) stresses the point that Confucian values can be very beneficial to maintaining an orderly society. He points out that in Confucian societies each person is viewed as being in the center of a relationship, not simply an isolated individual. Each person has a duty to family and society that supersedes responsibility to oneself. These values helped to shape a managerial mindset that placed a greater emphasis on collectivism, teamwork, family-staffed businesses, and harmony over conflict.

Along with Confucian values, an informal, worldwide networking among the overseas Chinese has helped fuel an explosion of Chinese capitalism. This networking can be seen not only in China, but also in Chinese businesses worldwide. Success for the Chinese is facilitated through *guanxi* or connections (Chatterjee, Pearson, and Nie 2006) and (Zhang and Zhang 2006). These close relationships provide information, contacts, and financing to members of the network. The overseas Chinese have succeeded in their business pursuits because they have been able to maintain unity and solidarity, and have adopted a Confucian work ethic. Many of their businesses, although large and often multinational, are family-based, providing what in Chinese culture is an even stronger unit of support and solidarity. Concern for the welfare and survival of the clan and its members is of paramount importance to the Chinese. As Peter Drucker (1994) stated, "What holds these multinationals together is neither ownership nor legal contract. It is mutual trust and mutual obligations inherent in clan membership." This strong clan orientation is much more successful in maintaining commitment to purpose than any legalistic arrangement could achieve. Confucian principles have been found to not only influence current family-based structures, but to also determine the succession of family businesses (Yan and Sorenson 2006). The strong family orientation created by Confucius is still present today in China and in the businesses of the overseas Chinese.

Another important aspect of Confucianism involves relationships. Termed the *Five Relationships*, appropriate behavior, or *li*, is dictated through Confucian thought in terms of one's relationship with superiors, parents, husband/wife, elders, and friends. Confucius was very concerned with relationships and social propriety. The Confucian term *li* actually refers to ritual. Rituals as manifested not only in terms of appropriate behavior and roles, but also for ceremonies and other social processes. Chinese culture and business practices may sometimes be perceived as long on formality, and over planned and managed by Western standards.

Confucianism remained a dominant social force in Chinese society for two thousand years. Up until the Han Dynasty, the teachings of Confucius were maintained through an informal mechanism that transmitted the wisdom of the sage from generation to generation. With the establishment of the Han Dynasty and its elaborate administrative system, a school was established to train civil servants. The *Analects* became part of the instructional material of this academy, and students were required to pass examinations on Confucianism in order to work in government. This requirement continued, for the most part, up until the fall of the imperial system in China. Confucius is responsible in part for the Chinese love of hierarchy and control, the importance of family relationships and business connections, and the autocratic and paternalistic nature of Chinese leadership.

Confucianism, like any other social construct, is a dynamic concept and will change and evolve over time. The purpose of Confucius' teachings was to create social harmony and prosperity for the people of China. Confucianism is considered more of a philosophy than a religion. Unlike a religion with eternal precepts, Confucianism was not bound to a fixed value system. Confucian principles have also been blended with the doctrines of Legalism and Mohism to influence managerial practice. The Legalist influence can be seen in the importance of self-control, and the Mohist influence can be found in the importance of helping the masses (Cheung and Chan, 2005). Perhaps it was easier for Confucianism to evolve and integrate into a capitalistic economic framework, since it essentially served a more pragmatic purpose than a spiritual one.

Leadership under the Confucian tradition emphasizes a holistic concern for the welfare of employees, a concern for harmony in groups, teamwork, and self-sacrifice. At the same time, Confucian leaders are frugal and demand loyalty and dedication to the organization. They expect employees to work tirelessly for the good of the group, the organization, and the nation. In Confucian cultures, managers are expected to display humanism, or *ren*. *Ren* is sometimes translated as "goodwill" or goodness towards others. Yao and Shun are examples of leaders who possessed *ren*. The Confucian manager is expected to be a good-natured manager and to manage with kindness. The manager is expected to focus on relationship building and to be more cordial. The Confucian manager values dedication, trustworthiness, and loyalty more than performance. Each employee performs to the best of his/her abilities and works for the good of the group. Differences in individual performance are not seen as important as long as the group functions effectively.

Sometimes referred to as the "Second Sage of China," Mencius, based much of his philosophy on the concept of *ren* or humanism. Mencius is believed to have been taught by the grandson of Confucius and helped maintain the Confucian tradition in China. At the time, Confucianism was facing competition from competing philosophies, and Mencius became the leading advocate for maintaining a Confucian society in China. Mencius, or probably his followers, authored *The Book of Mencius*, and this text became one of the Great Four Books of Chinese literature. While Mencius continued the Confucian tradition, he differed somewhat from Confucius in terms of respect for authority and the special emphasis placed on the inherent goodness of humankind. Some debate and reevaluation of the influence of Menicus on Chinese cultural development has taken place (Chan 2002), however, most Chinese scholars feel that Mencius followed the Confucian tradition with a few modifications. Where Confucius gave great deference to rulers, Mencius felt that rulers had to maintain *de*, or virtue, in order to maintain their position of power. Having *de* meant having the power to rule with wisdom, self-sacrifice, and humility. The concept of Mencius, called *Mandate of Heaven*, meant that if the ruler did not perform properly, the people would be morally right in seeking his removal, even through violent means. In China's long history, we find many examples of rebellion and revolution based on the inability of the ruler to properly act. While Chinese management today is properly characterized as authoritarian, the power of the leader is not absolute and managers must maintain de in order to gain the respect of employees.

SUN TZU AND SUN PIN

While Lao Tzu, Confucius, and Mencius spoke of harmony and cooperation, another strong influence on Chinese culture and managerial practice (especially strategic management) was a man of war. Sun Tzu, a Chinese military strategist authored *The Art of War*, or *Bing-fa*. The manuscript is believed to have been written sometime during the fourth century BCE. The ancient text has been studied for generations by military and business leaders in China, and throughout Asia, and provides recommendations on the use of deception, the value of information for decision-making, and the use of spies to gather information. *The Art of War* also discusses the importance of flexibility in strategy formulation and implementation, and the superiority of avoiding battle as a strategic choice. Legend has it that Sun Tzu's manuscript was read by King Ho-lu of Wu, and after a demonstration of his military skills for the king, Sun Tzu became his military advisor and began to establish himself as a great strategist (Ames 1993). It is alleged that even Napoleon used *The Art of War* in his battles against the armies of Europe.

Of particular interest to Sun Tzu was the ability of the leader. Without essential leadership a military campaign was doomed to failure. Without proper leadership, Sun Tzu felt the troops would lack discipline, direction, and a sense of mission. His approach was based primarily on the authority of the leader. Sun Tzu felt that effective leadership required a more directing orientation and a special emphasis on mission indoctrination. One of the frequently mentioned recommendations from Sun Tzu is the use of deception. One gains a competitive advantage by deceiving the enemy into thinking that one is weaker or stronger than one really is in order to confuse the enemy. Closely related to the use of deception is the importance placed on the strategic use of information. Sun Tzu felt that the use of information was essential to gaining victory and could be used to avoid major strategic mistakes. Sun Tzu provided valuable advice to the rulers of early China and the many readers of *The Art of War* over the centuries. Perhaps his major contribution was the importance of strategic thinking, and the use of flexible strategies in order to gain an advantage over an opponent. Westerners are sometimes surprised by the willingness of their Chinese counterparts to use deception and "steal" information in order to gain an advantage. Different cultural values and influences are present in this situation, producing differing perspectives on appropriate behavior. The Chinese saying "the marketplace is a battlefield" is a manifestation of these perceptual differences.

While most references to *The Art of War* refer to that of Sun Tzu, another manuscript with the same title, but by another author, gives us additional insight into early Chinese thought concerning strategic thinking. Sun Pin was born over a century after the death of Sun Tzu and was considered a brilliant student of the military arts. In fact, this exceptional ability produced a jealous rivalry that resulted in Sun Pin (pin meaning kneecap or removal of the kneecap) being mutilated at the knees by a fellow student of military strategy. Even with the extreme disadvantage of being handicapped and unable to mount a horse, Sun Pin rose to prominence and became military advisor to King Wei (Lau and Ames 1996). There is considerable overlap between the two manuscripts, however, they differ in a number of ways. In looking at the additional material found in Sun Pin's *Art of War*, we can conclude that the requirements of leadership are more broadly defined. The effective leader according to Sun Pin will need to be considerate of followers and tend to their needs. A more interpersonal approach to leadership is recommended, along with a more charismatic, or at least, likable nature. A good leader will view followers as valuable assets and seek to maintain their loyalty. The effective leader should be a person of good character and moral development. Sun Pin ties his recommendations to the yin/yang concept, and seeks balance. Strategic decisions should be based on seeking balance against opposing forces. A consistent driving force in any one direction runs contrary to his recommendations. Strategy is viewed as a more flexible and fluid concept. Long-term planning with a linear focus will be seen as too vulnerable to outside forces and should be avoided. Sun Pin places a greater emphasis on the value of human assets and thus the importance of good human resource management. Maintaining internal harmony and morale are seen as essential to effective organizational functioning. Balancing the skills and abilities of the workforce is seen as being superior to maintaining consistency in personnel qualities. And in terms of strategic attacks on established positions, Sun Pin provides recommendations that encourage, or at least do not discourage, going after larger competitors. Rather than avoiding stronger competition, Sun Pin recommends finding and exploiting weaknesses. Sun Tzu and Sun Pin have shaped the mindset of the Chinese as they view their relationship with competitors. To understand Chinese strategic thinking requires examining the writings of these ancient military men.

CONCLUSION

As China continues its movement towards a capitalistic economy it will be doing so under the influence of the great thinkers from China's past. The Chinese approach to economic change, pioneered by Deng Xiaoping has been one of long-term thinking and gradual movement towards capitalism, with attention paid to the losers of economic reform (Carew 2007). This approach is consistent with a collectivist society and one that has been guided by concerns for harmony with authoritarian rule. Likewise, the managerial practices of present day China are influenced by the ideas of China's early rulers, philosophers, and military strategists whose teachings are embedded in the Chinese psyche. As China becomes increasingly important to the global economy, it becomes increasingly important to understand the mindset of the Chinese. To gain a deeper understanding of Chinese culture and its business practices, one must become familiar with the timeless classics of Chinese literature.

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DO PARTNERS' DIFFERENCES AFFECT INTERNATIONAL JOINT VENTURE CONTROL AND PERFORMANCE?

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ABSTRACT

The paper examines the influence of differences between partners on the control of international joint ventures (IJVs) and its subsequent performance performance. The term "partners' differences" here refers to their perceptions of differences in cultures, objectives when entering IJVs, and partners' business relatedness to their IJVs. IJV control is conceptualized across three dimensions including mechanism, focus, and extent. The empirical evidence is based on a survey of Finnish which established firms having established IJVs with local firms in the 1990s. The results showed that the higher the level of the partners' perceived differences with their local counterparts were, the more likely they were to exercise formal, broad, and tight control over their IJVs. The results also indicate that in the case of major differences between partners, formal, broad and tight control by foreign partners lead to better IJV performance. In the case of lower level differences between partners, social, narrow, and loose control by foreign partners lead to better IJV performance.

INTRODUCTION

International joint ventures (IJVs) are formed between firms with different organizational and cultural characteristics (Duan, 2007). Problems occur in IJVs due to the difficulties in managing them caused by the presence of two or more partners (Inkpen & Beamish, 1997). In particular, conflicts between partners are caused by the differences between partners such as the incompatible management styles and approaches, and cultures (Killing, 1983). Differences between partners often increase the risk of misunderstanding and cooperation failures (Child & Yan, 2003). Thus, IJVs are notoriously difficult to control (Yan & Child, 2004). While previous research has not provided evidence directly explaining how parent firms make control structure choices (Groot & Merchan, 2000), it has suggested some possible determinant factors (Geringer & Hebert, 1989; Blodgett, 1991a; Werner, 2002) such as culture (Hennart & Larimo, 1998), and their motives (Calantone & Zhao, 2001). Chang and Taylor (1999), who studied the control exercised by 107 American and Japanese Multinationals (MNCs) over their subsidiaries in Korea, found that national culture was one of the key influence on the choice of control mechanisms. Child et al. (2005: 224) maintain that *foreign parent firms' cultures may well be expressed in the modes of their control in IJVs* However, previous research on the effect of cultural preference on management control is decidedly mixed (Chalos & O'Connor, 1998). Several researchers found no significant relationship between national culture and management controls (Chow, Shields, & Chan, 1991; Frucot & Shearon, 1991; Chow, Kato, & Shields, 1994; Merchant, Chow, & Wu, 1995). In contrast, other researchers proposed that there were significant interactions between national cultural dimensions and management controls (Harrison, 1993; Harrison, McKinnon, Panchapakesan & Leung, 1994; Lau, Low, & Eggleton, 1995; O'Connor, 1995). This is something of a puzzle and it has been suggested that, further research is needed to investigate the effects of cultural differences on IJVs (Pothukuchi et al., 2002).

Furthermore, partners are from different countries and therefore, often have different goals when they enter into IJVs. Luo and Park (2004) suggested that the incongruent goals of partners lead to reduced IJV performance. The existing research does not show how firms can handle the differences in partner's goals in joint venturing to stimulate an increase in IJV performance. Another potential factor that might influence IJV control and performance is the extent of business relatedness between partners and to the IJVs, which has received considerable attention in IJV research. Some studies have focused on relatedness between parent firms (Saxton, 1997), while others have focused on relatedness between partners and the units (Hanvanich et al., 2005). However, the results of business relatedness on IJV performance are thus far undetermined (Hanvanich et al., 2005). Moreover, previous studies have ignored the role of the relatedness on the IJV control. As such, there is a need to further investigate the factors that might influence IJV control and performance in the context of cultural differences, differences in motive, and business relatedness. This paper, therefore, attempts to fill this gap.

