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# JOURNAL OF INTERNATIONAL BUSINESS RESEARCH

## CONTENTS

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EDITORIAL REVIEW BOARD .....	v
LETTER FROM THE EDITOR .....	vi
US REIT INTERNATIONALIZATION AND FIRM VALUE .....	1
Jesse Holshouser, Nova Southeastern University & Silver Capital LLC	
H. Young Baek, Nova Southeastern University	
AN INVESTIGATION OF THE DAY-OF-THE-WEEK EFFECT ON THE ISTANBUL STOCK EXCHANGE OF TURKEY .....	15
Ravindra Kamath, Cleveland State University	
Chinpiao Liu, Cleveland State University	
QUALITY PERFORMANCE INDICES CONSTRUCTION OF BICYCLE COMPONENTS MANUFACTURING INDUSTRY USING A FUZZY ANALYTICAL HIERARCHY PROCESS .....	29
Jui-Kuei Chen, Tamkang University	
I-Shuo Chen, National Chiao Tung University	
FAMILY FRIENDLY POLICIES IN MALAYSIA: WHERE ARE WE? .....	43
Geetha Subramaniam, Victoria University of Wellington	
Doris Padmini Selvaratnam, Universiti Kebangsaan Malaysia	

IMPORTED PRODUCT ACCEPTANCE WHEN NATIONAL ORIGIN IS NOT AN ISSUE: THE INFLUENCE OF PERSONAL CHOICE IN A LOW CETSCALE ENVIRONMENT .....	57
John Lambert, The University of Southern Mississippi Adrine Harrell, The University of Southern Mississippi	
 GLOBALIZATION AND REGIONALIZATION: FOUR PARADIGMATIC VIEWS .....	 71
Kavous Ardalan, Marist College	
 POLITICAL SOURCES OF INTERNATIONAL BUSINESS RISK: AN INTERDISCIPLINARY FRAMEWORK .....	  103
Jay van Wyk, Pittsburg State University	

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## LETTER FROM THE EDITOR

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The manuscripts contained in this volume have been double blind refereed. The acceptance rate for manuscripts in this issue, 25%, conforms to our editorial policies.

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# US REIT INTERNATIONALIZATION AND FIRM VALUE

**Jesse Holshouser, Nova Southeastern University & Silver Capital LLC**  
**H. Young Baek, Nova Southeastern University**

## ABSTRACT

*Investment in U.S. real estate is becoming increasingly competitive due to increased capital flows and improving industry fundamentals. U.S. Real Estate Investment Trusts (REITs) are seeking new investment opportunities through international investments. This paper reviews the research literature to determine possible investor reaction to international diversification strategies by U.S. REITs and identifies recent diversification trends.*

*We find that the US REITs that specialize in corporate real estate are beginning to diversify internationally through joint ventures with local firms. Empirical evidence shows that Tobin's Q ratios are positively related to international investment in 2003 when asset size and property types are controlled for. The relationship, however, disappeared in a 2006 sample.*

## INTRODUCTION

U.S. real estate investment has become increasingly competitive in the last few years due to increased capital flows and improving industry fundamentals. Real estate sales to institutional investors, including hedge funds, overseas investors, private equity funds, partnerships, pension funds, and endowments, surged 50 percent in 2004 to \$180 billion (PNC Real Estate Finance, 2005). The market capitalization of U.S. Real Estate Investment Trusts (REITs) increased 34% in 2004 to \$275 billion as investors were attracted by high dividend yields and stable cash flows (National Association of Real Estate Investment Trusts, 2005). The weakening of the dollar against other western currencies has made U.S. real estate an attractive target for foreign capital (Froot and Stein, 1991). Foreign investment rose 59% in 2003 to \$385 million and increased another 11.9% in 2004 to reach \$431 million (Association of Foreign Investors in Real Estate, 2004). This increased competitive environment has resulted in high property values and lower returns, making it more difficult for investors to achieve the same returns as in the past.

As the demand for U.S. properties has increased, fewer properties are available to purchase. Most real estate investor capital is invested in corporate properties (office buildings, commercial/retail stores, industrial properties) or apartment projects. As real estate investment expanded in the last 20 years corporate users sold much of their real estate to investment groups

through sale-leaseback transactions. This freed up capital to invest in their core businesses, enhanced balances sheets (by removing the real estate assets and related liabilities) and improved profitability. Current estimates are that only 30% of U.S. corporate real estate is owner occupied (Brounen and Eichholtz, 2004). This market is maturing with fewer properties eligible for sale leasebacks. As a result, the inventory of corporate properties is not growing as fast as prior years while the demand is increasing substantially. With the maturing of the corporate property market, demand for apartment projects is high, resulting in record prices and low returns to investors.

Opportunities for international real estate investment are emerging. In Europe approximately 70% of corporate real estate is still owner occupied (Brounen and Eichholtz, 2004). European governments are encouraging privatization through the sale of real estate. The U.K. government is reported to be planning a £30 billion outsourcing of assets. In Germany, a number of federal and local governments plan to sell and lease back real estate portfolios. The French government recently said it intends to dispose of €1.5 billion in real estate assets over the next three to four years (Kilbinger, 2005). At the same time, more than 20 countries have adopted legislation to enable funds similar to REITs to attract investors to their real estate markets to provide a source of financing for property owners and developers and to create a more liquid, efficient form of investment (Larkin, Babin and Rose, 2004).

Recognizing these international opportunities and the competitive environment in the States, U.S. REITs that specialize in corporate properties are considering investing in foreign real estate. Proponents of international diversification argue that existing REITs can utilize their intellectual and financial capital to take advantage of the emerging opportunities and exploit possible inefficiencies in developing markets. In addition, there is less competition for properties and returns are generally higher than those produced by U.S. real estate. However, others argue that real estate investment requires extensive knowledge of local laws and customs and that the U.S. experience cannot be easily applied to foreign countries.

It is timely to ask how investors will react to U.S. REIT investments in foreign real estate, and whether they prefer to invest through existing U.S. REITs or directly in foreign REITs. Although the very recent nature of international diversification of real estate funds limits our sample size, this study finds that REITs that specialize in corporate real estate are beginning to diversify internationally through joint ventures with local firms, and that investors are reacting favorably to REITs' international diversification.

This paper first examines the research literature on international diversification and the role of international real estate investment in investor portfolio diversification. It then examines recent empirical data to identify international diversification trends and determine investor reaction to these trends.



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## LITERATURE REVIEW

The benefits of international corporate diversification at the investor level are well documented (Grubel 1968; Levy and Sarnat 1970; Lessard 1973; Solnik 1974). Addition of international securities to a diversified but domestic portfolio reduces risk due to the low correlation between foreign and domestic equity markets. Investors can either invest directly in foreign companies or indirectly in multinational enterprises (MNEs). However, there is mixed evidence about whether investors perceive value from MNEs (Agmon and Lessard 1977; Fatemi 1984). Furthermore, investors are increasingly able to realize the benefits of international diversification by investing directly in foreign firms.

Theories on the market valuation of MNEs fall into three areas – internalization, imperfect capital markets and agency costs (Saudagaran, 2002). The internalization theory posits that companies with firm-specific intangible assets (e.g., superior skills in production, management, marketing or R&D; patents; consumer relationships) cannot easily transfer or license their assets to established firms. Instead, they create internal markets for these assets and exploit them by expanding into foreign markets (Rugman, 1981).

The imperfect capital markets theory suggests that multinational firms provide value to investors who might otherwise be constrained in making global investments by restrictions on capital flows, information asymmetries and high transaction costs (Agmon and Lessard 1977; Errunza and Senbet 1981, 1984).

The agency theory posits that managerial objectives may not be aligned with those of shareholders (Jensen and Meckling, 1976). Amihud and Lev (1981) posit that corporate managers may attempt to diversify at the corporate level in order to diversify their personal wealth, which is highly correlated to firm value. Duru and Reeb (2002) found that top management compensation increases as their firms become more multinational. As MNEs grow and become more complex, it is more difficult for shareholders to monitor management, giving managers more opportunities to act in their own self-interests. This may reduce the value of MNEs

Despite these theoretical arguments favorable to international diversification, there is mixed evidence about the value (or discount) that investors place on international involvement by firms. A number of papers have concluded that investors discount the value of firms as they increase their international involvement (e.g., Denis, Denis and Yost, 2002). However, others have concluded that there is a diversification premium and that the discounts found by other researchers are a result of firm size, other factors unrelated to diversification or the methodology used in the studies (Bodnar, Tang and Weintrop, 2003).

Prior studies have identified diversification benefits when real estate as an asset class is added to an investment portfolio. Numerous studies have concluded that domestic real estate returns are lowly correlated to those of domestic stocks and bonds (Ennis and Burik 1991; Ziobrowski and Ziobrowski 1997; Seiler, Webb and Myer 1999; Goodwin and Zumpano 2007 SFA).

Direct investment in real estate, however, involves numerous drawbacks, including relatively large sums of money, lack of liquidity, high transaction costs, need for market knowledge and management requirements (Wilson and Zurbruegg, 2003). The advent of public investment funds that invest in real estate, most commonly in the form of REITs, allows investors to overcome these problems.

Early research was divided on the merits of international real estate diversification (Wilson and Zurbruegg, 2003). However, more recent research shows that international real estate diversification is beneficial to investors. Hoesli, Lekander and Witkiewica (2004) find that both domestic and international real estate are effective portfolio diversifiers. Conover, Friday and Sirmans (2003) find that returns on foreign real estate investments show lower correlations with the returns on US stock portfolios, and international real estate has a significant weight in efficient international portfolios. Campbell, White-Huckins and Sirmans (2006) examined a sample of 185 domestic and international equity REIT joint ventures (JVs), and documented a negative average abnormal return around the announcement of JVs. Cumulative average abnormal return during a three-day announcement period was insignificant, however, for the 11 JV acquisitions of foreign real estate.