This paper aims to further analyze the influence of foreign partners' differences on their control of IJV and on the IJVs' performance. The general research question is ***"How do partners' differences influence IJV control and performance?"*** Expressed in more detail, the paper's aim is to answer the questions:

1. *How do partners' perceptions of differences in management style, joint venturing objectives, and business relatedness affect the control they exercise in IJVs?*
2. *What are the relationships between partners' differences, IJV control, and IJV performance?*

This paper departs from existing work in two ways. First, while most previous researchers have focused on only one or two dimensions of control in their IJV research, in this paper, the IJV control adopted is broader than usual in taking into consideration three dimensions of IJV control: mechanisms, focus, and extent. Second, much previous research has focused on differences in IJVs and how these differences affect IJV performance. Taking one step further, this paper points out how a parent company can cope with the differences through its control strategies, leading to better IJV performance. In this paper, an *IJV* is regarded as a separate firm formed by two or more partners with an expected proportional share of dividend as compensation (Contractor & Lorange, 1988). *Partner's differences* refer to the differences in businesses (e.g. Merchant & Schendel, 2000), objectives of entering to the joint ventures (e.g. Harrigan, 1985), and the partner's management style (e.g. Kogut & Singh, 1988). *IJV control* refers to the influence of foreign partners on IJV operation (Geringer &Herbert, 1983). *IJV performance* is the achievement of goals set by parent firms and is evaluated from a different perspective (Duan & Chuanmin, 2007). Moreover, Beamish and Delios (1997) concluded from their review that perceptual and objective measures of IJV performance are generally correlated. In the present study, *perceptual measures* such as parent satisfaction with the IJV, total performance and financial performance are used to in investigate the performance of IJVs. The paper is organized as follows; first it conceptualizes the IJV control along three dimensions including control mechanism, focus, and extent. Then, it develops several hypotheses regarding the influence of partners' differences on IJV control structure and IJV performance. Next, the paper discusses the methodology used, the results, and the implications of the study.

CONCEPTUALIZATION OF IJV CONTROL

Management control refers to the process by which an organization influences its members and its units to work in ways that meet the organizational objectives (Glaister, 1995). In IJV, because there are two or more parties involved, management control is complex (Geringer & Hebert, 1989). Furthermore, researchers have acknowledged that the control systems are multidimensional (Berrell, 2007; Kumar & Seth, 1998; Lu & Hebert, 2005). Unfortunately, the existing research tends to focus on only one or two dimensions. In order to be able to capture the complex nature of the IJV and conduct IJV control research thoroughly, this study adopts the multidimensional approach of control developed by Geringer and Hebert (1989).

Control mechanisms

Control mechanisms are structural arrangements deployed to determine and influence what the members of the organization do (Geringer &Hebert, 1989; Fryxell, Dooley, & Vryza, 2002). Control mechanisms consist of a variety of instruments including formal and social controls that are available to firms for the exercise of effective control over their members (Friedman & Beguin, 1971). *Formal control* depends on hierarchies, standards, codified rules, procedures, goals, and regulations that specify desirable patterns of behavior (Das & Teng, 1998). These instruments of formal control are usually agreed upon and imposed by both foreign and local parent firms (Fryxell et al., 2002) and typically include control over the constitution of the board of directors, the appointment of key personnel, the planning and approval process for capital budgeting and resource allocation, and the lay down procedures and routines for IJV (Lu & Hebert, 2005; Mjoen, 1993).

Social control is designed to promote expectations and mutual commitments through which IJV managers learn to share the common attitudes and knowledge of the organization (Nonaka & Takeuchi, 1995). Social control refers to various mechanisms such as informal communication, information exchange and training, mentoring, and personal relationships. Social control develops a common organizational culture that fosters shared values and norms, without explicitly restricting the behavior of the targeted people through the means of those social controls (Chalos & O'Connor, 1998; Fryxell et al., 2002; Schaan, 1983).

Control focus

Control focus can be divided into broad control and narrow control (Geringer & Herbert, 1989). In control focus, the partners can choose to have a *broad control* focus and attempt to exercise control over the entire range of the IJV's activities, or they can have a *narrow control* focus and confine their control activities to the performance dimensions they consider to be critical (Geringer & Hebert, 1989; Groot & Merchant, 2000). Child et al. (2005) maintain that depending on several factors, such as the parent firm's competencies and the critical nature of such activities parent firms may focus their control on activities related to technology in one case but on market related activities in another. There are also cases when the parent firms may focus their control on both technology and market related activities (Child et al., 2005). The areas of control focus are marketing, sales and distribution, procurement, general management and operation, finance and accounting, research and development, production and quality, and human resources.

Control extent

The control extent refers to the degree or tightness of control which is exercised on the venture (Geringer & Hebert, 1989). Control extent consists of tight control and loose control. In *loose control*, the parent firms tend to use only one or two control mechanisms and focus their control exercised on only one or two control areas in the IJVs. Furthermore, the parent firms are more flexible in their evaluation of employees' behavior and their performance. The frequency of report submission by the IJV managers to the parent firms is low and there are very few meetings between the parent firms and the IJV managers. In contrast, the *tight control* mode tends to be strict with respect to the employee's dress code, punctuality, and cost-consciousness; and also detail oriented, and precise in operation. Tight control can be effected through any mechanism that provides the partner with a high degree of certainty that the personnel in the IJV will act as the given partner wishes. Tight control is manifest also if the IJV staff is held strictly accountable for adhering to a complete set of prescribed actions such as policies and procedure. Tight control is also related to very frequent and precise reporting (Child et al., 2005).

In summary, IJV control consists of three dimensions mechanisms (Formal; Social), focus (Broad, Narrow), and extent (Tight, Loose). These three control dimensions produce eight possible control structures, namely Formal, Broad, Tight (FBT), Formal, Broad, Loose (FBL), Formal Narrow, Tight (FNT), Formal, Narrow, Loose (FNL), Social, Broad, Tight (SBT), Social, Narrow, Tight (SNT), Social Broad, Loose (SBL), Social, Narrow, Loose (SNL).

PARTNERS' DIFFERENCES AND IJV CONTROL AND PERFORMANCE

Partners coming to joint venturing differ in their businesses, the objectives they have in mind when forming the IJV, and in their management styles. IJVs usually experience management difficulties when partners who come from different backgrounds work together (Wang et al., 1999). Thus, establishing control over the IJVs becomes crucial for IJV operations and therefore, has a direct effect on IJV performance.

Management style

Foreign and local parent firms differ in their management styles, which may result in conflict and incompatible goals (Ding 1997, Hennart, Kim, and Zeng, 1998; Yan & Gray, 2001). This is because the more diverse the organizational cultures of the partners are, the greater the differences in their organizational and administrative practices, employee expectations, and interpretation of and response to strategic issues (Kogut & Singh, 1988). This may lead to bargaining and negotiating between foreign and local parent firms, which slows down the decision-making process and adds to bureaucratic costs (Balakrishnan & Koza, 1993; Ding, 1997). In the case of organizational cultural differences, foreign and local partners are also different in routines (Hennart et al. 1998) and in dealing with conflicts over issues of product quality, exports, employee wages, or labor policy. These may result in higher uncertainty, the possibility of opportunism, and higher bureaucratic costs as a result of greater bargaining ad negotiating between partners (Ding 1997, Pangarkar & Klein, 2004). To eliminate the problems arising from long negotiation processes and delays in decision-making, foreign partners may need to exercise broad and tight control over the IJVs. In addition, to avoid misunderstanding in the IJVs, partners are required to establish clear hierarchical control by creating formal control over the IJVs. According to Egelhoff (1984), the greater the organizational cultural distance between foreign and local parent firms, the greater the need to exercise formal control over the IJVs. As a result, it can be expected that:

Hypothesis 1: *The greater the management orientation differences between foreign and local partners, the more likely foreign partners are to exercise broad, formal, and tight control over the IJVs.*

Objectives of entering into IJVs

Partners from different firms might have different objective when entering IJVs. According to Harrigan, (1985), partner firms form IJVs to generate internal benefits, competitive benefits, and strategic benefits.

TABLE 1. Selected empirical studies on IJV published in 1995-2008

Author	Sample Size	*IJV* Location	Industrial Type	*IJV* Establishment Time	Data Collection	Concept of Control	Area of Focus
Glaister (1995)	94	UK	C-S	1980	Survey	Mechanism, extent, focus	Different degree of IJV control between partners, IJV autonomy
Hébert (1996)	70	Canada	C-S	Since 1988	Survey	Extent of control	Control, trust, conflict
Dianne (1997)	3	East Europe	M	1991	Interview & Survey	Scope, extent, mechanism	Local culture and foreign control
Mjoen & Tallman (1997)	102	C-N	C-S	Not provided	Survey	Specific activity control	Strategic resources, equity, control and performance
Kumar & Seth (1998)	64	US	M	Prior to 1992	Survey	Control mechanism	Strategic interdependence, environmental uncertainty, and control
Ramaswamy, Gomes, Veliyath (1998)	83	India	M	Prior to 1982	Survey	Ownership control	Optimum range of control and performance
Wang et al. (1998)	132	China	C-S	1991-1993	Survey	Control mechanism	Relationship between control and performance
Child & Yan (1999)	67	China	M	Not provided	Survey	Strategic and operational control	Resource provision, appointments control
Gulati & Westphal (1999)	218	US	C-S	Not provided	Survey	Board control	Cooperative and control
Lyles et al.(2000)	73	Vietnam	C-S	Around 1992	Survey	Social and formal control	Trust, knowledge acquisition, control and performance
Guidice (2001)	750	US	C-S	Prior to 1999	Survey	Board of director, staffing, socialization	Experience, strategy, control
Luo, Shenkar, & Nyaw (2001)	295	China	M	Not provided	Survey	Specific and overall control	Relationship between dual parent control and IJV performance
Yan & Gray (2001)	90	China	M	1981-1991	Survey	Strategic and operational control	The effect of parent control on IJVs
Fryxell et al. (2002)	129	US	C-S	Not provided	Survey	Formal and social control	IJV age, trust, and control
Johnson et al. (2002)	51	North America	M	Not provided	Survey	Decision control	Fairness, commitment, and control

TABLE 1. Selected empirical studies on IJV published in 1995-2008							
Author	Sample Size	*IJV* Location	Industrial Type	*IJV* Establishment Time	Data Collection	Concept of Control	Area of Focus
Li (2003)	215	China	M	Around 1994	Survey	Decision control	Ownership, control and performance
Mohr (2003)	110	China	C-S	Not provided	Survey	The extent of control	Trust and control
Chalos & O´Conor (2004)	117	China	C-S	Not provided	Survey	Control mechanism	Determinant factors of control
Choi & Beamish (2004)	71	Korea	M	1986-1996	Survey	Split, share, dominant control	Relationship between control and performance
Pangarkar & Klein (2004)	76	C-N	C-S	Prior to 1996	Survey	Strategic control	Relationship between control and performance
Barden et al. (2005)	12	Vietnam	C-S	1988-1996	Interview & Survey	Operational control	Control and conflict
Buckley et al. (2005)	20	UK	C-S	Not provided	Interview & Survey	Control mechanism, focus, and extent	Different control mechanisms used in IJVs
Lu & Hébert (2005)	720	C-N	C-S	1985-1993	Secondary sources	Ownership control	Initial conditions, control, and performance
Duan & Chuanmin (2007)	3	China	C-S	1982-1986	Interview & Survey	Ownershio, control mechanisms, strategic operations	Relationship between control and performance
Whitelock & Yang (2007)	61	C-N	C-S	Around 1997	Survey	Strategic operations	Parent control, objectives, IJV performance
Riccio (2008)	234	Brazil	C-S	1973-2004	Interviews and Secondary data	Not applicable	Country risk, national cultural differences, and IJV survival
Kwon (2008)	94	Korea	C-S	Not provided	Survey	Social exchange	Trust, commitment, parent´s satisfaction
C-N: Cross Nations		M: Manufacturing		C-S: Cross Section			

From the local government perspective, IJVs are often a means to protect local firms and to foster the development of the local economy and industry (Makino, 1995). Previous researchers suggest that the objectives of parent firms determine their adoption of control mechanisms in IJVs (e.g. Calantone & Zhao, 2001). Gaining management control over an IJV is one way to ensure that one's strategic objectives are actively pursued, and to actively monitor and curb possible opportunism by one's partner (Williamson, 1975). When the differences between partners are great, these often result in conflictual behavior between partners, leading to misunderstandings and interaction problems (Pothukuchi et al., 2002). Killing (1983) proposed that IJVs work most effectively when they avoid the coordination costs of shared management. Coordination costs often occur when there is a constant need for communication, shared decision-making and ongoing negotiations (Gulati & Singh, 1998, Barden et al., 2005). These are often time consuming and reduce IJV performance. Thus, when foreign and local partners' objectives are different, foreign partners need to impose broad and tight control over their IJVs. In addition, as partners' expectations are different, precise guides to the procedures and operations of the IJVs are needed, leading to the exercise of formal control by the foreign partners. As a result, it can be expected that

Hypothesis 2: *The greater the differences in objectives between foreign and local partners, the more likely foreign partners are to exercise broad, formal, and tight control over the IJVs.*

The partners' business relatedness

The partners' business relatedness is a measure of how similar or connected are the business activities in nature of the partners relative to those performed by the IJVs (Merchant & Schendel, 2000). Firms are involved in the same industry when they joint venturing, and the ventures have the potential to learn from both partners. IJV control is therefore designed to support IJVs in their learning from their parents. Thus, when partners are involved in a similar business, less control is needed so as to leave room for learning to take place in the IJV. This is because similarities in the business activities of the parent and the IJVs lead to increased economies of scale and scope by increasing learning opportunities and reducing production cost. Therefore, partners should let the IJVs to take full advantages of the similarities, and learning opportunities by exercising narrow and loose control over their IJVs. In addition, previous researchers have pointed out that social control can promote increased learning in the ventures (Inkpen & Beamish, 1997). On the other hand, the management of a joint venture becomes critical when the new business is unrelated to a firm's existing operations (Kogut, 1988). When working in the new and unfamiliar business, the partners are required to work closely with IJV management teams in order to follow the situations and to make sure that the new business will develop in the desired direction. Thus, formal, broad, and tight controls are needed. As a result, it can be expected that:

Hypothesis 3: *The higher the degree of partners' business relatedness to each other and to the IJVs, the more likely foreign partners are to exercise social, narrow, and loose control over the IJVs*

Partners' differences and IJV control and performance

Child et al. (2005) maintain that control is critical for the successful management and performance of a strategic alliance. Lorange et al. (1986) maintain that through exercising a proper IJV control structure, foreign parent firms can make sure that their strategies are effectively implemented, and their resources are efficiently utilized for the enhancement of the IJV's performance. To achieve the overall objectives in the IJVs, partners have to consider both the IJV control structure and the risks involved (Lynch, 1998), taking into account the extent of the differences between partners and the degree of trust between them (Birnberg, 1998). Differences between partners often results in ineffective communication and quite often lead to the dissolution of IJVs (Meschi & Ricio, 2008). Lorange et al. (1986) maintained that by exercising formal control in dealing with the internal uncertainty caused by differences, the foreign partners can make sure that their strategies are effectively implemented, and that their resources are efficiently utilized for the enhancement of the IJV performance. In contrast, adopting narrow and loose control to cope with internal uncertainty can lead to IJV failure (O'Connor, 1995). Mjoen (1993) found that a tight level of control was associated with better performance in cases where partners have differences in their businesses and objectives. In addition, broad control has a crucial role to play in the success of IJVs (Barden et al., 2005; Berrell, 2007), especially, when transaction costs are high and partners know little about each other (Pangar & Klein, 2004). Thus, as a result of hypothesis 1 to hypothesis 3 we expect that:

Hypothesis 4a: *Formal, broad, and tight control exercised by foreign partners over their IJVs leads to better IJV performance in cases of greater differences between partners*

Hypothesis 4b: *Social, narrow, and loose control exercised by foreign partners over their IJVs leads to better IJV performance in cases of lesser differences between partners*

METHODOLOGY AND RESULTS

Method

This study adopted a survey research design to fit with the nature of the research. In the survey, the questions about joint venture control and performance were collected directly from those involved in IJV operations. Furthermore, to be able to generalize conclusions about the joint venture control, a large number of IJVs is needed for any examination. This would have made face to face interviews very costly in terms of time and money, and an impractical way to proceed to achieve the desired sample size. The measure of variables is based on a 5 point-scare (see Appendix for more details). Following Blodgett (1991b), Beamish & Inkpen (1995), Glaister, (1995), Nguyen & Larimo (2008), the methodology used to analyze the relationships between dependent and independent variables in IJV research incorporates description statistics and the Chi-square test. The purpose of the methods is to determine how well an observed set of data fits an expected set of hypotheses. These methods are used to examine the differences with categorical variables and the relationships between internal uncertainty factors and IJV control structures, and IJV control structure and IJV performance. The method is particularly useful to find out whether an IJV control structure which is made up of different elements of IJV control dimensions (formal, social, broad, narrow, tight, and loose) has a normal distribution or if the structure has formed under the influence of the parents' differences and business relatedness. Similarly, the method evidences whether or not IJV performance is influenced by the IJV control structure.

Sample description

The target firms and investments were identified as follows 1) from the FDI data base collected by the project leader from the late 1980s based on press releases on IJVs published in leading business magazines and newspapers and 2) from annual reports and websites of the 250 largest Finnish firms; 3) based on the earlier surveys focusing on IJVs and WOS by Finnish firms conducted by the project leader. From the resources, we identified 340 qualifying IJVs formed by Finnish firms since 1988 and in operation at least up until 2002. The qualifying 340 IJVs involved 200 Finnish parent firms. From among those 200 firms, several firms were very difficult to contact either because they had been restructured or gone out of business. The firms were contacted to determine the correct informants. In some firms there was no longer anyone with sufficient knowledge required for the study. This left a total of 161 Finnish parent firms. Given time and cost constraints a postal questionnaire and online web survey were used to gather the data. The participants were those managers who had been directly involved in establishment and operations of IJVs.

To enhance the quality of the data, the respondents were contacted by phone in December 2006 to explain the key points of the study and the questionnaires. In exchange for their participation in the study and to provide motivation and stimulate accurate responses, the respondents were assured of anonymity, promised a summary report of the findings and entered into a draw for three gifts. After one reminder at the end of the January 2007, at another the end of February, 54 questionnaires were returned, of which 5 questionnaires were not usable. Thus, the final sample was 49 IJVs including 40 Finnish parent firms. The response rate was 24.84% which is relatively similar to that of earlier respective studies in Finland (see Larimo & Rumpunen, 2006).The sample was carefully examined for any systematic response bias using *t-tests*. Respondent and non respondent firms were compared by their age, size, international experience, and IJV experience. No statistically significant difference was found. Thus, there was not response bias to be found in the final sample. Among the 49 IJVs of the final sample, 45% were established in 1988-1995, 55% in 1996-2006; 53 % through partial acquisitions, 47% through greenfields, 76 % were with 2 partners and 24 % with 3 partners; 61% with indefinite duration, 22% with duration of less than 5 years, 17 % with a duration of more than 5 years; 41 % had between 10% and 49% Finnish ownership, 10% had equal ownership, 49 % of had Finnish major ownership at establishment; 71% were located in emerging economies, and 29% in developed economies; 63% dealt with industrial products, 27 % with consumer products, 10 % with both consumer and industrial products. The summary of the operationalization of the key variables of the study is presented in Appendix 1.

Results and analysis

Regarding partners' differences and IJV control, most respondents regarded countries like Estonia, Russia, China in a very similar way, i.e having the same level of differences and with those differences being high level, in terms of management orientation with Finland norms (the mean is 1.5, with 1=very different and 5=very similar). With regard to the perception of the objectives of entering into the IJVs, most respondents when asked to consider whether objectives conflict, regard their partners who come from emerging economies as having conflicting objectives (with a mean of 4.1; where 1=strongly disagree and 5= strongly agree). Partners operating in developed economies are seen as having less conflictual objective when entering IJVs – with a mean here of 2.2.

Table 2 The results of the study based on the chi-square test.

Hypotheses			x^2	DF	Results
Partner's differences		**Control structure**			
H1: Greater management orientation differences		Broad, Formal, Tight	13.01	5	Significant at 0.05
H2: Greater objective differences		Broad, Formal, Tight	15.27	5	Significant at 0.01
H3: Greater business relatedness		Social, Narrow, Loose	17.01	5	Significant at 0.005
Partner's differences	**Control structure**	**Performance**			
H4: High	Broad, Formal, Tight	+	15.32	5	Significant at 0.01
Low	Social, Narrow, Loose	+	12.91	5	Significant at 0.05

The most common control structure adopted by Finnish partners in the reviewed IJVs was formal, broad, and tight control as utilized by 26 of the 49 which accounts for 53.06%. With regard to Hypothesis 1, over 70% of Finnish partners exercised formal, broad, and tight control when they perceived high organizational cultural differences with local partners. Less than 15 % of Finnish partners exercised social, narrow, and loose control, and the rest, about 15 % of the Finnish partners exercised other control structures such as social, broad, and tight; formal, narrow, and loose control, over their IJVs. Based on the chi-square test, where x^2=13.01, the result is significant at $p<0.05$ (df=5). Thus, the result supports H1. Turning to hypothesis 2 over 75 % of Finnish partners used formal, broad, and tight control when they perceived major objective differences with the local partners. Based on the chi-square test, where $x^2 = 15.27$, the result is significant at $p<0.01$ (df=5) (see table 2). Thus, the results support H2. Regarding Hypothesis 3, over 90% of Finnish partners exercised formal, broad, and tight control when they perceived high business relatedness with their local partners and with the IJVs. About 5 % of Finnish partners exercised formal, narrow, and loose control, and the remaining roughly 5 % Finnish partners exercised social, broad, and tight control over their IJVs. Based on the chi-square test, x^2=17.01 the result significant at $p<0.005$ (df=5). Thus, the result supported H3

Turning to partners' differences and the control and performance of IJVs, the performance was measured using seven different subjective measures. Respondents were asked to rank on a 5 point Likert scale, first the weight given and secondly their degree of satisfaction with all seven measures. The two most important measures of performance were total performance and financial performance. In the reviews, the mean of the assessment of financial performance of the IJVs was 2.9 and the mean relating to overall performance was 3.6. (1=very dissatisfied to 5=very satisfied). This shows that Finnish parent firms are somewhat more satisfied with their IJV' overall performance than they are with the financial performance. In addition, the findings of the study show that when they perceived high differences with their local partners, Finnish partners are more satisfied with their IJV performance (mean 4.09) when they exercise formal, broad, and tight control over their IJVs than other control structures (mean 2.25).
Based on the chi-square test, where x^2= 15.32 the result is significant at $p<0.01$ (df=5) (see table 2). Similarly, when Finnish partners perceived only minor differences with their local partner, they also seem to be more satisfied with IJV performance (with a mean for performance of 3.56) when exercising narrow, social, and loose control over their IJVs, than in the cases of using other control structures in IJVs (with a mean for performance of 2.47). Based on the chi-square test, where x^2 = 12.91 the result is significant at $p<0.05$ (df=5) (see table 2). Thus, the results support H4

CONCLUSIONS

The study investigated whether or not partners' differences influence IJV control and performance. Partners' differences are categorized into differences in business relatedness, objective held when entering IJVs, and management orientations. IJV control dimensions are based on the work of Geringer and Hebert (1989) including control mechanism, control focus, and control extent. The empirical evidence is based on a survey of Finnish firms that established IJVs with local firms in the 1990s.

The results show that partners' differences have strongly influenced IJV control and thus, having influences on IJV performance. The results reveal that partners perceiving high level of difference from each other require formal, broad, and tight control exercised over their IJVs. The results, in addition, indicate that in the case of high level of differences between partners, formal, broad and tight control by foreign partners lead to better IJV performance. In contrast, in the case of low level differences between partners, social, narrow, and loose control by foreign partners leads to better IJV performance.

This study has provided empirically tested hypotheses acting as an important continuation to current joint venture theory on control perspectives. It provides new insights into the way partners cope with internal uncertainty caused by partner's differences, and the resulting effect on joint venture performance. The findings extend the existing research and contribute to the understanding of the phenomenon of international joint venture control

The study does have some limitations due to its small sample size and due to the focus of the foreign partners being from only one country - Finland. In addition, because IJVs change over time and the partners' degrees of difference may also reduce over time, it would be interesting to know the control and performance of IJVs will change against the respective measures. Researchers could use the framework of the present study with a bigger sample size and foreign parent firms from several countries. Finally, it would be worth researching if control of IJVs functioning in the emerging markets differs from that of those located in developed markets.

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APPENDIX 1: OPERATIONALIZATIONS OF THE STUDY

Partners' differences

Management style

Partner's perceiving of organizational similarity Partners were asked to assess if they have similar management styles	Measured on a 5 point-scale with 1= strongly disagree to 5 strongly agree

Objectives set for the joint ventures

Partners were asked to evaluate if the objectives set for IJVs are in to conflicts between partners	Measured on a 5 point-scale with 1 = strongly disagree to 5= strongly agree

Partners' business relatedness

Partners were asked to evaluate how similar is their business with the other partners and the IJVs	Measured on a 5 point-scale with 1 = exactly the same and 5 = completely different.

Control dimensions

Control mechanisms

Formal control

a. Appointment of key venture personnel
b. Participation in the venture board meetings
c. Incentive plans for top management
d. Financial reports
e. Exercising veto rights at the board meetings
f. Taking part in planning JVs budgets
g. JV general manager participates in parent worldwide meetings
h. Parent-venture face to communication, formal meeting
i. Participation in JV's decision making
j. Control based on equity share

Social control

k. Feedback
l. Parent-venture informal socialization (informal phone call, outdoor activities)
m. Parent training of venture managers

Measured on a 5 point-scale, the respondents were asked to assess their method of monitoring and control of the IJVs. Control mechanism is formal (F) if the parents exercise control more on formal mechanisms (from a. to j. with response value from 4 to 5). On the other hand control mechanism is social (S) if parents exercise control mechanisms more on k. to m. (with response value from 4 to 5).

Control focus

a. International marketing
b. Local marketing
c. Domestic sales

Measured on a 5 point-scale, the respondents were asked to assess the focus areas of their monitoring and control of the IJVs. Control focus is broad (B) if parents exercise control on more than three

d.	Human resources	areas from a. to l. (with response value from 4 to 5). On the other hand, control focus is narrow (N) if the parents exercise control from 1 to two selective areas (with response value from 4 to 5).
e.	Procurement	
f.	Production	
g.	Quality control	
h.	Prices and costs	
i.	Financing and accounting	
j.	Research and development	
k.	Legal or local government relations	
l.	General management	
Control extent		
	degree or tightness of control which is exercised on the venture based on control mechanisms and control focus	Control is *tight* (T) if parent firms exercise more than three control mechanisms and broad control over the IJVs. Control is loose when parent firms exercise less than 3 control mechanisms and narrow control.
	Performance	
Financial performance Total performance		Measure on a 5 point-scale, respondent were asked if they satisfied with IJV performance on both financial and total performance with 1= "very unsatisfied" to 5= "very satisfied"

THE EFFECT OF INTERNATIONAL CURRENCIES UPON U.S. STOCK PRICES

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ABSTRACT

Over the years, the literature has demonstrated that the earnings of many non-US companies have been sensitive to the US dollar. Since earnings are a prime determinant of stock prices, then stock prices are also currency sensitive. All firms are exposed to foreign currency risk in today's global economy. This study takes an opposite approach to the literature and investigates the association between eight non-US currencies and US stock prices as reflected by the Dow Jones Industrial Average and the Standard and Poor's 500 Stock Index.

The results show that even though various currencies exhibit significant relationships with stock prices at times, the impact is limited. These findings suggest that many firms take an active stance in managing their currency risks. . The results also demonstrate the changing relationships of paired currencies used in this study. Positive relationships were expected when paring currencies by region. For example, one would expect the European currencies (Euro, Pound, and SSFranc) or the Asia Pacific currencies (Yen, Sing$, and Rupee) would be positively related to each other in the same region over the time periods used and this was not the case during this investigation.

INTRODUCTION

The introduction of the euro in 1999 brought to the forefront the active research area of currency rate sensitivity. Early euro proponents foresaw the possibility of capital market integration that would bring a group of fragmented currencies together into a giant market of simple, less risky, cross-border transactions. The euro's initial fall and subsequent rise since its introduction along with fluctuating currencies of those countries that did not join the union has been the catalyst for the interest. There has clearly been a structural change in the financial markets as was expected.

Some companies take an active stance in managing their currency risks by using some sort of financial hedge. On the other hand, many companies chose not to hedge or to hedge only some currencies. These companies are looking for diversification benefits of being exposed to foreign currencies. Intuitively, currency movements should even out over the long run.