Prior literature focused on the return correlations and mean-variance efficiency at the country or property sector index level. Lacking in the literature is the study of international direct investments by REITs and their value impact at corporate level. We attempt to fill in the gap in the literature by examining the firm value impact of the U.S. REITs that are involved in international real property investments.

### **SAMPLE AND DATA**

Data were collected for U.S.-based REITs for the year ended December 31, 2003 and December 31, 2006. Of the 173 publicly-traded REITs, 86 and 84 were included in the sample for years 2003 and 2006, respectively. Only equity REITs that invest in the four primary property types (office, retail, industrial and apartments) were included. Specialty REITs (lodging, self storage, manufactured housing) and mortgage REITs were excluded from the study (See Table 1 for sample selection details).

Data were obtained from annual SEC filings (form 10-K) for each REIT, including the book value of assets, liabilities and equity. The market capitalization for each REIT was collected from data provided by the National Association of Real Estate Investment Trusts (NAREIT).

<b>Table 1: Sample Selection</b>				
Dec. 31, 2003			Dec. 31, 2006	
Total Equity REITs	173		Total Equity REITs	173
Industrial/Office			Industrial/Office	
Office	21		Office	18
Industrial	9		Industrial	7
Mixed	6		Mixed	5
Retail			Retail	
Shopping Centers	19		Shopping Centers	15
Regional Malls	9		Regional Malls	9
Free Standing	7		Free Standing	4
Residential			Residential	
Apartments	21		Apartments	17
Manufactured Homes	4		Manufactured Homes	4
Diversified	19		Diversified	9
Lodging/Resorts	14		Lodging/Resorts	16
Self Storage	3		Self Storage	4
Health Care	13		Health Care	11
Specialty	8		Specialty	9
Home Financing	12		Home Financing	25
Commercial Financing	8		Commercial Financing	13
			Hybrid	7
<b>Sample OBS #</b>	<b>86</b>		<b>Sample OBS #</b>	<b>84</b>

Out of 86 REITs in our 2003-year sample, we found seven with some degree of international involvement, and out of 84 2006-year REITs, ten were found to have some international involvement. Our sample is consistent with the sample of Campbell, White-Huckins and Sirmans (2006), which contains only 11 announcements of JVs with a foreign partner during an 8-year period from 1994 to 2001. Also consistent with Campbell, White-Huckins and Sirmans (2006), most of their involvement is through joint ventures where the REIT owns minority interests that are not included in the REIT's consolidated statements; instead they are reported using the equity method whereby the REIT reports only its share of income (or loss). Only one apartment REIT has some involvement in Germany, most probably because the demand for new U.S. properties is providing

them with more than enough product. Table 2 lists the REITs that reported some degree of international involvement.

<b>2003 REIT Name</b>	<b>Property Type</b>	<b>Assets (\$M)</b>	<b>Foreign Countries</b>	<b>2006 REIT Name</b>	<b>Property Type</b>	<b>Assets (\$M)</b>	<b>Foreign Countries</b>
				General Growth Properties	Regional Malls	25,242.4	<b>Brazil, Turkey, Costa Rica</b>
Simon Property Group	Shopping Centers	15,684.7	Canada, Europe	Simon Property Group	Regional Malls	22,084.4	Canada, Europe
ProLogis Trust	Industrial	6,369.2	Mexico, Europe, Japan, China	ProLogis Trust	Industrial	15,903.5	Mexico, Europe, Japan, China
				Archstone-Smith Trust	Apartments	11,467.1	<b>Germany</b>
Kimco Realty Corp.	Shopping Centers	4,603.9	Canada, Mexico	Kimco Realty Corp.	Shopping Centers	7,869.2	Canada, Mexico
				Developers Diversified Realty	Shopping Centers	7,179.7	<b>Brazil</b>
AMB Property Corp.	Industrial	5,420.6	Europe, Asia	AMB Property Corp.	Industrial	6,713.5	Europe, Asia
Chelsea Property Group	Shopping Centers	1,970.4	Japan				
Mills Corporation	Shopping Centers	3,294.6	Europe	Mills Corporation	Shopping Centers	6,103.2	Europe
Liberty Property Trust	Office/Industrial	3,834.0	UK	Liberty Property Trust	Office/Industrial	4,910.9	UK
				DCT Industrial Trust	Industrial	2,849.5	<b>Mexico</b>

Firm value was measured using Tobin's Q, the ratio of the market value of the REIT's assets to its replacement cost. Higher ratios are indicative of positive investor views of the REIT. The market value was calculated as the sum of the market value of the equity and the book value of all liabilities (including minority interests and preferred stock). The replacement cost of the assets was assumed to be the book value. Variable descriptions are given in Table 3.

**Table 3: Variable Description and Source**

Variable	Description	Source
Company	Company Name	NAREIT
Ticker	Stock exchange ticker symbol	NAREIT
Exchange	Stock exchange	10-K
Property Sector	Office/Industrial; Retail; Residential; Diversified	NAREIT
Market Cap	Common stock market capitalization	NAREIT
Assets	Total assets	10-K
Liabilities	Total liabilities	10-K
Min Interest	Minority interests	10-K
Pref Stock	Preferred stock @ redemption value	10-K
Common Equity	Total assets – BV liabilities – BV preferred stock	10-K
Profit	Profit to common shareholders	10-K
Domestic	Domestic diversification	10-K
Imputed Value	Total assets - liabilities - minority interest - preferred stock - mkt cap	10-K and NAREIT
Tobin's Q	imputed value divided by total assets (book value)	10-K and NAREIT
Subsector	Office; Industrial; Mixed; Shopping Center; Regional Mall; Freestanding; Apartments; Diversified.	NAREIT
Global	1 = international involvement; 0 otherwise	

## RESULTS

Descriptive statistics are presented in Table 4. The average market capitalization of our sample equity REITs was \$1.938 billion in 2003, and the average book value assets and liabilities are \$3.152 billion and \$1.832 billion, respectively. In 2006, sample averages of market capitalization, assets and liabilities went up to \$3.325 billion, \$3.915 billion, and \$2.436 billion, respectively. Tobin's Q ratios were 1.32 and 1.50 in 2003 and 2006, respectively. About 8 percent and 12 percent of REITs had international involvements in 2003 and 2006, respectively. Both years show similar composition of REITs by subsectors. Office REITs is the largest component of our sample followed by apartment and shopping center REITs.

Note from Panel A of Table 5 that both the average market capitalization and Tobin's Q rose significantly during the real estate booming period from 2003 to 2006. The U.S. REITs with some international involvement in 2003, on average, were much larger in market capitalization and assets than the ones without (Panel B). They also showed higher valuation in terms of Tobin's Q (1.51 vs. 1.30). Size differentials continued to exist in 2006 between the REITs with and without international

involvement. Average Tobin's Q ratio, however, is not statistically different between two groups in 2006 (Panel C). This could result from the general trend of overvaluation of real properties in the states during the 2003-2006 period.

**Table 4: Descriptive Statistics 2003 (n=86) and 2006 (n=84) Year-Ends**

<i>2003</i>	<b>Min</b>	<b>Max</b>	<b>n=1</b>	<b>Mean</b>	<b>Std. Dev.</b>
MktCap	142,391.5	11,453,209.9		1,937,041.0	2,023,017.9
Assets	341,307.0	24,189,010.0		3,151,842.0	3,597,865.8
Liabilities	112,957	12,454,042		1,831,685.2	2,095,045.8
TobinQ	0.8789	1.9798		1.3178	0.2222
Global	0	1	7	0.0814	0.2750
SubAPT	0	1	17	0.1977	0.4006
SubDIV	0	1	6	0.0698	0.2562
SubFREES	0	1	4	0.0465	0.2118
SubIND	0	1	7	0.0814	0.2750
SubOFF	0	1	20	0.2326	0.4249
SubREGM	0	1	9	0.1047	0.3079
SubSCTR	0	1	17	0.1977	0.4006
SubMIX	0	1	6	0.0698	0.2562
<i>2006</i>	<b>Min</b>	<b>Max</b>	<b>n=1</b>	<b>Mean</b>	<b>Std. Dev.</b>
MktCap	14,540.0	22,370,038.3		3,324,641.3	4,318,688.5
Assets	42,730.0	25,242,445.0		3,914,640.3	4,704,467.4
Liabilities	22,680	23,046,785		2,435,962	3,546,187
TobinQ	0.6452	2.6187		1.5012	0.3792
Global	0	1	10	0.1190	0.3258
SubAPT	0	1	17	0.2024	0.4042
SubDIV	0	1	9	0.1071	0.3112
SubFREES	0	1	4	0.0476	0.2142
SubIND	0	1	7	0.0833	0.2780
SubOFF	0	1	18	0.2143	0.4128
SubREGM	0	1	9	0.1071	0.3112
SubSCTR	0	1	15	0.1786	0.3853
SubMIX	0	1	5	0.0595	0.2380

MktCap (market capitalization), Assets and Liabilities are in \$000's. Tobin's Q is the imputed value divided by total assets (book value). Global takes the value of 1 if the REIT has some international involvement and 0 otherwise; SubAPT, SubDIV, SubFREES, SubIND, SubOFF, SubREGM, SubSCTR, and SubMIX denote the apartments, diversified, freestanding retails, industrial, office, regional malls, shopping centers and mixed industrial/office, respectively.