In today's global economy, all firms are exposed to foreign currency risk whether in an accounting or economic sense. Exchange rate changes are thought by many to be a major source of financial uncertainty since currencies influence a firm's asset and liability values, as well as profitability. In turn, profitability affects cash flows and stock prices for those firms that have not adopted or taken an active stance in managing currency risks.

A particular exchange rate regime also affects the behavior of all economic variables which, in turn, leads to uncertainty across all stock markets. Investors seek the highest return with the lowest risk and when investing in foreign countries, they face currency risk. Recent literature has concentrated on how the euro or other non-US currencies affect respective foreign markets. Taking an opposite view, this study investigates the effect of eight foreign currencies, one of which is the euro, upon US stock prices. Results will provide insight towards possible higher returns for investors as well as international portfolio risk aversion.

LITERATURE REVIEW

A review of the literature indicates that there has been considerable research seeking significant relationships between currency rates and stock returns. These interactions cover domestic markets (Jorion, 1990), international (Friberg & Nydahl, 1999), and emerging markets (Vaziri, 2003; Beer & Vaziri, 2004).

Early empirical currency research by (Adler & Dumas, 1984; Jorion, 1990) focused on the individual company's currency exposure by observing changes between a firm's price change and the US dollar. They found that the concept of exposure is arbitrary in the sense that stock prices and exchange rates are determined jointly. This early work on exchange rate exposure was pursued by (Kroon & Van Veer, 2004) who criticized the relatively closed nature of the US economy during the time period used in the early investigations. The authors used data from 1996-2002 and conclude that most companies are currency insensitive. They further offer as a possible explanation of their findings the statement that international companies tend to hedge their currency risks.

Holder and Sinha (2001) analyzed the euro experience over the first two years of the euro's introduction and report that the European Monetary Union had a substantial impact on securities markets. In addition, they report of an explosive growth of euro-denominated bond issues, a growth of derivatives trading, and portfolio re-balancing due to the introduction of the euro.

Cheung and Westermann (2001) studied stock price movements from both Germany and US equity markets before and after the introduction of the euro; i.e., the effect of an exchange rate regime choice on equity markets. They report that a switch in the exchange rate arrangement was not significant although the volatility of the German stock index fell relative to the US index.

Fernandez (2006) examined data from six countries over the 1999-2002 time period and found that no evidence of asymptotic dependence was exhibited by paired currencies against the euro or European stock markets. This study takes the opposite view from Fernandez and investigates the association between the currency changes of the Euro along with seven other currencies and US stock prices.

METHODOLOGY

Monthly exchange rates and index values for the 8-year period, 1999-2006, were used in this investigation. This period was selected to coincide with the introduction of the euro in 1999. The eight currencies selected include the following: European euro to the US dollar (Euro), British pound to the US dollar (Pound), Swiss franc to the US dollar (SSFranc), Japanese yen to the US dollar (Yen), Canadian dollar to the US dollar (Can$), Mexican peso to the US dollar (MxPeso), Singapore dollar to the US dollar (Sing$), and the India rupee to the US dollar (Rupee). Two US stock indexes were also used: the Dow Jones Industrial Average (DJIA) and the Standard and Poor's 500 Stock Index (S&P500). All rates and values were those on the last trading day per month.

The 8-year data set allowed enough data to observe relationships among the variables over five recent periods: 8 years (1999-2006), 6 years (2001-2006), 4 years (2003-2006), 2 years (2005-2006), and 1 year (2006). Correlation matrixes were computed using the currency rates and index values over each time period in order to find significant relationships.

RESULTS AND ANALYSIS

Table 1 shows the correlation matrix for the eight currencies along with the DJIA and the S&P500 for the entire 8 years of monthly data. Looking initially at only how the currencies associate with each other, all currencies show significant relationships. In most cases, the relationships are negative which might suggest diversification possibilities for currency traders. Most of the correlations are relatively high which suggests that the economies of those countries are closely linked either positively or negatively.

Table 1 also shows that even though there are significant associations between the currencies and both the DJIA and S&P500, they are not strong. The Euro exhibits a weak positive significant correlation with the DJIA over the 8-year period, but an insignificant one with the S&P500, even though the two indexes are strongly related as shown by a coefficient of .8446 between the two. Correlation coefficients above .60 are observed only between the Sing$ and the DJIA as well as the Rupee and the S&P500

Table 2 shows the correlation matrix for the eight currencies along with the DJIA and the S&P500 for the last 6 years of monthly data. Again, in all cases the currencies exhibit significant correlations when paired among themselves.

Table 1: Correlation Matrix--8 Years Monthly Data, 1999-2006										
	Euro	Pound	SSFranc	Yen	Can$	MxPeso	Sing$	Rupee	DJIA	S&P500
Euro	1.000									
Pound	0.974a	1.000								
SSFranc	-0.976a	-0.932a	1.000							
Yen	-0.428a	-0.484a	0.335a	1.000						
Can$	-0.885a	-0.889a	0.825a	0.390a	1.000					
MxPeso	0.897a	0.859a	-0.928a	-0.392a	-0.780a	1.000				
Sing$	-0.801a	-0.852a	0.703a	0.492a	0.848a	0.617a	1.000			
Rupee	-0.484a	-0.511a	0.335a	0.628a	0.451a	-0.213b	0.617a	1.000		
DJIA	0.280a	0.388a	-0.105	-0.276a	-0.529a	0.057	-0.602a	-0.510a	1.000	
S&P500	-0.026	0.084	0.218a	-0.377a	-0.220b	-0.264b	-0.422a	-0.624a	0.844a	1.0000
aSignificant at the .01 level bSignificant at the .05 level										

Table 2: Correlation Matrix—6 Years Monthly Data, 2001-2006										
	Euro	Pound	SSFranc	Yen	Can$	MxPeso	Sing$	Rupee	DJIA	S&P500
Euro	1.000									
Pound	0.980a	1.000								
SSFranc	-0.990a	-0.950a	1.000							
Yen	-0.793a	-0.764a	0.779a	1.000						
Can$	-0.909a	-0.896a	0.846a	0.627a	1.000					
MxPeso	0.923a	0.889a	-0.943a	-0.813a	-0.765a	1.000				
Sing$	-0.874a	-0.898a	0.817a	0.578a	0.915a	-0.728a	1.000			
Rupee	-0.809a	-0.799a	0.727a	0.768a	0.823a	-0.689a	0.736a	1.000		
DJIA	0.458a	0.528a	-0.299b	-0.216	-0.669a	0.236a	-0.646a	-0.594a	1.000	
S&P500	0.360a	0.426a	-0.196	-0.177	-0.620a	0.132	-0.587a	-0.588a	0.966a	1.0000
aSignificant at the .01 level bSignificant at the .05 level										

Table 2 also reveals some significant, but not strong relationships between the currencies and the two indexes. The Euro shows positive significant coefficients with both indexes. The strongest associations with the indexes are exhibited by the Can$ and the Sing$, all negative.

Table 3 uses the last 4 years of data, 2003-2006, and very interestingly; the currencies exhibit strong correlations in all cases except for the Yen and the MxPeso. In other words, US stock prices and currencies moved either up or down in unison depending on the particular currency. Investors might want to consider this information when making future diversification decisions.

Table 3: Correlation Matrix—4 Years Monthly Data, 2003-2006

	Euro	Pound	SSFranc	Yen	Can$	MxPeso	Sing$	Rupee	DJIA	S&P500
Euro	1.000									
Pound	0.953a	1.000								
SSFranc	-0.958a	-0.913a	1.000							
Yen	-0.533a	-0.460a	0.640a	1.000						
Can$	-0.730a	-0.691a	0.606a	0.045	1.000					
MxPeso	0.420a	0.453a	-0.495a	-0.616a	-0.034	1.000				
Sing$	-0.771a	-0.796a	0.657a	-0.028	0.853a	-0.102	1.000			
Rupee	-0.639a	-0.606a	0.579a	0.525a	0.557a	-0.125	0.460a	1.000		
DJIA	0.793a	0.820a	-0.628a	-0.061	-0.879a	0.166	-0.887a	-0.576a	1.000	
S&P500	0.766a	0.787a	-0.621a	-0.042	-0.937a	0.084	-0.894a	-0.632a	0.976a	1.0000

aSignificant at the .01 level
bSignificant at the .05 level

Table 3 also reveals correlation coefficients for the Euro relative to the DJIA and the S&P500 as being .7930 and .7668, respectively. It was during this time period that the Euro started its rapid rise against the US dollar which had a positive association with US stock prices.

Using the most recent 2 years of monthly data, 2005-2006, Table 4 shows that the Yen, the Can$, and the Sing$ exhibit strong significant correlation coefficients. All are negative. The Rupee exhibits an inverse relationship with the DJIA and a positive one with the S&P500.

Table 4: Correlation Matrix—2 Years Monthly Data, 2005-2006

	Euro	Pound	SSFranc	Yen	Can$	MxPeso	Sing$	Rupee	DJIA	S&P500
Euro	1.000									
Pound	0.946a	1.000								
SSFranc	-0.939a	-0.827a	1.000							
Yen	-0.374	-0.187	0.640a	1.000						
Can$	0.047	-0.025	-0.245	-0.741a	1.000					
MxPeso	0.733a	0.597a	-0.775a	-0.458b	-0.035	1.000				

Table 4: Correlation Matrix—2 Years Monthly Data, 2005-2006										
	Euro	Pound	SSFranc	Yen	Can$	MxPeso	Sing$	Rupee	DJIA	S&P500
Sing$	-0.628a	-0.694a	0.370	-0.399	0.611a	-0.342	1.000			
Rupee	-0.066	-0.002	0.197	0.638a	-0.828a	-0.061	0.406b	1.000		
DJIA	0.362	0.517a	-0.036	-0.674a	-0.616a	0.044	-0.869a	-0.418b	1.000	
S&P500	0.152	0.317	-0.164	-0.777a	-0.687a	0.136	-0.794a	0.415b	0.956a	1.000
aSignificant at the .01 level bSignificant at the .05 level										

The final correlation matrix was computed using only one year of data, 2006, and Table 5 shows that the two indexes are significantly correlated with the Euro, the Pound, and the Sing$. These pair-wise correlations are relatively high. On the other hand, most of the coefficients between currencies were weak and not significant.

Table 5: Correlation Matrix--1 Year Monthly Data, 2006										
	Euro	Pound	SSFranc	Yen	Can$	MxPeso	Sing$	Rupee	DJIA	S&P500
Euro	1.000									
Pound	0.972a	1.000								
SSFranc	-0.929a	-0.847a	1.000							
Yen	0.029	0.194	0.321	1.000						
Can$	-0.206	-0.089	0.437	0.658a	1.000					
MxPeso	0.514	0.374	-0.588b	-0.325	-0.549	1.000				
Sing$	-0.958a	-0.966a	0.802a	-0.233	0.025	-0.445	1.000			
Rupee	0.323	0.214	-0.466	-0.369	-0.813a	0.548	-0.153	1.000		
DJIA	0.744a	0.832a	-0.464	0.615b	0.301	0.152	-0.871a	-0.179	1.000	
S&P500	0.636b	0.725a	-0.377	0.529	0.472	0.023	-0.787a	-0.461	0.935a	1.0000
aSignificant at the .01 level bSignificant at the .05 level										

CONCLUSION

This study was very interesting. The results of the study are mixed as the tables demonstrate. Apparently, the effects of the currencies used in this study have a limited impact on the DJIA and the S&P500. In other words, the indexes are currency insensitive. Although there were many strong associations, the relationships changed as different time periods were observed. Very few relationships remained strong over all time periods and some coefficient signs changed across each time period. Only the Sing$ exhibited strong negative correlation coefficients against both indexes in each table. The Pound exhibited positive coefficients against both indexes in all tables; all significant, except in only one case.

The results also demonstrate the changing relationships of paired currencies when correlated among the ones used in this study. Positive relationships were expected when paring currencies by region. For example, one would expect the European currencies (Euro, Pound, and SSFranc) or the Asia Pacific currencies (Yen, Sing$, and Rupee) would be positively related to each other in the same region over the time periods used. This was not the case as the tables demonstrate.

These conclusions have practical implications for investors as well. Apparently, companies are using hedging strategies to eliminate currency risks. Diversification benefits resulting from international investing activities historically were obtained because foreign economies were in various stages of growth or recession. Investors had to consider the accompanying related currency impact on the expected returns. Over the last decade as economies have become more interconnected, the benefits derived from investing in different economies are decreasing as demonstrated by the weak currency sensitivity of the two US indexes used in this study.

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A COMPARATIVE ANALYSIS OF SIGNIFICANT INFLUENCES ON THE ACCOUNTING SYSTEMS OF DIVERSE EUROPEAN COUNTRIES AND THE U.S.A

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ABSTRACT

An accounting system can be defined as a combination of inputs organized into a complex whole with the purpose of providing relevant information for decision making. The purpose of this paper is to analyze the "inputs" that are involved in the accounting systems of France, Sweden, and the United Kingdom as compared with the United States.

These inputs are economic, political, legal, educational, and religious factors. As each input varies from country to country, it only stands to reason that the accounting systems from country to country vary.

INTRODUCTION

The main purpose of accounting is to provide to stakeholders, information useful for economic decision making. Stakeholders may be within a company, society, the government, etc. Since accounting is designed to provide information to stakeholders, their wants and interests naturally are reflected in the accounting systems that serve them. This paper analyzes the economic, legal, political, educational, and religious impact on accounting systems in three European countries (France, Sweden, and the United Kingdom), and compares them to the United States. The European countries have similar themes that link them together and in some ways relate to the United States.

THE ECONOMIC IMPACT ON ACCOUNTING SYSTEMS

According to the Financial Accounting Standards Board exposure draft, *Objectives of Financial Reporting and Elements of Financial Statements of Business Enterprises*, "accounting objectives stem from users' information needs……needs, in turn, depend significantly on the nature of the economic activities and decisions with which the users are involved" (Frank, 1979). Economic environments in which accounting operations take place vary by country; therefore, it stands to reason that accounting systems must essentially differ from country to country in order to maintain the smooth operation of markets and preserve confidence in business

Essentially, governments are concerned with the healthy functioning of the economy for which they are responsible. Increasingly, accounting standards are becoming the necessary step to establish controls on markets and corporate behavior. This section analyzes the potential economic impact on accounting systems in France, Sweden and the United Kingdom. In addition, the varying economic conditions of the countries mentioned will be compared to the United States, who is at the forefront of economic development.