<b>Table 5: Test of Mean Difference</b>					
<b>Panel A. Mean Differences: 2003 vs. 2006</b>					
	2003 (n=86)	2006 (n=84)	Difference '06 – '03	t-stat	Sig.
<b>MktCap</b>	1,937,041.0	3,324,641.3	1,387,600.3***	2.6723	0.0086
<b>Assets</b>	3,151,842.0	3,914,640.3	762,798.3	1.1855	0.2376
<b>TobinQ</b>	1.3178	1.5012	0.18***	3.8363	0.0002
<b>Global</b>	0.0814	0.1190	0.04	0.8149	0.4163
<b>Panel B. Mean Differences for 2003 Sample: Domestic vs. Global</b>					
2003	Global=0 (n=79)	Global=1 (n=7)	Difference Global - Non	t-stat	Sig.
<b>MktCap</b>	1,694,345.4	4,676,034.5	2,981,689.1***	4.064	.000
<b>Assets</b>	2,837,113.4	6,703,779.7	3,866,666.3***	2.836	.006
<b>TobinQ</b>	1.3004	1.5134	.2130**	2.506	.014
<b>Panel C. Mean Differences for 2006 Sample: Domestic vs. Global</b>					
2006	Global=0 (n=74)	Global=1 (n=10)	Difference Global - Non	t-stat	Sig.
<b>MktCap</b>	2,500,435.0	9,423,768.2	6,923,333.2***	3.260	.009
<b>Assets</b>	2,952,784.5	11,032,373.5	8,079,589.0***	3.321	.008
<b>TobinQ</b>	1.4914	1.5733	.0819	.639	.525
<b>Panel D. Mean Differences for Combined Sample: Domestic vs. Global</b>					
'03 + '06	Global=0 (n=153)	Global=1 (n=17)	Difference Global - Non	t-stat	Sig.
<b>MktCap</b>	2,084,218.8	7,468,819.0	5,384,600.2***	3.841	.001
<b>Assets</b>	2,893,058.9	9,250,011.4	6,356,952.5***	3.840	.001
<b>TobinQ</b>	1.3928	1.5487	.1559*	1.906	.058
MktCap (market capitalization) and Assets are in \$000's. Tobin's Q is the imputed value divided by total assets (book value). 2-tail tests assuming independent samples. *, ** and *** denote statistical significance at 10%, 5% and 1% levels, respectively.					

A multivariate regression analysis is used to determine whether international involvement affects Tobin's Q ratio when size and property sectors of REITs are controlled for. A dummy variable, GLOBAL, is coded as 1 if the REIT had international involvement at the end of a given year and 0 if solely domestic. Fund size is proxied using the natural log of the book value of assets, and property types are divided into office, apartment, diversified, free standing retail, industrial, regional malls, shopping centers, and mixed use.

<b>Table 6: Regression Analysis</b> <i>Dependent Variable: Tobin's Q</i>		
	<b>Year 2003</b>	<b>Year 2006</b>
(Constant)	1.4678***	-0.0346
	3.4334	-0.0616
Global	0.1908**	-0.0522
	2.0138	-0.3413
SubAPT	0.0918	0.1509
	1.3560	1.1882
SubDIV	0.2744***	-0.0251
	2.8728	-0.1637
SubFREES	0.2301**	0.3312
	2.0004	1.5979
SubIND	0.1938**	0.0468
	2.0597	0.2615
SubREGM	0.1126	-0.0645
	1.2761	-0.4084
SubSCTR	0.1975***	0.1700
	2.7970	1.2762
SubMIX	0.0863	-0.0617
	0.9030	-0.3222
LnAssets	-0.0197	0.1014***
	-0.6761	2.7055
n	86	84
adj R <sup>2</sup>	0.1469	0.0480
F	2.6267	1.4653
sig	0.0106	0.1769

Tobin's Q is the imputed value divided by total assets (book value). Global takes the value of 1 if the REIT has some international involvement and 0 otherwise; LnAssets denotes the log of total assets. SubAPT, SubDIV, SubFREES, SubIND, SubREGM, SubSCTR, and SubMIX denote the apartments, diversified, freestanding retails, industrial, regional malls, shopping centers and mixed industrial/office, respectively. Office is the default subsector type. t-stat in small font below coefficient. \*, \*\* and \*\*\* denote statistical significance at 10%, 5% and 1% levels, respectively.

The results of the regressions are presented in three columns of Table 6 for the 2003, 2006 and combined samples. The regression for the sample of 86 U.S. REITs in year 2003 shows that



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international involvement (GLOBAL) had a significant positive affect on Tobin's Q Ratio ( $t = 2.014$ ) once controlled for asset size and property types. Its coefficient of .1908 is also economically significant. The regression was significant ( $F = 2.628$ ) with an adjusted  $R^2$  of .1469. Although the REITs with international involvement were on average larger in asset size and more valuable in Tobin's q ratio (Table 5), size doesn't seem to affect the q ratio. Property types, however, were important valuation factors in 2003: Diversified, free standing, shopping center, and industrial REITs had statistically and economically higher q ratios than office REITs.

Results of a similar regression analysis for the 2006 sample of 84 U.S. REITs are given in the second column. Surprisingly, international involvement (GLOBAL) and property types are not related to Tobin's q ratio any more. Only the asset size had a positive effect on the q ratio.

### CONCLUSION AND DISCUSSION

Three theoretical arguments were presented that favor international diversification – internalization, imperfect capital markets and agency costs. REIT managers have extensive expertise in acquiring, financing, owning and marketing real estate properties, which may support the internalization theory that firms have unique intangible assets that can best be exploited by diversifying internationally. The imperfect capital markets theory may not be immediately supported due to the advent of REIT-like industries in 20 different countries; however, these funds have not yet demonstrated an ability (or desire) to market to U.S. investors, who may continue to prefer U.S. real estate funds and managers with experience in the industry. Noteworthy is that the recent trend in electronically traded funds (ETFs) makes foreign investment, especially foreign real estate investment, costing less than ever. Finally, the agency costs theory has always been a concern in the REIT industry, which typically has relatively weak governance structures and low levels of stock ownership by senior managers.

With the increasing globalization of financial markets and the maturing of the U.S. corporate real estate market, the question of the value that investors place on international involvement will continue to be an important issue. This study shows that investors seemed to value international involvement by REITs in year 2003. Although we don't find the valuation effects of asset size, we do find property types are key valuation factors in terms of Tobin's q ratio. Another interesting finding from this study is that the valuation effects of international involvement and property types disappeared during the intra-sample period of 2004-2006, when the U.S. real estate markets experienced historic changes.

Some limitations exist in this preliminary draft. With the limited size of the sample, care should be taken in drawing any conclusions. In addition, necessary is the answers to the question of whether the foreign real property investments via JVs increase the firm value *or* more valuable firms are more likely to invest in foreign real estates. Even the REITs with high Tobin's q ratio do not necessarily have a large amount of free cash flow to abuse in the sense of Jensen's (1986) study,

because all REITs are required to pay out at least 90% (from year 2001) of income as dividends. To explain the disappearance of the impact of international involvement on valuation, the relationship between overvaluation and predictability of value should be reviewed from the evidence from other markets including stock markets.

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# AN INVESTIGATION OF THE DAY-OF-THE-WEEK EFFECT ON THE ISTANBUL STOCK EXCHANGE OF TURKEY

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## ABSTRACT

*This empirical study examines the day-of-the-week effect on the nascent stock exchange of Istanbul, Turkey. The investigation relies on the most recent 60-month period from January 2003 through December 2007. During this period, the Turkish stock market registered a 424 percent gain. Numerous studies have indicated that the stock market returns depend on the day of the week in the U.S. as well as in many stock markets around the world. For the most part the literature points to significantly negative returns on Mondays and significantly positive returns on the last trading day of the week. More recent studies which have utilized a robust methodology such as the GARCH model, have questioned the presence of such an effect in some of the markets. To investigate the presence of this anomaly in the Turkish market, this study utilizes both, the OLS methodology as well as the GARCH methodology. Irrespective of the method used, we find that the said effect to be very much present in the first half of the 5-year test period but to have completely vanished in the second half of the test period.*

## INTRODUCTION

Until about fifteen-twenty years ago, the empirical evidence has steadfastly indicated that the equity market returns depend on the day of the week. For the U.S. market indicators, the documented evidence had suggested a significantly negative and the lowest rate of return on Mondays and a diametrically opposite pattern on the last trading day of the week. A comparable evidence of the day-of-the-week anomaly has also been documented for both developed and developing markets around the world. Kamath, et al. paper (1998) presents a table of empirical findings regarding this anomalous effect in Australia, Canada, Finland, France, Germany, Greece, Italy, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, Hong Kong, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, and Thailand.

More recently, some researchers have questioned the findings reported by utilizing the OLS methodology (see for example Connolly (1989), Chang, et al. (1993) and Dubois and Louvet (1996)). However, the reliance on a robust econometric technique to observe the day-of-the-week effect has

not always succeeded in disputing the OLS findings. For example, while Alexakis and Xanthakis (1995), and Kamath, et al. (1998) papers concluded that evidence on the anomalous effect was not dependent on the methodology, the Chen, et al. (2001) study noted that their findings of the Chinese stock market were dependent on the estimation method as well as the period of study. The purpose of this study is to present empirical evidence on the day-of-the-week effect on the Istanbul Stock Exchange of Turkey. The secondary objective is to determine if the conclusions regarding the presence of such an effect are dependent on the methodology adopted as well as the sample period itself. To meet these objectives, we rely on the most recent 60-month period from January 2003 through December 2007.

The rest of the paper is organized as follows. A brief review of literature on the subject at hand is contained in the next section. The data and the methodologies utilized are described in the third section. The findings of this investigation are reported in the fourth section. A brief summary of the paper is included in the last section.

### **PREVIOUS RESEARCH**

Abundant empirical evidence concerning the day-of-the-week effect as well as other seasonal anomalies in the equity markets can be found in the finance literature. Specifically, some of the most cited articles on the subject (French (1980), Gibbons and Hess (1981), Keim and Stambaugh (1984), Jaffe and Westerfield (1985) and Lakonishok and Smidt (1988)) have noted that the market indicator returns tend to be dependent on the day of the week. For example, Lakonishok and Smidt (1988) have reported that such an anomaly existed in each of their ten sub-periods dating back to 1897 for the Dow Jones. By and large, the methodology of choice in the earlier studies was the standard OLS formulation. Connolly (1989) questioned the evidence of such an effect based on the OLS methodology since he believed that the distributional attributes of the equity market data were inconsistent with the underlying assumptions of the OLS technique. Connolly also noted that the interpretation of the findings of studies which relied on very large sample sizes could have been distorted. In particular, he indicated that in such cases, the F-tests tend to reject the null hypothesis too often. Connolly's study concluded that the intensity of the day-of-the-week effect in the U.S. markets had reduced considerably after 1975. Indeed the studies of Keim and Stambaugh (1984), Rogalski (1984), Smirlock and Starks (1986), and Condoyanni, et al. (1987) detected reduced intensity of such an effect in the post-1975 sub-periods of their respective studies.

Chang, et al. (1993) study confirmed that "the effect" had become insignificant in the U.S. as well as in Belgium, Denmark and Germany during the 1986-1992 period upon adjusting for the OLS error term or the sample size. However, they did find evidence of a robust effect in Canada, Hong Kong and seven European markets even after the adjustment for the OLS error term. Dubois and Louvet (1996) also found "the effect" to disappear in the 1985-1992 sub-period in the U.S., Canada, Japan, Germany and Australia. On the other hand, Wilson and Jones (1993) found the

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presence of “the effect” even after making corrections for the non-normality of the data in four U.S. equity market indices including the S&P 500.

The presence of the day-of-the-week effect has been examined for numerous markets around the world, for both, developed and developing markets. For example, the said effect has been investigated for the markets of Canada, Finland, France, Germany, Greece, Italy, the Netherlands, Spain, Sweden, Switzerland, Turkey, U.K., Australia, Hong Kong, China, Japan, South Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand, Taiwan, and Israel. <sup>1</sup> With some glaring exceptions, the evidence points toward a persistent day-of-the-week effect. In case of Israel, for example, the returns were found to be positive on all days of the week with the largest return registered on Sundays. (see Lauterbach and Unger (1992)). Studies by Ho (1990), Lee, et al. (1990) and Wong, et al. (1992) found the return to be positive on all days in Taiwan as well. With respect to the Spanish stock market, Santemases (1986) did not find “the effect” but Chang, et al. (1993) reported a robust presence of such an effect during the 1986-1992 period. Steely (2001) study of the UK market concluded that the said effect to have disappeared during the 1990s. However, upon partitioning the data based on the market direction, Steely found the negative returns on Mondays and Fridays to be significantly different from the other days of the week. The recent investigation by Hui (2005) reported that there was evidence of the said effect in Singapore but not in Korea, Hong Kong and Taiwan. The Demirer and Karan (2002) study of the Turkish stock market during the January 1988-March 1996 period did not find clear evidence of “the effect” even though they noted that the Friday returns were “consistently high”. Moreover, they found that “the effect” became even more insignificant when they adjusted the returns for the inflation rate and the overnight rate.

The evidence found in the literature on the said effect robust methodologies have not always disputed the results obtained with the OLS methodology. For example, in case of the S&P 500 index futures, Najand and Young (1994) reported the absence of “the effect” when they considered the impact of conditional heteroskedasticity in the returns. Easton and Faff (1994) for Australia, Alexakis and Xanthakis (1995) for Greece and Kamath, et al. (1998) for Thailand found “the effect” to be present regardless of the methodology employed. Kamath and Chasanachoti (2002) found “the effect” to be robust in the 1980s but to have completely vanished in the 1990s in Korea, irrespective of the methodology utilized. However, Chen, et al. (2001) paper states that “The evidence of the day-of-the-week anomaly in China is clearly dependent on the estimation method and sample period” (p 139).

## **DATA AND METHODOLOGY**

This study relies on 1,250 daily rates of return from January, 2003 through December, 2007. These returns were calculated from the daily closing prices of the ISE 100 index of the Istanbul Stock Exchange of Turkey.

The present day Turkish Stock Market can be truly considered a nascent stock market in view of the fact that the Istanbul Stock Exchange trading commenced on January 3<sup>rd</sup> of 1986. Yet, the history of financial market in Turkey points out that the origins of the first securities market date back to 1866, during the glory days of the Ottoman Empire. In the first 21 months of the new stock market, the ISE indices were calculated on a weekly basis. By the end of the 8<sup>th</sup> year of its existence, that is, by the end of 1993, ISE initiated computerized stock trading for 50 stocks. Within the next 12 months, the stock trading was fully automated on the ISE. Short selling transactions were initiated for the 100 stocks which make up the ISE100 index in 1995. Before September, 1999, both, margin trading and short selling were permitted on all stocks traded on the ISE. For the 60-month period considered in this investigation, the stock market operated on Monday through Friday in two 150 minute sessions between 9:30 a.m. to 12:00 noon and between 2.00 p.m. to 4:30 p.m.

The ISE100 index is a value weighted index (for detailed information, see <http://www.ise.org/indices/stckindx.hetm> ). The information on the raw data of the ISE100 index prices and the ISE volumes are contained in Table 1. The ISE100 index began the 2003 year just under 10,600 and on the last trading day of 2007, it closed just over 55,538. This phenomenal rise of the Turkish stock market translates into a gain of almost 425 percent. Of the five calendar years covered by the study, only during 2006 did the ISE100 register a negative return. Table 1 also shows that the ISE trading volume doubled between 2003 to 2007.

Time Period	1/1/2003	1/1/2004	1/1/2005	1/1/2006	1/1/2007
	-12/31/2003	-12/31/2004	-12/31/2005	-12/31/2006	-12/31/2007
Highest Index	18,625.02	24,971.68	39,837.27	47,728.50	58,231.90
Close Date	12/31/2003	12/29/2004	12/29/2005	02/27/2006	10/15/2007
Lowest Index	8,892.65	15,922.44	23,285.94	31,950.56	36,629.89
Close Date	03/24/2003	05/17/2004	04/18/2005	06/26/2006	01/10/2007
Last Day Index Close	18,625.02	24,971.68	39,777.70	39,117.46	55,538.13
Return for the year %	75.73	34.08	59.29	-1.66	41.98
Highest Volume (000)	1,014,475.3	619,339.1	608,087.9	768,757.5	913,015.5
Date	10/7/2003	03/24/2004	01/14/2005	03/24/2006	09/21/2007
Lowest Volume(000)	59,480.0	75,152.9	172,852.1	176,753.0	89,819.3
Date	07/30/2003	06/21/2004	04/04/2005	10/09/2006	12/19/2007
Average Daily Volume (000)	239,696.3	279,077.6	319,289.2	366,538.2	463,566.2



From the raw data of the ISE100 closing prices, the daily rates of return were computed using equation (1). In this equation,  $R_t$  is the daily return on the index, and  $P_t$  and  $P_{t-1}$  are the index closing values on day  $t$  and day  $t-1$ , respectively.

$$R_t = ((P_t/P_{t-1})-1) \times 100 \quad (1)$$

Descriptive statistics of the daily returns on the ISE100 index of Turkey are tabulated in Table 2. The statistics are shown for the entire 60-month period of the study as well as for the two 30-month sub-periods. The third column of this table shows that while all three test periods had impressive mean daily returns, the mean daily return of the second 30-month period appears pale in comparison to the same of the first 30-month period. However, the higher mean return of the first period (1/2003-6/2005) is accompanied by a higher standard deviation. The return distributions are found to be negatively skewed in all three periods. Moreover, the considerable Kurtosis values contained in Table 2 indicate fatter tails than the normal distribution. To emphasize this issue, we present a comparison of distributional findings of ISE100 with the standard normal distribution in Table 3. The Jarque-Bera test statistics shown in Table 2 reject the normality hypothesis at the 1 percent level for the ISE100 index returns in all three periods. These findings of the present study are comparable to those of numerous international markets by Chang, et al. (1993), Corhay and Rad (1994), Easton and Faff (1994), Kamath, et al. (1998), Chen et al. (2001), and Hui (2005).