United States

The U.S. has the largest and most technologically powerful economy in the world. In this market-oriented economy U.S. business firms enjoy greater flexibility than Western Europe in decisions to expand capital plant, to lay off surplus workers, and to develop new products. At the same time, they face higher barriers to enter their rivals' home markets than foreign firms face entering U.S. markets (United States, CIA, 2007). Long-term problems include inadequate investment in economic infrastructure, sizable trade and budget deficits, and stagnation of family income in the lower economic groups.

Accounting standards are influenced by the economic and social environment in which they are established and applied. For example, almost all countries use historical cost and the lower of cost or market; however, accounting principles applied, differ considerably due to undervaluation, varying depreciation methods, selective application of inventory valuation methods, and different rates of economic development (Schoenfeld, 1981). Several characteristics of the U.S. environment are important in that regard. These characteristics also influence the ways in which the United States adapts to and promotes the internationalization of accounting standards.

The United States has a heavy reliance on open capital markets. Whereas European corporations have relied on banks for financing, American companies have tended to rely on their countries well-developed capital markets (Amatori, 1999). In the United States, both debt and equity capital are raised in large measure through marketable securities issued in active auction markets where buyers are both individual and institutional investors. Bank loans and private placements are important, but they are priced and transacted in the shadow of the auction markets. U.S. law prohibits banks from owning significant equity interests in industrial companies. In the United States, there is a clear emphasis among American corporations on shareholder value, as opposed to European corporations, which focuses on the broader interest of all stakeholders.

U.S. financial accounting standards are designed almost exclusively to facilitate investor-creditor decision making. Audited general-purpose external financial statements help bridge the information gap between suppliers and seekers of capital (Blake, Amat, Gowthorpe, and Pilkington, 1998). Financial statements are a substitute for close relationships whereby capital suppliers have continuing access to confidential information about the entities in which they invest.

All of these factors have played a prominent role in the development of U.S. accounting standards. Nevertheless, differences in domestic business organization and capitalization, legal and political systems, and historical and cultural factors influence all national accounting systems. In today's global economy, we have to cope not only with the pressures of the domestic environment, but also with the protocols and complexities of foreign direct investment (Leisenring, 1998). There has been an increasing awareness that accounting can be an impediment to cross-border financing, and thus there has been a demand for comparability in financial reporting among companies of different domestic origin. Comparable accounting standards enable European companies to participate in the capital markets on equal terms with their non-European competitors (Ortiz, 2007).

France

France is the fifth-largest economy in the world and is in the midst of transitioning from a modern economy with extensive government ownership and intervention to one that relies more on the market. It has substantial agricultural resources, a large industrial base, and a highly skilled work force. Despite significant reform and privatization over the past 15 years, the government continues to control a large share of economic activity (United States, USDS, 2007). Government leaders remain committed to free enterprise by means of laws and tax policies that aim to promote investment and domestic growth in a stable fiscal and monetary environment.

The earliest regulation in Europe was aimed at small businesses whose owners did not measure the success of their business. Consequently, they went into liquidation. The 1673 Savary Ordonnance in France was the first national accounting regulation created in the world. The French government required all businesses to make an annual inventory, in effect, a balance sheet using current market values, to assess the health of their business. The 1673 Ordonnance was created because the government observed numerous bankruptcies, leading to a loss of confidence in business and a downturn in economic activity. The regulation was intended to build confidence.

As required by law a detailed uniform accounting systems has been adopted in France. In countries similar to France, with legislative accounting principles, disclosure is more limited and is determined by legal requirements rather than materiality (Schoenfeld, 1981). In past years, France experienced some degree of inflation. During a period of inflation, assets reported on the balance sheet at historical cost are understated. Understated assets results in understated expenses, which in turn results in overstated net income (Doupnik, 2007). Overstated net income can create several problems for a company. In order to reduce the effects of inflation on financial statements the standard setting body in France, Conseil National de la Comptabilite, abandoned historical cost and adopted a series of government indexes for the adjustment of accounts (Seildler, 1967). In contrast, the United States has no formal accounting recognition given to the decline in value of the dollar, other than through indirect approaches such as the LIFO inventory method and accelerated depreciation. Like France, other countries' accounting systems have developed in response to the environment in each country. For example, the uniform accounting system Plan Comptable seems to function well in France. However, in France, accountants are accustomed to a substantial degree of legal control over their activities. There is still question as to whether it could feasibly be transferred to the very different business environment found in the United States. A system, which operates in the European stock markets, may encounter considerably different problems in the unique capital market of the United States.

Sweden

Sweden is a highly industrialized country. Agriculture, once accounting for nearly all of Sweden's economy, now employs less than 2% of the labor force. Extensive forests, rich iron ore deposits, and hydroelectric power are the natural resources which have enabled Sweden to become a leading producing and exporting nation. Sweden's export sector has grown significantly as the information technology industry, telecommunications, and services have overtaken traditional industries such as steel, paper, and pulp (United States, USDS, 2007). The Swedish economic picture has brightened significantly since the severe recession in the early 1990s, but has recently been showing signs of possibly heading toward a new recession. Growth has been strong in recent years, with an annual average GDP growth rate of 2.7% in 2005, 4.1% in 2006, 2.7% in 2007, and an expected drop in 2008 to 2.4%. The inflation rate was low in 2006, with an annual average of about 1.5%. The rate increased to 2.2% in 2007.

Sweden is a country torn by two accounting approaches, a formal legal accounting system based on a binding tax-accounting link and a private sector, standard setting body seeking to break that link. There is a substantial body of accounting and tax law, all of which rank above Swedish GAAP. In contrast, the U.S. has a nearly total separation of financial and tax accounting. In Sweden, a specific tax accounting system was established before a basic legal accounting framework was put in place, creating conflicting ideologies on the best system for business and the economy. Accounting regulators in Sweden establish standards in the best interest of the business community. A standard cannot be imposed if it is against the views of the business community. However, American regulators do not assess the merits of any investments.

Tax accounting is an obstacle to the application of International accounting Standards (IAS) in Sweden. IAS will facilitate Sweden’s efforts to achieve international harmonization. However, compliance with IAS is difficult when the tax system, designed at the national level, dominates accounting practices. Taxation is at the forefront of accounting standards. In order to steady, the economic impact of taxation, tax authorities and business interests came to support the development of an accounting standard approach to foreign currency translation, which would result in lower taxation for companies with foreign operations.

United Kingdom

The United Kingdom (UK) has the fourth-largest economy in the world. It is the second-largest economy in the European Union, and is a major international trading power. In addition, the UK is a highly developed, diversified, market-based economy with extensive social welfare. Agriculture is intensive, highly mechanized, and efficient by European standards; producing about 60% of food needs with less than 2% of the labor force. The UK has large coal, natural gas, and oil reserves; primary energy production accounts for 10% of GDP, one of the highest shares of any industrial nation. Services, particularly banking, insurance, and business services, account by far for the largest proportion of GDP. The economy is one of the strongest in Europe; inflation, interest rates, and unemployment remain low. While, the UK has relatively low inflation rates compared to surrounding countries, inflation accounting was introduced in the UK in 1980 through Statement of Standards Accounting Practice 16. This statement required additional presentation of Current Cost financial statements. However, as a result of declining inflation rates and company complaints, SSAP 16 was rescinded.

The United Kingdom is a culturally self-sufficient country with a strong equity-outsider system. Accounting principles in the United Kingdom emphasize investor needs and the importance of transparency. While, the UK relies heavily on outside financing from shareholders UK legislators have never felt the need to have a powerful securities commission to regulate accounting and financial reporting with detailed rules. In addition, European countries have accepted the state as a major player in the economy, as well as close relations between the banking and industrial sectors, often formalized by means of cross-shareholdings (Amatori, 1999).

In comparison, the United States has an extensive network of capital market regulation. The Securities and Exchange Commission (SEC) and all of the national regulators have the power, if they choose to exercise it, to impose accounting requirements for regulatory purposes. Furthermore, in the United States, state intervention in the economy has historically been much more limited.

In order for the continued investments by shareholders in the UK, full disclosure must be maintained. Full disclosure assures stakeholders that management is conducting operations in the best interest of the owners. Countries that rely on banks and family sources for investments do not have the pressures to ensure full disclosure of financial statements (Aghimien, 2001).

THE LEGAL AND POLITICAL IMPACT ON ACCOUNTING SYSTEMS

The legal environment takes into account the needs and culture of a society and based upon those influences creates rules and regulations. There are some countries where the government directly regulates accounting standards. However, other countries choose to allow the private sector to regulate themselves within the confines of the laws they have enacted. Whether accounting systems are privately or publicly regulated, politics will often influence the directions they take in terms of policy. While the speed in which the legal system responds to the public varies, at some point it is inevitable that they will take action. Since the legal system is often a reflection of the people it serves, it can incorporate many of the outside influences i.e. economy, religion, education into the laws and standards it sets. This section analyzes the potential legal and political impact on accounting systems in France, Sweden and the United Kingdom, and compares them to the United States.

United States

The rules and regulations that govern accounting in the United States are referred to as Generally Accepted Accounting Principles (GAAP) and are made up of standards set by the U.S. Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB).

The two laws that created the SEC and its purpose are the Securities Act of 1933 and the Securities Exchange Act of 1934. Both of these laws came about after the stock market crash of 1929 and sought to protect investors and restore their confidence in the market. The basic objectives of the Securities Act of 1933 are to "require that investors receive financial and other significant information concerning securities being offered for public sale" and to "prohibit deceit, misrepresentations, and other fraud in the sale of securities." The Securities Exchange Act of 1934 created the SEC and empowered it with "broad authority over all aspects of the security industry". The SEC not only has the power to regulate but it also has disciplinary powers as well.

Additional laws that affect the SEC include: the Investment Company Act of 1940, the Investment Advisors Act of 1940, and the Sarbanes-Oxley Act of 2002. This is a reflection of how politics affects the direction of the SEC. The Sarbanes-Oxley Act in particular was enacted in reaction to the public outcry following recent accounting scandals. The government may leave regulation up to the SEC and FASB, but they step in to provide direction at the urgings of the public.

The SEC has the authority to "establish financial accounting and reporting standards for publicly held companies" but has always relied on the private sector to fulfill this responsibility. Since 1973, the FASB (a private entity) has established and improved standards for financial accounting and reporting. They operate under the authority of the SEC, but act as a separate entity from the government.

France

France's accounting regulation and standards come from multiple entities working together; the Comite d'urgence of the Conseil National de la Compatabilite, the Conseil National des Commissaires aux Comptes (CNCC), the Conseil National de la Comptabilite (CNC), the Commission des Operations de Bourse (COB), and Comite de la Reglementation Comptable (CRC).

The Comite d'urgence, CNCC and COB interpret existing standards, then the CNC approves Avis (opinions) that are passed on to the CRC for final approval that makes them binding (France, 2007).

Although France has their own set of accounting rules, three 'alternative' sets of standards are used: the International Accounting Standards (IAS), 'international principles,' and the U.S. GAAP (Stolowy and Ding, 2003). The ability to choose among alternative standards is in stark contrast to the accounting environment in the U.S. in which you must follow U.S. GAAP. This may stem from the fact that accountants have traditionally been looked down upon and only recently has there been some progress in establishing the accounting profession in France (Nioche and Pesqueux, 1997).

The Enron debacle and the United States' Sarbanes-Oxley Act have had ripple effects around the world. France felt they were immune from this type of situation happening in their country because of the 'exeption francaise', but in 2003 enacted the French Financial Security Law (FSL) to further strengthen their measures. The 'exeption francaise' regulates the auditing industry and states that the external auditor be appointed for renewable six year terms, for joint auditors to be appointed for companies with consolidated financial statements, and forbids accounting firms from providing auditing services if they also perform consulting. The FSL strengthens some of these rules and adds an internal control disclosure on auditor's reports (Stolowy, 2005). France had many provisions similar to Sarbanes-Oxley before the U.S. This shows that they were ahead of the curve in terms of preventing fraudulent activity by accounting firms and a recent denial to the 'Big Four' accounting firms shows they are serious. The 'Big Four' has recently challenged that a decree stemming from the FSL was too restrictive because it "bars an accounting firm from auditing a company's accounts if it has provided advisory services to the client in the past two years" and includes work outside of France (Chong, 2006). Despite the influence that the 'Big Four' possess, the French government held their ground.

Sweden

Sweden has three accounting regulatory bodies: the Foreningen Auktoriserade Revisor (FAR), the Bokforingsnamnden (BFN), and the Redovisningsrodet (RR). The FAR was founded in 1923 and issued accounting recommendations until 1989. In 2006, the FAR merged with the Swedish association of auditors (SRS) and currently "plays a leading role in the development of professional standards, education and information for the audit profession in Sweden. The BFN is an accounting standards board set up in 1976 that has mainly dealt with internal accounting records. RR is the financial reporting council and they issue standards for listed public companies. After 1989, only RR has issued new standards, although they all remain in use. Additional standards are issued from the Swedish Financial Accounting Standards Council (SFASC) for listed entities and the Swedish Accounting Standards Board (SASB) for non-listed entities.

The Accounting Act of 1995 created what is known as "Swedish GAAP" and it requires that companies follow good accounting practice. The accounting standards apply primarily to listed companies and base all their standards on the IAS, unless the IAS is in conflict with Swedish laws. The Financial Accounting Standards Council's recommendations shall follow International Financial Reporting Standards and International Accounting Standards and that deviation from these standards shall be permitted only if Swedish law prohibits (Swedish, 2007).

Although Swedish GAAP is named after the concept of U.S. GAAP, its meaning is much different in Sweden. To the U.S., GAAP is the set of standards and regulations issued from FASB and the SEC. In Sweden, it is a practice specified from the FAR, BFN, or RR and a practice that leading companies follow. Accounting regulators cannot, as in the USA or UK, impose a standard against the views of the business community. Furthermore, their accounting and tax laws rank above their GAAP.