Table 2: Summary Statistics of Daily Stock Index Returns in Turkey, 1/2003 - 12/2007

Period	N	Mean %	Median %	Maximum	Minimum	Std. dev. %	Coeff. of Skewness	Coeff. of excess kurtosis	Normality test	Q(23) statistic	Adj. Q(23) statistic	Q <sup>2</sup> (23) statistic
1/2003 -2/2007	1250	0.151	0.172	11.585	-12.49	1.925	-0.183	7.445	1036.0**	34.2	23.0	255.3**
1/2003-6/2005	620	0.173	0.241	11.585	-12.49	2.100	-0.145	8.460	772.2**	39.4*	24.4	148.1**
7/2005-12/2007	630	0.130	0.100	6.699	- 8.306	1.737	-0.259	4.529	65.5**	28.8	25.2	80.8**

\*\* and \* represent significance levels of 1 and 5 percent, respectively

The Box-Pierce Q(23) statistics of the three return series of this paper are included in Table 2. The Q(23) statistic is found to be significant only for the first half of the study period and thus suggesting the linear dependency in the return series in this period. But, when Q(23) measures are adjusted for heteroskedasticity, none of the Adj Q(23) are found to be statistically significant. The values of the Box-Pierce statistics for the squared return series up to 23 lags and their significance in all three test periods suggest the rejection of the null hypothesis of conditional homoskedasticity.

**Table 3: A comparison of Turkish Stock Index Return Distribution with the Normal Distribution, 1/2003-12/2007**

Interval						
Normal						
Distribution	1S.D.	2S.D.	3S.D.	4S.D.	5S.D.	>5S.D.
	0.6826	0.9545	0.9973	0.9999	0.9999	0.0000
1/2003-12/2007	0.7472	0.9584	0.9904	0.9952	0.9968	0.0032
1/2003-6/2005	0.7500	0.9629	0.9823	0.9919	0.9952	0.0048
7/2005-12/2007	0.7333	0.9492	0.9937	0.9984	1.0000	0.0000

The non-normal distributional attributes of the ISE100 index return series exhibited in Table 2 are very much comparable to those reported for numerous equity markets around the globe. Thus, these attributes do not readily suggest the use of the OLS methodology to examine the day-of-the-week effect. Yet, this estimation technique is initially employed to ascertain if the findings for the Turkish market are dependent on the methodology employed. The OLS model used in this investigation is described by equation (2). In this equation,  $d_1$ ,  $d_2$ ,  $d_3$ ,  $d_4$  and  $d_0$  are the dummy variables to represent Monday through Friday, respectively.

$$R_t = d_0 + d_1M_t + d_2T_t + d_3W_t + d_4Th_t + \beta R_{t-1} + \varepsilon_t \quad (2)$$

Bollerslev's Generalized Autoregressive Conditional Heteroskedasticity (GARCH) model (1986) is considered to be a robust estimation tool which captures the time dependence of return variability. The GARCH (p,q) model is given by equation (3) in which  $\varepsilon_t$  is the regression error term conditional on the information set  $\mathcal{F}_t$  at t-1, and  $h_t$  is the conditional variance dependent on past squared errors (return shocks).

$$Y_t = \alpha + \beta X_t + \varepsilon_t$$

$$\varepsilon_t | \mathcal{F}_{t-1} \sim N(0, h_t),$$

$$h_t = \alpha_0 + \sum_{i=1}^p \alpha_i \varepsilon_{t-i}^2 + \sum_{j=1}^q \beta_j h_{t-j} \quad (3)$$

To determine if there is day-of-the-week effect present in the Turkish Market, we employ GARCH (1,1) model. Such a model has been suggested by French, et al. (1987) and Corhay and Rad (1994), among others for stock market return series. The GARCH model utilized in this study is

shown in equation 4. In this formulation,  $R_t$  is the daily return, and  $d_1$ - $d_4$  are the dummy variables for Monday through Thursday, respectively, and  $d_0$  is the dummy variable for Friday.

$$R_t = d_0 + d_1M_t + d_2T_t + d_3W_t + d_4Th_t + \beta R_{t-1} + \varepsilon_t$$

$$\varepsilon_t | \phi_{t-1} \sim N(0, h_t), \text{ and}$$

$$h_t = \alpha_0 + \alpha_1 \varepsilon_{t-1}^2 + \alpha_2 h_{t-1} \quad (4)$$

### FINDINGS OF THE STUDY

The means and standard deviations of the daily returns on the ISE100 index of Turkey for the overall 60-month period and two 30-month sub-periods are presented in Table 4a. The Monday returns are negative in the overall period and in the first sub-period though not significantly different from zero in any period. On the other hand, the Friday returns are significantly positive in the first sub-period as well as in the overall period. In the second sub-period, the Friday return is not significantly different from zero as is the case for all other days of the week.

**Table 4a: Means and Standard Deviations of Turkish Stock Index Returns  
Across the Days of the Week, 1/2003-12/2007**

Period	1/2003---12/2007		1/2003---6/2005		7/2005---12/2007	
Day	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
Monday	-0.018	2.329	-0.121	2.799	0.084	1.747
Tuesday	0.091	1.899	0.185	2.179	-0.003	1.573
Wednesday	0.118	1.727	0.113	1.691	0.122	1.789
Thursday	0.219	1.988	0.098	2.056	0.338	1.919
Friday	0.351**	1.588	0.602**	1.466	0.110	1.667

\*\*and\* represent significance levels of 1 percent and 5 percent, respectively.

In Table 4b, we show the percentage of times the ISE100 index returns were positive on each day of the week in three periods. In the first half of the study period, the Monday returns were positive in less than 50 percent of the time while the Friday returns were positive over 70 percent of the time. In the second half, however, the Friday returns were found to be positive on lower percentage of days than on Thursdays, Wednesdays as well as Mondays. Tables 4a and 4b together indicate that Fridays produced rather impressive returns in the first 30 months of the study but in the second 30 months, the Fridays had ceased producing comparable positive results.

**Table 4b: Percentage of days the Turkish Stock Index returns were positive, 1/2003---12/2007.**

Period	1/2003---12/2007	1/2003---6/2005	7/2005---12/2007
Monday	49.80	48.00	51.59
Tuesday	47.22	47.62	46.83
Wednesday	55.20	58.06	52.38
Thursday	59.60	55.65	63.49
Friday	59.92	70.25	50.00

The results of the day-of-the-week effect testing utilizing the OLS methodology are exhibited in Table 5. In the first 30-month period as well as in the overall 60-month period, the tabulated results provide strong evidence of the anomalous effect. In these two study intervals, the estimated coefficients of Friday returns and Monday returns are both statistically significant. However, as we move to the second study interval, none of the estimated coefficients are found to be significant. In other words, “the effect” seems to have completely disappeared in the second 30-month study period.

**Table 5: Day-of-the-week effects on the Istanbul Stock Exchange: OLS results <sup>a,b,c</sup>**

$R_t = d_0 + d_1M_t + d_2T_t + d_3W_t + d_4Th_t + \beta R_{t-1} + \epsilon_t$							
Period	$d_0$	$d_1$	$d_2$	$d_3$	$d_4$	$\beta$	LL
1/2003 -12/2007	0.352** (2.87)	-0.360* (-2.09)	-0.262 (-1.52)	-0.232 (-1.34)	-0.130 (-0.75)	-0.034 (-1.21)	-2586.1
1/2003 -6/2007	0.599** (3.134)	-0.688* (-2.57)	-0.422 (-1.58)	-0.475 (-1.78)	-0.496 (-1.85)	-0.060 (-1.50)	-1332.1
7/2005 -12/2007	0.087 (0.56)	-0.004 (-0.02)	-0.091 (-0.42)	0.035 (0.16)	0.249 (1.14)	0.011 (-0.28)	-1237.4

a. Statistics in parenthesis are t-statistics.

b. LL represents the log-likelihood value given by the OLS estimations.

c. \*\*and \* represent significance levels of 1 and 5 percent, respectively.

Since we had found the distributional characteristics of the Istanbul Stock Exchange return series to be non-normal and thereby violating the assumptions underlying the OLS technique, additional evidence on serial correlation is shown in Table 6. The Q(23) statistics pertaining to the OLS errors from the first order autoregressive model are found to be barely significant in the overall period and in the first 30-month interval. However, when the OLS errors are adjusted for heteroskedasticity, the outcomes, the Adj Q(23) statistics, are insignificant in all three study intervals.

This table also points out that the  $Q^2(23)$  statistics pertaining to the square of the OLS error terms are definitely significant in all three study periods. Thus, we believe that the Turkish index return series data could be better handled with the heteroskedasticity consistent formulations. Accordingly, in the next step, we utilize the GARCH (1, 1) model to reassess the day-of-the-week effect in the Turkish returns.

$R_t = \alpha_0 + \alpha_1 R_{t-1} + \epsilon_t$					
Period	$\alpha_0$	$\alpha_1$	Q(23)	Adj. Q(23)	$Q^2(23)$
			Statistic	Statistic	Statistic
1/2003	0.155***	-0.034	32.1*	22.3	243.9***
-12/2007	(2.80)	(-1.20)			
1/2003	0.181**	-0.064	33.5*	22.1	132.9***
-6/2005	(2.14)	(-1.61)			
7/2005	0.125	0.011	28.8	24.9	86.5***
-12/2007	(1.80)	(0.27)			

\*\*\*, \*\* and \* represent significance levels of 1, 5 and 10 percent, respectively.

The findings of GARCH (1, 1) estimation are summarized in Table 7. The examination of these results indicate that they are comparable to the results obtained with the OLS method. Specifically, there is evidence of “the effect” in the first “30-month” interval and to a smaller extent in the overall 60-month study period. As noted in conjunction with Table 5 results, the GARCH (1,1) formulation also shows a complete absence of the day-of-the-week effect in the second 30-month period. The likelihood ratios (LR) which measure the relative fit of the GARCH model as compared to that of the OLS model indicate the significantly better fit of the GARCH model. The estimated parameters,  $a_1$  and  $a_2$ , are found to be significant at the one percent level in all 3 estimations in Table 7. The sum of  $a_1$  and  $a_2$  are found to equal 0.970, 0.978, and 0.954 in the overall 60-month period, in the first 30-month period and in the second 30-month period, respectively. These sums which are very close to 1.0 indicate that the shocks to volatility persist over time.

Since we found a strong evidence of day-of-the-week effect in the first sub-period of the study and a complete disappearance of the same in the second sub-period for the Turkish stock market, our conclusions concur with those of Chen, et al. study (2001) of Chinese stock markets in that the results are sample period specific. However, unlike the Chen, et al. study, we do not find the evidence on the day-of-the-week effect to be dependent on the methodology utilized to detect it. Our diametrically opposite findings in the two sub-periods can be attributable to the Turkish market’s performance on Fridays in the two sub-periods. In the 1/2003 – 6/2005 sub-period, the Friday return was the dominant

return. The Friday mean return in this first sub-period was almost 9 times the mean return for the other four days of the week. In the 7/2005 – 12/2007 sub-period, the Friday mean return was found to be about 20 percent smaller than the mean return for the remaining four days of the week. In fact, as shown in Table 4b, in this sub-period, the Friday returns were positive exactly 50 percent of the time. In this respect, there were no consistent and predictable patterns in the daily returns in the Turkish stock market in the most recent 30-month period and thus, the absence of the anomalous effect.

**Table 7: Day-of-the-week effects on the Istanbul Stock Exchange: Garch (1, 1) results<sup>a,b</sup>**

Period	d <sub>0</sub>	d <sub>1</sub>	d <sub>2</sub>	d <sub>3</sub>	d <sub>4</sub>	β	α <sub>0</sub>	α <sub>1</sub>	α <sub>2</sub>	LL	LR
1/2003- 12/2007	0.281*	-0.198	-0.194	-0.106	-0.021	0.016	0.106**	0.071**	0.899**	-2517.0	138.2**
	(2.31)	(-1.26)	(-1.16)	(-0.65)	(-0.13)	(0.53)	(4.49)	(8.29)	(98.97)		
1/2003- 6/2005	0.568**	-0.582*	-0.351	-0.532	-0.496	0.011	0.086**	0.064**	0.914**	-1293.5	77.3**
	(2.64)	(-2.18)	(-1.24)	(-1.88)	(-1.81)	(0.25)	(2.94)	(6.33)	(97.74)		
7/2005- 12/2007	0.050	0.131	-0.108	0.275	0.367	0.031	0.144**	0.086**	0.868**	-1211.9	51.2**
	(0.33)	(0.60)	(-0.51)	(1.39)	(1.89)	(0.69)	(2.77)	(4.73)	(35.04)		

a LL: Log likelihood value and LR: likelihood ratio.

b \*\*and\* represent significance levels of 1 and 5 percent, respectively

## SUMMARY

This study examined the daily return data of the Istanbul Stock Exchange of Turkey to determine if there was evidence of the day-of-the-week effect. The study period included two recent 30-month sub-periods from January, 2003 through December, 2007. Over this 60-month period, the Turkish equity market registered a gain of almost 425 percent. Of the five calendar years covered by the study, only during 2006 the ISE 100 index had a slight negative return.

The study uncovered the presence of the day-of-the-week effect during the first sub-period and consequently, during the overall 60-month period. However, in the second sub-period, the said anomalous effect was found to have completely disappeared. In this respect, we can say that our conclusions were sample period specific. Moreover, these conclusions were not dependent on the methodology utilized. The Friday mean return which was found to be almost 9 times the mean return for the other four market days in the first sub-period, was found to be about 20 percent smaller than the mean return of the other four market days in the second sub-period. In fact, in the second 30-month period, none of the days of the week had a significant rate of return. Only time and further research would tell if the reversal from the presence to the absence of the day-of-the-week effect is long term in nature.

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## ENDNOTE

1. See for example, Jaffe and Westerfield (1985), Aggarwal and Rivoli (1989), Condoyanni, et al. (1987), Lee, et al. (1990), Solnik and Bousquet (1990), Ho (1990), Barone (1990), Lauterbach and Unger (1992), Wong, et al. (1992), Santemases (1986), Chang, et al. (1993), Alexakis and Xanthakis (1995), Easton and Faff (1994), Martikainen and Puttonen (1996), Kim (1998), Kamath, et al. (1998), Kamath and Chusanachoti (2002), Chen, et al. (2001), Demirer and Karan (2002), Hui (2005), Steely (2001), Dubois and Louvet (1996), Lee and Chang (1988), among others.

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# QUALITY PERFORMANCE INDICES CONSTRUCTION OF BICYCLE COMPONENTS MANUFACTURING INDUSTRY USING A FUZZY ANALYTICAL HIERARCHY PROCESS

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## ABSTRACT

*This study developed quality performance indices for the Taiwanese bicycle component manufactory industry. After extensively studying the current Taiwanese quality assessments, NQA, and performing in-depth interviews with relevant experts, we developed 33 quality performance indices. The methodology used here, Fuzzy Analytic Hierarchy Process (FAHP), handled the input of prior quality performance indices. We found that the Taiwanese bicycle component manufactory industry needed to concentrate on the top five indices due to limited organization resources. The most important indices were Process of R&D and Innovation (0.122), Strategy for a Product (0.101), The Operation and Improvement of Strategy (0.092), Social Responsibility (0.077) and Input of R&D and Innovation (0.048). Discussions of the study and implications for top managers are provided at the end of this article.*

**Keywords:** Total Quality management (TQM); Bicycle Components Manufacturing Industry; Fuzzy Analytical Hierarchy Process (FAHP)

## INTRODUCTION

Due to intense global competition, each industry must develop self-assessment protocols to continually improve organizational performance (Crosby, 1979; Deming, 1986; Garvin, 1991; Neves & Nakhai, 1993; Mele & Colucio, 2006; Sitalakshmi, 2007), especially in unexpected situations (Sousa & Voss, 2002; Sila & Ebrahimpour, 2002, 2003). Many organizations implement total quality management (TQM) to generate a competitive advantage (Nilsson et al., 2001; Chan & Quazi, 2002) and to reduce cost (Antony et al., 2002).

Although the advantages of successful implementation of TQM can be numerous (Philips et al., 1983; Garvin, 1983; Cole, 1992; Zhang, 2000), studies have indicated that some organizations fail to implement TQM successfully (Brigham, 1993; Dooyoung et al., 1998). They have also found

that the way TQM is implemented is central to its long-term success within an organization (Ghobadian & Gallear, 2001). Therefore, successful implementation of TQM is a critical issue for various organizations.

Because Taiwan recently joined the World Trade Organization (WTO), expanded economic ties with China, and has begun to face competition from foreign countries, industries in Taiwan are encountering numerous new challenges. Therefore, more and more studies in both academia and industry are focusing on improving performance. However, such studies on Taiwanese-owned industries in China are rare. Because China has the advantages of low costs, a large labor force, etc., Taiwanese-owned industries in China have begun to focus on high quality to create their market shares. Taiwanese bicycle companies such as Giant has become famous around the world. However, such companies cannot produce excellent bicycles without high quality components. Some Taiwanese bicycle component manufacturing has been moving to China because of lower labor costs. Therefore, it is important to discuss how to maintain and improve quality when labor costs are low. This study aims to provide the Taiwanese-owned bicycle component manufacturers in China with a clear way to improve quality performance.

## LITERATURE OVERVIEW

### Quality

Quality has historically been defined as the degree of conformance to a standard (Sitalakshmi, 2007). Quality is also considered “fitness for use” (Juran & Gryna, 1980) and “conformance to requirement” (Crosby, 1979). Deming (1986) defined quality as a predictable degree of uniformity and dependability at low cost that is suited to the market. In general, quality is a relative concept (Harvey & Green, 1993). Quality has a variety of meanings (Sitalakshmi, 2007), and its range of meanings can cause confusion (Shield, 1999). Since higher quality is associated with greater market share and return on investment (Philips et al., 1983; Cole, 1992), lower manufacturing costs, improved productivity (Garvin, 1983) and improved strategic performance (Zhang, 2000), a growing number of industries are emphasizing quality improvement.

### Total Quality Management

TQM is also known as Continuous Quality Improvement (CQI) and Strategic Quality Management (SQM), but TQM is the term most frequently used (Sitalakshmi, 2007). TQM can be defined as a strategic architecture requiring evaluation and refinement of continuous improvement practices in all areas of business (Roosevelt, 1995). TQM requires long-term perspective, customer focus, top management commitment, system thinking, providing training and tools in quality, increased employee participation, development of a measurement system and continuous

improvement (Neves & Nakhai, 1993). Corrigan (1995) defined TQM as a management philosophy that builds a customer-driven, learning organization dedicated to total customer satisfaction through continuous improvement in the effectiveness and efficiency of the organization and its processes. Recent literature has defined TQM as a management style based upon producing quality service as defined by the customer to achieve an organization's strategic imperative through continuous process improvement (Tseng et al., 2007).

A body of recent literature has proved that practicing TQM can help companies improve their performance (Knod, Jr. & Schonberger, 2001; Wadsworth et al., 2002; Chase et al., 2006; Han et al., 2007), reduce the costs of poor quality such as scrap, rework, late deliveries, warranty, replacement, etc. (Antony et al., 2002), and generate unique competitive advantages (Reed et al., 2000). In addition, many studies have constructed a framework for quality improvement (Johnson, 1993; Susan, 1995; Martinez-Lorente et al., 2000). Martinez-Lorente et al. (1998) found that an organization's size, nationality and product value affect the application of TQM. Grandzol (1998) indicated that employee satisfaction has a positive correlation with TQM and annual employee turnover rate (Dean & Bowen, 1994; Adam et al., 1997). Studies have also discovered that positive employee perceptions of TQM lead to higher satisfaction (Boselie & van der Wiele, 2002). In addition, researchers have pointed out that an organization's willingness to change and desire to satisfy its customers also affects TQM success (Madu & Kuei, 1993; Brah et al., 2002). The major focuses of TQM are summarized in Table 1.