In Sweden there has been much debate over the years between using the Prudence or Matching principle:

Table 1: Comparing Prudence and Matching Principles

	Prudent (conservatism)	Matching (realism)
Revenue Reporting:	Realization by form	Realization by substance
Cost Reporting:	Expenditure is expensed	Expenditure is capitalized

The law favors prudence, however the international community favors matching. The influence of the international community led to many companies not following existing standards and using the matching principle instead. Eventually the FAR made the matching principle acceptable like the prudence principle (Artsberg, 1993). This example shows how outside influences affect the business community much sooner than the standard setters are able to respond to. The business community takes matters into their own hands regardless of what the regulations say. In the U.S., there are more strict guidelines to which companies must follow the country's standards. Therefore, the FASB, SEC, and government are more responsive and are quicker to act on political pressures, i.e. Sarbanes-Oxley.

While the U.S. may be more responsive and quicker to act on political pressures, Sweden does not ignore the business community. Accounting systems in Sweden are subject to increased political pressures with regard to the central government. The introduction of accrual accounting in the central government was part of a wider reform agenda, to support the performance management system that was introduced in the late 1980s. In addition, the government in Sweden recognized financial management accounting in order to control central government finances and to allocate resources in accordance with political priorities (Paulsson, 2006).

Swedish accounting requirements are based on the Annual Accounts Act incorporating the European Union Directives. While many companies within Sweden would prefer the Anglo-Saxon approach offered by the Fourth Directive, Sweden has implemented the EU directives with its emphasis on a prescriptive tax-driven accounting system in the German tradition. Sweden says they are working toward international harmonization, but seem to be going about things in a different way than the U.S. and other countries within the EU.

United Kingdom

The United Kingdom regulates accounting and financial reporting through legislation (Companies Act), professional pronouncements, and stock exchange listing requirements. The main bodies responsible for these duties are the Accounting Standards Board (ASB) and the London Stock Exchange (LSE).

The ASB has issued standards since 1990 and is recognized under the Companies Act of 1985. Comparable to the United States' FASB, the ASB is institutionally separated from the accounting institutes. The Financial Reporting Council (FRC) provides guidance to the ASB and has the responsibility of overall policy control over the standard setting process. The ASB also works in conjunction with the Financial Reporting Review Panel (FRRP), which reviews companies' financial statements to ensure fair presentation of information.

The London Stock Exchange issues listing requirements. The LSE requires publication of a semiannual interim report and disclosure of information about corporate governance and directors' remuneration. The LSE fulfills a similar purpose as that of the United States' SEC, but it does not have the same type of power that the SEC wields.

The UK has a strong internal audit accounting function and has been applying their expertise to many of the newer EU members from the former Soviet Union. The main challenge with these countries is overcoming the 'command culture' that they have followed for ages. With corruption usually overlooked in their societies the introduction of internal audit is a process that is taking time, but is a necessary one to protect EU subsidies in these countries (Percy, 2007). The mentality of helping other countries, while also helping yourself is often followed by the U.S. as well. The U.S. and UK share many similarities, and the fact that their influence expands way beyond their borders is an important one to the world.

THE EDUCATIONAL IMPACT ON ACCOUNTING SYSTEMS

The goal of education is to make it possible for anyone with the ability and desire to succeed to achieve their goals. Education and especially higher education are not universally available worldwide. The things that most Americans take for granted are not widely available in many parts of the world. The goals of the higher education system are economic efficiency and to promote social mobility, reducing the connection between parents' social status and their children's economic status (Haveman, 2006). This section analyzes the educational impact on accounting systems in France, Sweden, and the United Kingdom and compares them to the United States.

United States

In the United States accounting classes are often first offered in high school and specific programs in accounting are offered at universities around the country. In order to become a Certified Public Accountant (CPA), an individual must obtain certain educational and experience requirements in addition to passing the CPA exam. In order to sit for the exam an individual must have completed 150 credit hours at a college/university with a minimum amount of credits in accounting and other business classes. Furthermore, individuals must have work experience, generally two years, in accounting related fields before being granted a license to practice. Once someone becomes a CPA, there are continuing education requirements (CPE credits) that must be completed in order to remain an active CPA.

Many CPAs in the U.S. belong to the American Institute of Certified Public Accountants (AICPA), whose mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients. Some of the key aspects of the AICPA are their role in influencing the certification process and continuing education.

The United States ensures that CPAs have a proper educational background and the skills necessary to perform their jobs. This level of assurance provides the public with confidence in the abilities of CPA. This is important to the market-place that relies heavily on the opinions of CPAs in determining that financial statements provide an accurate portrayal of a business.

France

Accounting education in France can be traced back almost 400 years. A 1673 order requiring bookkeeping for commercial activity led to a bookkeeping profession and in turn an accounting education. Given France's historic roots in accounting education, today's environment consists of detailed programs at all levels. In secondary schools, there are specific programs focused on accounting that prepares individuals for a five-step process for the CPA that includes university education (Ding, 2000). The five steps are:

- ♦ DPECF – Preparatory Diploma in Accounting and Financial Study
- ♦ DECF – Diploma in Accounting and Financial Study
- ♦ DESCF – High Diploma in Accounting and Financial Study

- ♦ An internship – Three years at an accounting firm
- ♦ DEC – CPA Diploma

Given the CPA requirements in France and the foundation in place throughout their educational system, it is clear that although the profession has not always been well respected there is an educational system in place to provide ample accounting education. France's upper level education is four years minimum which is similar to the time frame of the United States' 150 credit requirement that usually takes around four to five years to complete. Furthermore, France requires a three year internship which is comparable to the work experience necessary for a CPA in America.

Sweden

Education has a very important role in Swedish society. In Sweden education is free; there is no tuition at any level. The Swedish model is now characterized by highly decentralized education systems on all levels. There has been an increased focus on improving education by policymakers. This comes from a desire to improve productivity and to increase management responsibility within Swedish corporations (Bengtsson, 2006). As a result, accounting education in Sweden has changed in the past twenty years from focusing primarily on financial accounting to focusing more on management accounting (Duubas, 2005). In order to comply with International Auditing Standards, Sweden passed the Auditing Act (2001). This act outlined the educational requirements of certified accountants and defined the role of the Supervisory Board of Public Accountants. There are two tiers in the public accounting profession: authorized public accountants and approved public accountants. The qualifications of an authorized public accountant are as follows:

- ♦ Have an approved university degree in economics or business of at least 160 credit hours or have a master's degree.
- ♦ Complete five years of practice with a public accounting firm
- ♦ Training must cover auditing and have taken place under the supervision of an authorized public accountant.
- ♦ Pass the examination of professional competence as an authorized public accountant arranged by the Supervisory Board of Public Accountants.

The educational and qualifications of accountants in Sweden are similar to the United States in the fact that work experience is required. Sweden focuses a great deal on auditing experience whereas the United States wants CPAs to have a broad range of accounting experience.

United Kingdom

The United Kingdom's educational system not only influences accounting systems within their country but has had a significant influence on the development of accounting profession in many countries including the United States and member countries of the British Commonwealth such as Canada, Australia, and New Zealand. The UK's extensive collection of accounting bodies began in 1853 with the establishment of the Society of Accountants in Edinburgh. This body can be regarded as the beginning of the modern accounting profession. Today, there are six professional bodies that are coordinated through the Consultative Committee of Accountancy Bodies (CCAB).

Although the professional bodies do not require an undergraduate degree in accounting to become a member, individuals with an accounting degree are exempt from some of the steps in the certification exam. The certification exam consists of two stages; a professional stage and an advanced stage. The professional stage is a series of assessments that can be exempt with an accounting degree, while the advanced stage integrates tax, audit, financial reporting and business topics and must be completed by everyone going through the certification process.

The multitude of professional accounting bodies within the UK serves a similar purpose as that of the United States' AICPA. They are there to monitor the accounting environment and to ensure the integrity of their members. The main difference between the professional bodies in the UK and U.S. are the educational requirements. The U.S. is very strict in terms of the educational requirement that must be met in order to become a CPA. However, the UK, offers a stage within their professional accounting training process that substitutes the things that individuals would learn at a university.

THE RELIGIOUS IMPACT ON ACCOUNTING SYSTEMS

Culture, social norms, and belief systems are very important factors in determining how individuals comprehend external information. Accounting is the science of "comprehending" financial information. It only follows that culture, social norms, and belief systems affect accounting values within a given society. The purpose of this section is to compare how religion affects the accounting systems in, France, Sweden and the United Kingdom versus the United States of America. This section will first look at the current religious statistics of each country. From those statistics each country will be classified into a "religious model" and historical and current influences on each religious model will be analyzed. The final part of this section will involve making some conclusions on the accounting values of each country as compared to the United States.

Religious Demography:

United States

One of the main reasons that the United States was founded was to allow for freedom of religion. Most of the people in America adhere to Christianity in some form. According to the CIA World Fact-book, 52 percent of the American populations is Protestants, and another 24 percent are Catholic. Of the total, 10 percent are non-religious (United States, CIA, 2007).

France

France is a secular country whose constitution provides for freedom of religion. Roman Catholicism is no longer considered the state religion as it was prior to the 1789 Revolution. However, according to the U.S. Department of State's International Religious Freedom Report (2006), 64.3 percent of people surveyed regarding their religious affiliation indicated that they were Catholic. Of the remaining respondents, 27 percent said they had no religious affiliation, and 8.7 percent said they were of another religion.

Sweden

Most of the people in Sweden belong to the church of Sweden. The Church of Sweden's membership is approximated at 77 percent of the population. Many of the church's former members left the church after it separated from the state in 2000. The Church of Sweden adheres to a protestant doctrine. There are over 400,000 people who attend other Protestant churches and 145,000 people profess to be Catholic. The Constitution of Sweden provides for religious freedom.

United Kingdom

The 2001 census for the United Kingdom reported that 72 percent of the people in the United Kingdom identified themselves as Christians. More than 9 million people (15.5 percent) stated that they did not prescribe to any religion. Another 2.7 percent reported that they were Muslim. Religious freedom is supported in the United Kingdom.

Religious Models:

There are certain conclusions that can be drawn in looking at the religious statistics of each country. First of all the predominant religion of France, Sweden, the United Kingdom, and the United States have their roots in Christianity. For the purpose of this paper, a country whose predominant religion is Christianity has been classified into a Judeo-Christian model. This model is influenced by the teachings of Jesus Christ as contained in the Holy Bible. The Judeo-Christian model emphasizes theology and knowing the right articles of faith to hold.

Historical Religious Influences on Accounting:

Judeo-Christian Model

There are some significant religious influences that have affected the accounting systems of those countries classified under the Judeo-Christian model. In ancient Jerusalem, (823 B.C.E to 70 C.E.) the Hebrew Talmud accounts for stringent procedures that would safeguard temple assets. This system was established after the Israelites were freed from Babylonian captivity. The armies of Babylon destroyed the temple in Jerusalem. When the Israelites were freed from captivity they engaged in a massive fund raiser campaign to rebuild the temple. At this time, they also created a complex system for maintaining and expending temple assets. The Talmud, which consists of oral teachings passed from generation to generation, lays out a detailed standard operating procedure for the collection of funds for religious purposes. Many of these controls are based upon religious convictions, such as fearing God and desiring to be a good steward. However, Robert Fonfeder, describes this system as a set of intricate accountability mechanisms that serves as the basis for the internal control ideology that is exhibited in Judeo-Christian models (Fonfeder, 2003).

Another accounting invention that had a tremendous impact on the accounting systems of Judeo-Christian nations is double-entry accounting. A precursor to this system can be found in the records of The Venerable Society of the Living and the Dead. This society was incorporated in 1304 in the Basilica Cathedral of Parma. The Society was established in honor of God, the Holy Virgin, and the saints venerated in the church of Parma. The goal of this society was to provide suffrages for the souls of benefactors throughout eternity, to engage in charitable work, and to promote the liturgical service of the church of Parma. These activities required considerable amounts of financial resources. As a result the society kept ledgers that recorded sales and expenditures in a form that was very similar to the debit and credit system. Their book of account was called the *Libr Rationum*. Each book began with the month of April which denoted a new accounting period. The book was comprised of various account including doubtful receivables, creditors of the Society, and various expenses. The accounting system of this religious society influenced the debit and credit system invented by Lucia Pacioli in 1494 (Bisaschi, 2003).

Accounting and Religion in the Modern World:

Historically, the effect of religion on accounting systems are obvious. However, many scholars suggest that religion has less of an impact today than it did in the past due to secularization.

There are two views of secularization. The first is the notion that religion is replaced by science and rationality. This definition of secularization has been contended because it ignores historical influences (Jacobs, 2005). The second deals with the separation of religion from science. It does not do away with religion but it compartmentalizes religion. Therefore, religion has a very limited space in society and science and rationality have a space as well (Hardy, 2005). Accounting would thus be considered a science and would then be separate from religion and its influence.

Secular and Sacred Models:

Two frameworks can be proposed that will aid in the conceptualization of how religion affects accounting practices today.

The secular model consists of two spheres, private and public. Religious ideologies and practices dwell in the realm of the private sphere. The Legal-entities and the private organizations that set accounting standards, exist in the public sphere. In the secular model governmental regulation ensures that the two spheres remain separate and distinct from the other. In some countries, the role of the government in maintaining this distinction is greatly emphasized.

It is important to clearly define what the public sphere is. A general definition of the public sphere is the concretized and organized common space for any given population. In Blandine Chelini-Pont's article entitled "Religion in the Public Sphere: Challenges and Opportunities", he argues that there are two views of the definition of the public sphere. One view is largely affected by Europe and the other by the United States (Chelini-Pointe, 2005).

The European definition of the public sphere is conservative and basically deals with the notion that the "State" is the main liaison between society and citizens. It is responsible for legal and practical oversight and for protecting civil society. The objective of the state is to act in manners that benefit the common good and to ensure that the distinction between civil society and private life is maintained.

A slightly different definition is derived from American tradition. In this definition, the public sphere is the space common for all where citizens are able to freely discuss issues and work to improve life. The role of the government in protecting the "public sphere" is not as important as in the European definition. The government serves to protect the "private sphere" and to ensure that all religious ideologies are allowed and that religious freedoms are upheld.

The second model that can be used to analyze religion in an accounting context is the sacred model. The sacred model differs from the secular model in that there is only one sphere. This sphere is that of society as a whole. Religious codes and edicts dictate accounting values which then in turn become the foundation for accounting principles. There is no separation between religious beliefs and business practices. Religion affects every aspect of spiritual and practical life.

The social sphere as it relates to the sacred model deals with the responsibility of business practices to benefit the entire society. The main focus is the interaction of society and the society's religious beliefs.

Secularization Classifications by Country:

Most, of the studies involving the idea of secularization only include western countries and would be classified under the Judeo-Christian model. As a result, secularization theories do not encompass all of the accounting systems that exist in the world.

France

One of the fundamental ideas of the French Republic is laicite. This concept embodies the constitutional principle of the States Neutrality in religious manners. It calls for a state that is free from an official or exclusive religion. Laicite began in 1905 as a way to restrict religious expressions in the public sphere in order to prevent clashes between religious groups (Cox, 2006). It also prohibits discrimination on the basis of faith. In looking, at the legal structure of France one might conclude that France would be classified under the secular model. In other words, religion exists in the private sphere but may not currently affect what is happening in the public sphere particularly as it relates to accounting systems. Laicite is comparable to American separation of church and state. One of major difference of this concept between France and America, however, is the affect that it has on ones right to manifest religious conviction in the public sphere. This is evidenced by laws banning student from wearing religious clothing in public schools. In America, though there is a prohibition of religion being taught in public schools people are allowed to express their religious convictions publicly. As a result, religion may be more likely to affect accounting systems in America as opposed to France.

Sweden

Separation of church and state was enacted in Sweden in 2000. Sweden does not require any religious organization to register. The national tax system allows the Church of Sweden and eight other denominations to raise revenue through member-contributions. All recognized religious organizations can claim direct government support. In addition, the state does not favor the Church of Sweden over any other religious organization. Religious education is mandated in all public schools. All major religions are covered. The Government actively promotes interfaith interactions. Sweden is a secular state of whose accounting policies would not be affected by religion. The United States would be considered more secular because religion is strictly prohibited in public schools. It is however very similar to Sweden in its policy of not favoring one religious organization over another.

United Kingdom

In the United Kingdom there are two established state churches, the Church of England and the Church of Scotland. The reigning monarch is the “Supreme” Governor of the Church of England. They must always be a member of the Church. Other religious groups are not required to register. In addition no church is subsidized by the government. The law provides for religious freedom and the government legally enforces it. There does seem to be pressure for separation of church and state laws similar to those in France. In 2006, a court ruled in favor of a high school expelling Muslim teenagers for not adhering to the dress code. Also, Christian teenagers were banned from wearing “purity rings’. Currently, there are no plans to disband any of the state churches. The United Kingdom has characteristics of both a secular and sacred society. There is a state church in place but freedom of religion is allowed. In the United States, the President is not required to have any particular religious affiliations. There are no state churches. As a result, the United Kingdom would be less secular than the United States.

It is evident that religion has affected the accounting systems of each of these countries in the past. Currently, the secularization trend has made religion less of an impact on accounting standards in countries such as France, Sweden, and the United States. Religion has more of an impact in the United Kingdom.

In looking at religion as a subset of culture it may be advisable to classify each of the countries into certain Gray/Hoftstede frameworks. It is clear that the United States and the United Kingdom are Anglo-Saxon dominated countries. These two countries would thus be classified as Fair Presentation and Full Disclosure Models, in which the purpose of accounting is to provide useful information for investors. According to the Gray/Hofstede model, Anglo-Saxon countries would be characterized by high individualism, low uncertainty avoidance, and a medium level of masculinity. In addition, Anglo countries would have high transparency in financial statements and take more risks in regard to accounting practices. Sweden, and France would be considered Continental European countries or Legal Compliance countries. The purposes of their accounting systems are to provide information to governments for taxation purposes and to banks for financing decisions. Continental European countries would rank high on statutory control and uniformity.

CONCLUSION

Throughout the world basic accounting standards are similar. However, national needs create diversity within accounting standards. This analysis shows that economic, legal, political, educational, and religious variables all strongly influence national accounting systems. Depending on the relative importance of certain variables, individual countries tend to emphasize specific aspects within their accounting system. In order for accounting systems to remain useful and relevant, they must respond to and reflect the cultural, social, economic and political conditions within which it operates. As the world evolves so will the accounting systems that serve the people of the world. Although a general harmonization of accounting standards is very possible, as long as the uniqueness of societies remain there will always be some differences due to the impact that the immediate environment has on accounting systems.

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DOES SARBANES-OXLEY ACT CHASE AWAY FOREIGN FIRMS? EVIDENCE FROM ADR TERMINATIONS

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ABSTRACT

This paper provides empirical evidence of the impact of Sarbanes-Oxley Act of 2002 (SOX) on the determinants of American Depositary Receipts (ADR) terminations between 2000 and 2004. The results suggest that the implementation of SOX increased the propensity of foreign firms to terminate their ADR programs and decreases the optimal duration of ADR programs. Pre-SOX, foreign firms with high Market-to-Book and high Sales Growth are less likely to terminate their ADR programs from U.S. capital markets explainable with a need to finance their growth opportunities. Post-SOX, firms with high growth opportunities are more likely to terminate existing ADRs and likely seek bonding with large capital markets outside of US that are not subject to SOX regulations.

INTRODUCTION

Foreign firms cross-list ADRs in U.S. to achieve greater capital access, overcome market segmentation, increased shareholder base, greater liquidity, and transparency (Doidge, Karolyi, and Stulz, 2004; Foerster and Karolyi, 1999; Miller, 1999). In addition, legal literature offers an explanation for cross-listings from the functional convergence stand point, also referred to as bonding hypothesis (Coffee, 1999, 2002; Stulz, 1999). According to bonding motivation, by cross-listing in U.S. foreign firms "rent" U.S. regulations but retain their domestic country allegiance, and therefore only functionally converge to U.S. There are two types of bonding – legal, by listing shares on exchange and fully complying with exchange and SEC rules and reputational, which implies reputational benefit from being present in the U.S. capital markets (usually OTC) but not fully legally complying with the regulations mandated by U.S. exchanges.

The implementation of Sarbanes-Oxley Act of 2002 (SOX) introduced a shift in the set of bonding benefits for foreign firms. The main purpose of SOX was to increase the corporate governance standards in U.S. by mandating stricter disclosure and monitoring of accounting practices. It considerably toughened accounting and disclosure requirements for the listing firms, raising the "rent" on U.S. laws (Ribstein, 2003). Compliance with SOX provides increased benefits by bonding with stronger regulatory environment as well as increased compliance costs.

Foreign firms listing shares in US capital markets are facing the increased costs associated with compliance with SOX. As a result there has been an increased trend in foreign delistings from US (Pozen, 2004; Marosi and Massoud, 2006). These delistings lead to value decrease. Due to the restrictive requirements imposed by SOX, there has been a shift in foreign listing from NYSE to European exchanges – mainly London and Luxemburg. Furthermore, Witmar (2006) shows that firms are more likely to voluntarily cross-delist after 2001, and that overall firms that cross-delist have higher proportion of trading volume in their home market, are from countries with weaker investor protection, and have lower Tobin's Q. Li (2007), Piotroski and Srinivasan (2007), and Witmer (2006) all report increased levels of foreign delistings following the adoption of SOX.

With the implementation of SOX, foreign firms benefit from cross-listing as they are subject to better corporate governance and disclosure regulations. However, SOX is associated with high compliance costs. Therefore, studying the decision to delist will provide a clarification on the question of cost benefit trade of SOX for the international issuers.

My study is the first to examine the impact of SOX on the determinants of ADR terminations based on the location of the ADR placement – exchange versus OTC markets. SOX has differential impact on the propensity of foreign firms to delist from OTC and exchange. In addition, I study the impact of SOX on duration of listing. My findings show that after SOX, foreign firms are generally more likely to terminate their ADR programs and SOX decreases the duration of optimal ADR listings. Pre-SOX, firms with high Market-to-Book ratio and high Sales Growth are less likely to delist from U.S. capital markets, consistent with a need a raise capital at a broader investor base to finance the potential growth. Post-SOX high Market-to-Book and Sales Growth firms are more likely to delist. The increased propensity of firms with high Sales Growth to delist post-SOX is attributable primarily to firms from common law countries. Firms from civil law countries post-SOX still benefit from ADR listing, consistent with the bonding hypothesis.

Overall, my study suggests that SOX on its own impacts the propensity of foreign firms to terminate ADR programs and that this impact is different depending on the location of listing, the type of firm, and the duration of the existence of the ADR program.

This paper is organized as follows: Section 2 provides literature review of the cross-listing and delisting process and the impact of SOX and the existing hypotheses from the cross-listing and delisting literature, Section 3 provides the hypotheses development of this paper, Section 4 discusses the data and Section 5 discusses the empirical results. Concluding remarks follow in Section 6.

LITERATURE REVIEW

The benefits of cross-listing have been widely discussed in the literature (Doidge, Karolyi, Stulz, 2004; Doidge, 2004; Coffee 1999; Reese and Weisbach, 2002). Cross-listing provides access to more developed capital markets, increased transparency, overcoming market segmentation and most importantly, has been proven to be an effective way of bonding with U.S. corporate governance laws. Foreign listings have been shown to enhance the value of the firm. It follows naturally, that foreign delisting from U.S. markets should reduce firm value.

Finance literature provides extensive evidence for negative effect of delisting on stock price both for American and foreign shares. Delisting U.S. firms experience stock prices drop of 8.5% after delisting from exchange trading, shareholders face a tremendous increase in trading, a significant decline in liquidity and loss in shareholder wealth. (Sanger and Peterson, 1990; Panchapagesan and Werner, 2004; Angel, Harris, Panchapagesan, and Werner, 2004). Similarly, in the case of foreign ADRs delistings there has been a significant drop in stock prices upon the announcement of delisting decision (Liu, 2003).

There are several hypotheses in the literature explaining the benefits of cross-listing in US capital markets and the motivations for delisting. This paper finds support of the bonding hypothesis however in addition I will provide a brief overview of two other hypotheses that provide further insights of the decision to cross-list and delist.

In recent years, *bonding hypothesis* has provided most reasonable explanation of the motivation to cross-list and subsequently will be used to explaining the delisting behavior of firms. It is a form of testing functional convergence (Coffee, 1999). According to bonding hypothesis, foreign firms can "leapfrog" their country's weak legal institutions by listing equity in the U.S. and voluntarily abiding by U.S. security laws. (Siegel, 2004) Further, Doidge, Karolyi and Stulz (2004) build a model around bonding hypothesis. They suggest that firms with higher growth opportunities should receive higher benefits from cross-listing, by showing that U.S. cross-listed firms have Tobin's q 17 % higher than foreign firms that are not cross-listed in U.S.

Further, Doidge (2004) provides support for bonding hypothesis by showing that foreign firms that cross-list shares in U.S. have voting premiums that are 43% higher than foreign firms that do not cross-list – explained by lower private benefits of control for majority shareholders that cross-list in U.S. Along the same lines, Doidge, Karolyi, Lins, Miller and Stulz (2005) show that firms with controlling insiders that have higher controlling rights in relation to cash flow rights are less likely to seek listing in U.S.

In addition, there are several other hypotheses explaining cross-listing. The most relevant to the issue of delisting is the hypothesis explaining the motivation to cross list as a source to access more developed capital markets and the information disclosure hypothesis.

Access to more developed capital market hypothesis explains the benefits of cross-listings from the perspective of reducing the dependence on internally generated cash flows, as U.S. capital markets provide opportunities for firms to raise capital at lower costs. This effect is further enhanced by specific features of more developed capital markets – liquidity, depth, and enhanced shareholder base (Lins, Strickland and Zenner, 2003).

The Information disclosure hypothesis is based on the concept of signaling. Foreign firms that list in U.S. are required to comply with strict disclosure requirements that require much more information than their respective domestic country. Compliance with this regulation sends a positive signal and therefore is beneficial to the company (Fuerst, 1998).

"Avoiding domestic governance hypothesis" is a contrasting hypothesis to bonding (Licht, 2003). According to avoiding hypothesis, firms cross-list in U.S. to avoid the governance standards in their domestic country that are less favorable. The reason is that the U.S. regulatory regime that is "out for rent by foreign issuers" is different from the domestic U.S. regulatory regime. According to the author, foreign issuer regime "cuts corners" on issues of corporate governance that are related to corporate insiders.

Further, support for the avoiding explanation is provided by Siegel (2004). He suggests that SEC has adopted "hands-off" informal policy of non-enforcement towards foreign issuers. Siegel observes the entire period after the enactment of the Securities Act and finds no reports about public enforcement steps even in cases of egregious misconduct that are even publicized in the issuer home country (Licht, 2003).

Perino (2005) also states that traditionally, before the implementation of SOX, SEC has treated foreign issuers differently than domestic issuers. However, when SOX was approved by the congress, this issue was simply overlooked and the same disclosure and corporate governance requirements were applied to both domestic and foreign issuers.

In addition, several studies (for example, Perino, 2005; Riebstein 2003) hypothesize that the implementation of SOX will generate additional and substantial costs of compliance with SOX. These costs are related to additional legal fees, disclosure, auditing and corporate restructuring. The extra costs of compliance are expected to be especially high for firms from civil law countries due to the difference between legal systems of those countries and that of U.S. (Perino, 2005).

HYPOTHESES

The implementation of SOX is associated with costs and benefits for foreign firm listing ADR shares in US capital markets. The costs stem from the increased compliance requirements and the benefits are derived from bonding with a legal system with higher regulatory standards. The impact of SOX on ADR terminations will be measured by the impact on the overall propensity of foreign firms to delist, the change in the optimal listing duration and the location of initial listing of the terminated ADRs.

There have been numerous evidences in the academic and practitioners' literature about the impact of SOX and the increased propensity of firms to delist after its implementation. SOX creates stricter disclosure requirements and thus imposes additional costs to foreign firms with ADR programs in U.S. After its implementation, I expect that firms will be more likely to terminate their ADR programs.

Hypothesis 1: *After the implementation of SOX, firms are more likely to terminate their ADR programs.*

Existing studies have shown several firm and country specific determinants of the decision to delist. The most significant determinants have been country legal origin (Witmer, 2006; Pagano, 2001), q-ratios, intangible assets (Marosi and Massoud, 2005), debt, etc. Doidge, Karolyi and Stulz (2004) show that firms with high growth opportunities are more likely to cross-list. Georgieva and Lee (2007) show that after SOX high Market-to-Book foreign firms are more likely to cross-list. In terms of the cross-delisting the results are the opposite – high Market-to-Book firms are less likely to cross-delist (Witmer, 2006). Consistent with the previous literature, I expect that high growth firms (as measured by Market-to-book and two year Sales Growth) will be less likely to terminate their ADR programs.