Taiwan's National Quality Award (NQA) has been widely used to evaluate industries. It involves the measurement of seven dimensions: leadership and operation ideals, strategy management, the development of customers and a market, human resources and knowledge management, the application and management of information strategy, process management, and operation performance. Because of NQA's prevalence, we have included its concepts in the development our measurement indices.

<b>Table 1. Different aspects of TQM</b>	
<b>Authors</b>	<b>TQM Factors</b>
Black & Porter, 1996	People and customer management, supplier partnerships, communication of improvement information, customer satisfaction orientation, external interface management, teamwork structures for improvement, operational quality planning, quality improvement measurement systems, and corporate quality culture.
Terziovski & Samson, 1999	Customer-focus related positively to organizational performance in the areas of customer satisfaction, employee morale, delivery, productivity, cash flow, and sales growth.
Reed et al., 2000	Customer focus, leadership and top management commitment, training and education, team and culture.
Ugboro & Obeng, 2000	Top management leadership and commitment, teamwork, flow of information within the organization, employee involvement and empowerment.

<b>Table 1. Different aspects of TQM</b>	
Authors	TQM Factors
Brah et al., 2000; Das et al., 2000	Top management support, customer focus, employee involvement, employee training, employee empowerment, supplier quality management, process improvement, service design, quality improvement rewards, benchmarking and cleanliness and organization.
Motwani, 2001	Top management commitment, employee training and empowerment, quality measurement and benchmarking, process management and customer involvement and satisfaction.
Antony et al, 2002	Management commitment, role of the quality department, training and education, employee involvement, continuous improvement, supplier partnership, product/service design, quality policies, quality data and reporting, communication to improve quality and customer satisfaction orientation.
Sila & Ebrahimpour, 2002	Top management commitment, employee involvement, employee empowerment, education and training, teamwork, customer focus, process management, information and analysis systems, strategic planning, open organization, a service culture and process management.
Shieh & Wu, 2002	Leadership, human resource management, process management, supply chain management and information management.
Sureshchandar et al., 2002	Top management commitment and visionary leadership, human resource management, technical systems, information and analysis systems, benchmarking, continuous improvement, customer focus, employee satisfaction, union intervention, social responsibility and service culture.
Besterfield, 2003	Quality culture, the quality chain, quality assurance, commitment to continuous improvement and the support of top management.

## **FUZZY ANALYTICAL HIERARCHY PROCESS (FAHP)**

### **Fuzzy Set Theory**

Professor L.A. Zadeh first developed the fuzzy set theory in 1965 while trying to solve fuzzy phenomenon problems that exist in the real world (e.g., uncertain, incomplete, unspecific and fuzzy situations). Fuzzy set theory can describe set concepts in human language better than traditional set theory can. It represents unspecific and fuzzy characteristics in the language of evaluation, and it uses a membership function concept to represent the field in which a fuzzy set can be permitted to “incompletely belong” and “incompletely not belong.”

## Fuzzy Number

In our Universe of Discourse, U is a whole target, and each target is called an element. Fuzzy  $\tilde{A}$ , which on U stated that a random  $x \rightarrow U$ , appoints a real number  $\mu_{\tilde{A}}(x) \rightarrow [0,1]$ . We consider anything above that level of x under A.

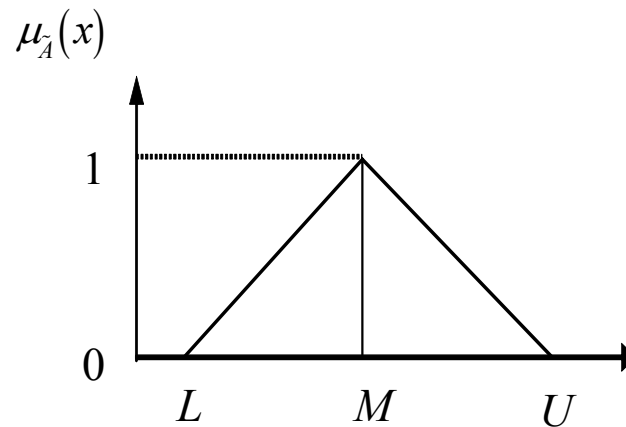
The universe of real number R is a triangular fuzzy number (TFN),  $\tilde{A}$ , which means  $x \in R$ ,

$$\text{appointing } \mu_{\tilde{A}}(x) \in [0,1], \text{ and } \mu_{\tilde{A}}(x) = \begin{cases} (x-L)/(M-L), & L \leq x \leq M, \\ (U-x)/(U-M), & M \leq x \leq U, \\ 0 & , \text{ otherwise,} \end{cases}$$

The triangular fuzzy number above can be written as  $\tilde{A} = (L, M, U)$ , where L and U represent fuzzy probability between the lower and upper boundaries of evaluation information, as shown in Figure 1. Assume two fuzzy numbers  $\tilde{A}_1 = (L_1, M_1, U_1)$  and  $\tilde{A}_2 = (L_2, M_2, U_2)$

1.  $\tilde{A}_1 \oplus \tilde{A}_2 = (L_1, M_1, U_1) \oplus (L_2, M_2, U_2) = (L_1 + L_2, M_1 + M_2, U_1 + U_2)$
  2.  $\tilde{A}_1 \otimes \tilde{A}_2 = (L_1, M_1, U_1) \otimes (L_2, M_2, U_2) = (L_1 L_2, M_1 M_2, U_1 U_2), L_i > 0, M_i > 0, U_i > 0$
  3.  $\tilde{A}_1 - \tilde{A}_2 = (L_1, M_1, U_1) - (L_2, M_2, U_2) = (L_1 - L_2, M_1 - M_2, U_1 - U_2)$
  4.  $\tilde{A}_1 \div \tilde{A}_2 = (L_1, M_1, U_1) \div (L_2, M_2, U_2) = (L_1 / U_2, M_1 / M_2, U_1 / L_2), L_i > 0, M_i > 0, U_i > 0$
- $$\tilde{A}_1^{-1} = (L_1, M_1, U_1)^{-1} = (1/U_1, 1/M_1, 1/L_1), L_i > 0, M_i > 0, U_i > 0$$

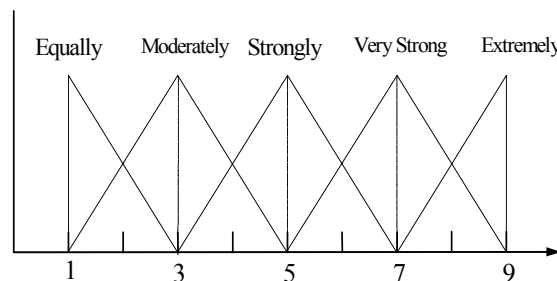
Figure 1: Triangular Fuzzy Number



### Fuzzy Linguistic Variable

The fuzzy linguistic variable is a variable that reflects the different levels of human language. Its value represents the range from natural to artificial language. When precisely reflecting the value or meaning of a linguistic variable, there must be an appropriate way to interpret the value. Variables for a human word or sentence can be considered with numerous linguistic criteria, such as equally important, moderately important, strongly important, very strongly important, and extremely important, as shown in Figure 2. Their definitions and descriptions are shown in Table 3. For the purpose of the present study, the five criteria above (i.e., equally important, moderately important, strongly important, very strongly important and extremely important) are used.

Figure 2: Fuzzy membership function for linguistic values for attributes





Fuzzy Number	Linguistic Variable	Triangular fuzzy number
$\tilde{9}$	Extremely important/preferred	(7,9,9)
$\tilde{7}$	Very strongly important/preferred	(5,7,9)
$\tilde{5}$	Strongly important/preferred	(3,5,7)
$\tilde{3}$	Moderately important/preferred	(1,3,5)
$\tilde{1}$	Equally important/preferred	(1,1,3)

### Calculation Steps of FAHP

The four-step procedure is as follows:

Step 1: Comparing the performance score

Assuming  $K$  experts, we precede to decision-making on  $P$  alternatives with  $n$  criteria.

Step 2: Constructing the fuzzy comparison matrix:

We use a triangular fuzzy number to represent the meaning of questionnaires, and construct positive reciprocal matrixes.

Step 3: Examine consistency of fuzzy matrix  $\tilde{A}$

Assume  $A = [a_{ij}]$  is a positive reciprocal matrix, and  $\tilde{A} = [\tilde{a}_{ij}]$  is a fuzzy positive reciprocal matrix. If  $A = [a_{ij}]$  is consistent,  $\tilde{A} = [\tilde{a}_{ij}]$  will also be consistent.

Step 4: Calculate fuzzy evaluation of number  $\tilde{r}_i$

$$\tilde{r}_i = [\tilde{a}_{i1} \otimes \dots \otimes \tilde{a}_{in}]^{1/n}$$

Step 5: Calculate fuzzy weight  $\tilde{W}_i$

$$\tilde{W}_i = \tilde{r}_i \otimes (\tilde{r}_i \oplus \dots \oplus \tilde{r}_m)^{-1}$$

Step 6: Make non-fuzzy

We find the best crisp value or non-fuzzy value in accordance with the center of area (COA or Center Index, CI) approach, which was developed by Teng and Tzeng (1993), allowing us to calculate clear weights for each index. The calculation method is as follows:

$$BNP_i = [(UR_i - LR_i) + (MR_i - LR_i)] / 3 + LR_i, \forall i$$

### AN EMPIRICAL STUDY

After summarizing the relevant literature and conducting in-depth interviews, we have extracted 33 indices within eight dimensions, as shown in Table 4. To sample the opinions of senior managers and related background experts in bicycle component manufacturing companies, 50 questionnaires were sent out, and 41 were returned (3 were discarded for statistical reasons). The overall response rate was 76%.