However, I expect that the implementation of SOX will shift the determinants of delisting. Given the high costs of compliance with SOX growth firms may find alternative sources to fund their growth opportunities and therefore might be more likely to delist post-SOX.

Hypothesis 2: *Before the implementation of SOX, firms with high Market-to-Book and high Sales Growth are less likely to delist from U.S. capital markets whereas after SOX, these firms are more likely to delist.*

The implementation of SOX provided stronger protection and better opportunities for legal and reputational bonding for foreign firms. By cross-listing on exchange, firms achieve stronger legal bonding. After SOX, this bonding is even stronger and is also associated with increased costs. By listing shares on the OTC market firms achieve reputational bonding. The OTC listed firms will not be subject to compliance with complete set of SOX regulations. Therefore, SOX will impact exchange and OTC listed ADRs potentially in different directions. It is suggested in a previous hypothesis that foreign firms listed on exchange are more likely to terminate their ADRs. However, I expect that after considering the location of initial ADR listing (exchange vs. OTC) that post-SOX the propensity of foreign firms to delist shares from U.S. capital markets would be primarily attributable to ADRs that were initially listed on an U.S. exchange.

SAMPLE DESCRIPTION

Data of delisted ADR programs is provided by Bank of New York. The data contains 984 companies with terminated ADR programs between 2000 and 2004. The file provides the initiation date for each DR program and the termination date. The number of terminated DR programs by year is presented in Appendix A. In addition, this file with matched and cross-checked with data from Citi bank in order to obtain the complete list of terminated depository receipt programs in U.S.

For each of these firms, annual accounting data is retrieved from Compustat Global. Country-specific variables are obtained from La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998). Capital access for each country across the years is obtained from the annual brochure of Milken Institute.

To find the determinants of the ADR terminations I compare the characteristics of foreign companies that terminate their ADRs with control sample of all foreign firms that have currently active ADR programs regardless of the time they originally listed. The sample of foreign firms with terminated ADRs consists of 146 firms terminating their ADRs between 2000 and 2004, and the control sample consists of 572 active ADRs. Foreign firms can sell their shares on exchange –NYSE, and NASDAQ, on the OTC market and PORTAL - private placements to qualified institution buyers (QIB).

Cross-listing in the U.S. is possible through four sponsoring banks - Bank of New York, City Bank, Deutsche Bank, and J.P. Morgan Chase. The break down by location of listing and sponsoring institution is presented in Table 1. The table shows that overall, the listing and delisting activities in NASDAQ are smaller compared to other listing locations.

Table 1: Existing and terminated ADR programs by year and location of listing

YEAR	NASDAQ	NYSE	OTC	PORTAL	Total
2000	1	9	15	6	31
2001	1	5	11	8	25
2002	8	9	10	8	35
2003	1	6	11	8	26
2004	5	3	16	5	29
Listed	50	120	302	100	572

Table 2 shows that most of the listing activities are focused in Bank of New York, who is the main depositary for the foreign firms. According to a recent study published by Oxford Metrica, ADR sponsored through Bank of New York overall have a stronger performance compared to ADRs sponsored by other depositaries. In terms of delisting, Panel B shows that the choice of depositary will not impact the delisting decision.

Table 2: Existed and terminated ADR programs by year and sponsoring institution					
YEAR	BNY	CIT	DB	MGT	Total
2000	16	11		3	30
2001	14	4	2	6	26
2002	22	10		3	35
2003	11	12	1	2	26
2004	24	2		3	29
Listed	382	75	32	83	572

Table 3 shows the firms in the listed and delisted sample by country – this table is on firm year level presenting the average Market-to-Book and assets for the observations from the panel data. On average, delisting firms have lower Market-to-Book, consistent with the notion of cross-listing premium (and therefore, cross-delisting discount).

Table 3: Firm year data on existing and terminated ADR programs						
	Existing ADR programs			Terminated ADR programs		
COUNTRY	N	MB	ASSETS	N	MB	ASSETS
Argentina	40	1.74	$2,286.59	24	0.91	$1,427.99
Australia	152	1.65	$10,942.47	23	1.56	$1,113.50
Austria	16	1.48	$3,655.91	5	1.13	$866.72
Belgium	8	1.71	$7,101.63	5	1.07	$1,778.84
Brazil	63	1.54	$8,533.18	45	1.18	$3,385.59
Chile	32	1.14	$3,842.39	24	0.91	$1,338.56
Colombia	5	0.83	$327.23			
Denmark	29	1.63	$45,866.90			
Egypt	5	4.5	$2,912.82	5	1.03	$4,232.67
Finland	8	1.46	$8,614.81	2	1.5	$363.99
France	128	1.43	$60,014.91	61	1.36	$171,784.21
Germany	123	1.53	$88,762.87	87	1.47	$15,002.71
Greece	28	1.53	$18,910.11			
Hong Kong	224	1.32	$4,609.09	52	1.08	$6,501.27
India	137	1.03	$5,735.78	23	1.16	$1,722.64
Ireland	13	1.39	$849.56	12	1.21	$526.56

Table 3: Firm year data on existing and terminated ADR programs						
	Existing ADR programs			Terminated ADR programs		
COUNTRY	N	MB	ASSETS	N	MB	ASSETS
Israel	18	1.5	$2,166.95	6	0.99	$1,168.74
Italy	31	1.72	$8,663.07	16	1.99	$8,487.87
Japan	465	1.27	$39,763.88	79	1.48	$32,713.47
Jordan	5	1.5	$548.14			
Korea	75	1.54	$22,327.50	12	0.99	$27,567.76
Malaysia	21	2.23	$10,928.02	5	1.19	$1,102.38
Netherlands	63	1.37	$24,745.49	10	1.03	$861.67
New Zealand	5	0.83	$98.34			
Norway	28	1.04	$9,281.38			
Philippines	12	0.75	$1,892.33	11	0.96	$955.08
Portugal	5	1.09	$866.23	9	1.36	$35,634.54
Singapore	71	1.27	$8,564.06	5	1.11	$1,566.84
South Africa	109	1.81	$1,862.98	42	1.48	$9,626.45
Spain	20	0.87	$23,426.13	5	1.07	$442,438.09
Sweden	25	1.24	$28,308.83	20	1.58	$6,396.36
Switzerland	37	1.34	$110,150.00	38	1.49	$332,328.82
Taiwan	134	1.26	$6,785.81	55	1.27	$1,894.58
Thailand	10	1.44	$1,328.60			
Turkey	18	1.6	$2,436.27	4	1.31	$125.63
United Kingdom	253	1.49	$58,953.00	110	1.48	$117,403.09
Venezuela				5	0.51	$4,601.36
Average		1.4	$28,725.05		1.33	$55,342.13

EMPIRICAL RESULTS

The decision to cross-list is determined by several company and country specific factors. The company specific factors measure the growth opportunities through Market-to-Book, two-year annualized Sales Growth, the age of the listing of the firms, and profitability (measured as EBIT/Assets). Legal origin dummy variable measures whether the firm belongs to a country with civil or common legal origin. Country specific variables used in this regression model, control for the quality of the domestic market, the legal tradition, and legal standards. This paper follows the variables used by La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998) - Accounting standards, judicial efficiency, and civil vs. common law legal tradition dummy variable. In addition, I use a measure for the capital access in the specific domestic countries available from Milken Institute, and liquidity ratio, following Doidge, Karolyi and Stulz (2004). I use a logit regression model is of the following form:

> Likelihood of ADR termination = f [Market-to-Book, Sales Growth, Profitability, age dummy, SOX, Legal origin dummy, Country market quality variables]

The results are shown in Table 4.

Table 4; Logit Regression on the Determinants of Adr Terminations

	M1	M2
SOX	**0.2251**	**0.2189**
	0.0001	***0.0003***
Market-to-Book	**-0.0573**	**-0.0548**
	0.0778	***0.0948***
Sales Growth	**-0.1952**	**-0.2076**
	0.0177	***0.0151***
Log(Assets)	0.0132	0.0129
	0.6427	*0.6577*
Leverage	-0.0029	-0.0057
	0.9229	*0.8504*
Profitability	-0.0383	-0.0376
	0.2076	*0.2223*
Exchange	-0.023	0.01
	0.8156	*0.9201*
Old	**0.2942**	**0.3608**
	<.0001	***<.0001***
CIVIL		0.0577
		0.5323
Antidirector rights		-0.0816
		0.0101
Rating on Acctg Standards		0.0059
		0.0052

Table 4; Logit Regression on the Determinants of Adr Terminations		
	M1	**M2**
Judicial efficiency		**-0.1064**
		<.0001
Capital Access		0.1303
		0.1094
Liquidity Ratio		-0.0119
		0.7304

The primary variable of interest is SOX dummy variable. Used on its own it shows the overall propensity of firms to terminate their ADR programs. Model 1 in Table 4 shows that after the implementation of SOX, firm overall firms are more likely to terminate their ADR programs, consistent with Hypothesis 1. The model also shows that high Market-to-Book and high Sales Growth firms are less likely to terminate their ADR programs. Georgieva and Lee (2007) show that high Market-to-Book and high Sales-growth firms are more likely to cross-list shares and the results in this paper are consistent with my previous findings. This model also shows that firms that have been listed for at least 7 years (in this paper referred to as “old firms”) are more likely to leave the U.S. A potential explanation for this result is that “old firms” have achieved the goals set forth the cross-listing decision – such as increased reputation, increased and sustained high profitability and capital raising.

Model 2 from Table 4 show that the results from Mode 1 are consistent with Model 1 and significant after controlling for country specific variables that define the regulatory environment, capital access and liquidity of the domestic country of the cross-delisting firms. In addition, Model 3 shows that firms from countries with high efficiency of the judicial system are less likely to delist. This is consistent with findings of Doidge, Karolyi and Stulz (2004) suggesting that high efficiency of the judicial system is necessary in order to reap the benefits of cross-listing.

In unreported regressions I study the interactions between the firm specific variables and SOX. It suggests that firms with growing sales and potential future growth opportunities are less likely to delist however after the implementation of SOX these firms are more likely to delist. These results suggest that there might be other potential sources to fund the growth opportunities and that other capital markets might also provide bonding benefits.

Next, I provide an alternative method for studying the impact of SOX on the delisting. I construct a subsample consisting only of firms that terminated their ADR programs. The purpose of this analysis is to study the company and country specific factors that determine the type of firms that would terminate ADR program after SOX. For this purpose, I perform a logit regression analysis in which the dependent variable is SOX and the independent variables are country and company specific variables:

Likelihood of ADR termination after SOX =
= f [Market-to-Book, Sales growth, Profitability, age dummy, Legal origin dummy, Country market quality variables]

The results are presented in Table 5.

Table 5: Logit analysis on the likelihood of ADR terminations before and after SOX		
	M1	**M2**
Market-to-Book	**0.3804**	**0.4839**
	0.0007	*0.0156*
Sales growth	0.371	**3.919**
	0.7145	*<.0001*
Profitability	0.0018	-0.0462
	0.9818	*0.7326*
Log(Assets)	-0.037	-0.2855
	0.5367	*0.1649*
Leverage	0.072	**0.2027**
	0.455	*0.0237*
Exchange	0.5161	-0.1805
	0.1798	*0.6977*
Old	**0.5629**	**0.7338**
	<.0001	*0.0011*
CIVIL	0.2014	**-0.2166**
	0.3299	*0.3038*
Market-to-Book*CIVIL		-0.172
		0.5096
Sales growth*CIVIL		**-3.832**
		<.0001
Profitability*CIVIL		0.0435
		0.7849
Log(Assets)*CIVIL		0.2773
		0.1868
Leverage*CIVIL		-0.1768

Table 5: Logit analysis on the likelihood of ADR terminations before and after SOX		
	M1	M2
CIVIL*Old		-0.2565
		0.3306
Exchange*CIVIL		1.0678
		0.1187
Antidirector rights	0.0735	0.0808
	0.1892	*0.1646*
Rating on Acctg. Standards	-0.0008	-0.0009
	0.4436	*0.3832*
Judicial efficiency	-0.0537	-0.0472
	0.4465	*0.5653*
Capital Access	0.0588	0.0374
	0.7476	*0.8582*
Liquidity Ratio	-0.011	0.0005
	0.8177	*0.9916*

Model 1 shows that old firms and firms with high Market-to-Book are more likely to terminate their ADR programs after SOX. In Model 2 I included interaction variables of all firm specific variables and the legal tradition dummy variable. The results suggest that the delisting behavior of firms with high Sales Growth is based on the legal tradition of their domestic country. High Sales Growth firms are more likely to delist after SOX if they are from a common law country as suggested by the coefficient estimate of Sales Growth (3.919) while they are less likely to delist after SOX if they are from a civil law country (as suggested by the coefficient of Sales Growth*CIVIL which captures the incremental impact of high sales growth firms and Civil law legal tradition).

This result is consistent with the bonding hypothesis. Civil law countries provide weaker protection for the minority shareholders La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998). In order to cross-list in the U.S. these firms have to comply with regulatory requirements of U.S. and therefore "bond" themselves with a stronger governance system. It might be that the providers of capital in these firms require the U.S. cross-listing and also cross-listings helps increase the reputation and trustworthiness of the firms.

Next section is focused on the value discount created by the ADR termination process. Previous research shows the existence of a cross-listing premium. Doidge, Karolyi and Stulz (2004) define the cross-listing premium as the increase in Market-to-Book for cross-listed foreign firms compared to non cross-listed foreign firms. In the case of terminating ADR programs, I expect the opposite effect – decrease in Market-to-Book for the delisting firms. In unreported regression results I observed a delisting discount of -0.11. After the implementation of SOX, there is a small incremental increase in the delisting discount that is not significant and is probably economically negligible.

CONCLUSION

In this paper I provide an explanation of the determinants of ADR terminations and the impact of SOX on these determinants. The impact of SOX on ADR terminations depends on the location of ADR listing, the legal origin of the domestic country and the length of existence of the ADR program. Overall my results suggest that there are both costs and benefits of cross-listing associated with SOX. The increased compliance costs may drive foreign firms with growth opportunity to alternative locations to finance their growth and an alternative location to increase their international reputation. However, U.S. capital markets have not lost their attractiveness as an environment that provides opportunity for firms from countries with weaker investor protection to bond themselves with a stronger regulatory environment.

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