Variable	Item	Distribution	Percentage	Variable	Item	Distribution	Percentage
1. Gender	(1) Male	21	55%	4. Educational Degree	(1) Bachelor's	6	16%
	(2) Female	17	45%		(2) Master's	29	76%
2. Age	(1) Under 30	5	13%		(3) Doctoral	3	8%
	(2) 31 ~40	13	34%	5. Background	(1) Academia	5	13%
	(3) 41 ~50	20	53%		(2) Industrial	33	87%
	(4) Above 51	0	0%		(3) Gov Unit	0	0%
3. Served Years	(1) Under 5	6	16%				
	(2) 6 ~10	18	47%				
	(3) 11 ~20	11	29%				
	(4) Above 21	3	8%				

Table 4: Overall factors and their rankings.

Goal	Evaluation Dimensions	Global Weight	Ranking	Evaluation Factors	Local Weight	Global Weight	Ranking
	Leadership and Operation Ideals	0.204	2	Operational Ideals and Values	0.076	0.0155	20
				Organizational Mission and Vision	0.128	0.026	15
				Leadership Abilities of Top Managers	0.192	0.0392	7
				TQM Culture	0.224	0.046	6
				Social Responsibility	0.380	0.077	4
	Strategy Management	0.158	3	Organization Strategy Planning	0.179	0.0284	13
				Operation Model	0.239	0.038	9
				The Operation & Improvement of Strategy	0.581	0.092	3
	R&D and Innovation	0.210	1	Process of R&D and Innovation	0.584	0.122	1
				Input of R&D and Innovation	0.231	0.048	5
				Evaluations of R&D and Innovation Results	0.185	0.0387	8
	The Development of Customers and a Market	0.146	4	Strategy for a Product	0.691	0.101	2
				Customer and Business Management	0.196	0.0287	12
				CRM	0.113	0.0165	18
	Human Resources and Knowledge Management	0.083	6	HRP	0.335	0.0278	14
				HRD	0.273	0.023	17
				Human Resources Utilization	0.188	0.0157	19
				Employee Relationship Management	0.125	0.0104	26
				KM	0.079	0.007	31
	The Applications and Management of Information Strategy	0.046	8	Information Strategy Planning	0.622	0.0289	11
				Internet Applications	0.253	0.012	24
				Information Applications	0.125	0.0058	33
	Process Management	0.056	7	Product Process Management	0.604	0.034	10
				Supportive Activity Management	0.224	0.013	23
				Cross-Organization Management	0.173	0.0096	27
	Operation Performance	0.097	5	Customer Satisfaction	0.245	0.024	16
				Market Development Performance	0.158	0.0152	21
				Financial Performance	0.150	0.014	22
HRD Performance				0.094	0.00912	28	
Information Management Performance				0.110	0.011	25	
Process Management Performance				0.085	0.008	30	
Innovation and Core Competitive Ability Performance				0.094	0.00911	29	
Social Measurement				0.064	0.0062	32	

Over half (55%) of the respondents were male; 53% of the respondents were between 41–50 years old, and 34% were 31–40 years old; 47% of the respondents had worked in the field between six and ten years, and about 29% had worked between 11 and 20 years; 76% of the respondents has master's degrees and 16% had bachelor's degrees. Over half (87%) the respondents had a background in industry, and about 13% of respondents had an academic background. Detailed demographic information is provided in Table 3. The overall ranking of factors is given in Table 4 which is above.

## CONCLUSION

With increasing economic ties to China, joining the WTO and competition from foreign countries, industries in Taiwan must develop competitive advantages to survive. In addition, because of China's low labor costs, large real estate, etc., more and more Taiwanese companies have moved to China to expand their factories. Maintaining and upgrading overall product quality has become an important issue for such companies. At this time, some Taiwanese bicycle manufactures (e.g., Giant) have achieved global success; however, it's impossible for them to produce excellent bicycles without high quality components. This study aims to provide a clear way for Taiwanese bicycle component manufacturing companies in China to conduct quality improvement.

After analyzing the opinions of senior managers and related background experts, we found that the five most critical factors are Process of R&D and Innovation (0.122), Strategy for a Product (0.101), The Operation and Improvement of Strategy (0.092), Social Responsibility (0.077), Input of R&D and Innovation (0.048).

For bicycle component manufacturers, creating low cost processes to produce components will greatly affect their final prices. Thus, we suggest that Taiwanese bicycle component manufacturers in China create R&D teams to focus on the construction of processes. This study indicates that companies ought to develop product strategies to make components more durable, to make them more interchangeable, etc. These kinds of strategies will help make the bicycle component manufacturers attractive to more bicycle companies. Today's bicycle manufacturing market is changing drastically, and more bicycle companies are customer oriented. Thus, it is crucial for bicycle component manufacturers to create products that can be used in various kinds of bicycles. This study suggests that component manufacturers can allocate marketing employees to different branch companies. Since people in China generally use bicycles for their daily transportation, if branch companies can fully understand the main needs of customers, they can justify allocating large amounts of resources to create key components for their buyers. In addition, social responsibility has become both a way of marketing and an avenue for social contribution for various industries. Thus, this study suggests that bicycle component manufacturers can create more social activities to promote their products while contributing to society. Lastly, making used or discarded parts into useful resources can decrease costs and increase the quantity of products. Hence, we suggest that bicycle component manufacturers organize recycling groups.

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Although many factors can contribute to the quality improvement of Taiwanese bicycle component manufactures in China, due to the limited resources of organizations and the 80/20 theory, it is critical to focus on the most profitable and helpful ways to improve quality and performance. Towards this end, this study suggests that those companies ought to first focus on the top five factors to improve quality performance. If additional resources remain, addressing other TQM factors based on the individual needs of an organization will make quality improvement more successful.

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# **FAMILY FRIENDLY POLICIES IN MALAYSIA: WHERE ARE WE?**

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## **ABSTRACT**

*Constituting nearly half of the labour force, Malaysian women sometimes face the issue of balancing work and life which is quick becoming a major concern among most dual career families. As a result of this phenomenon, family friendly policies at the work place is becoming a challenge for the employers to provide. Family friendly policies which commonly refers to policies that enable employees to balance the demands of paid work and personal life can be in the form of workplace flexibility or work time flexibility. Even though family friendly policies are not gender bias, generally female employees are more affected by it as they try to juggle work, home and the family.*

*This study which is based on a primary survey, first tries to assess how family friendly are some of the work places in Malaysia. The more common modes of family friendly policies were identified based on focus group discussion. This study concentrates more on family friendly policies in terms of work time flexibility. It further sets out to investigate how interested are the employees with regards to some of the modes of family friendly policies offered by the employers. Finally, the paper concludes with discussions on the implications of family friendly policies on work life balance. The study shows that there are many work places in Malaysia which have implemented various family friendly policies but there still exists a gap between employee's practical needs and the availability of family friendly policies.*

Keywords : Family Friendly Policies, Flexible working Arrangements, Work life balance

## **INTRODUCTION**

The phrase “family friendly policy” (FFP) has increasingly become a popular issue of discussion and of particular interest especially among female employees. Flexible work arrangements such as flexi time, job sharing, work sharing, home working, term time, variable working hours, annualized hours, compressed working week, part time work, teleworking and voluntary reduced hours have been widely practiced in developed countries for several decades.

In the early 1970s, Malaysia's industrialization policy shifted from an import-oriented industrialization (IOI) to an export-oriented industrialization (EOI) which saw an increase in foreign

owned multinational labour intensive electrical and electronics industries. This structural change led to an increase in women's participation in the labour force. Official statistics show that women's participation increased from a mere 30% in 1970 to 47.3% by 2008.

However, a recent UNESCAP report showed that Malaysian women were still under-represented in the job market. In another UNDP study (2007), some immediate measures which were recommended to increase women into paid labour in Malaysia were better family friendly policies, such as reforms to maternity benefits and child care arrangements as well as flexible time and working arrangements. Noticing the importance for workplace reform, the Malaysian Women's Summit in 2007 and 2008 highlighted the urgent need for more family friendly policies at the work place such as flexible working arrangements and child care facilities. The Malaysian government in its endeavour to encourage more women to participate in paid work, has started staggered starting times in the government departments. In the private sector, FFPs have been implemented but it is more evident in foreign owned multinational corporations, educational institutions and a few small firms.

While many studies have shown that this non-conventional mode of employment can benefit employers and employees (See for example Mccann, 2004; Hill, Martinson et. al. 2004, Warne & Holland, 1999), this mode of employment is still very new and not very common in Malaysia. According to Cox (1997) the participation of women in mainstream economics is evidenced by the demand for domestic help to do household task. Nevertheless, the pattern of women and male participation can vary according to cultural differences across the globe (Jones 1998).

This study which is based on a primary survey, first tries to assess how family friendly are some of the work places in Malaysia. The more common modes of family friendly policies are identified based on focus group discussion. Family friendly policies can be in the form of workplace flexibility or work time flexibility. This study however, concentrates more on family friendly policies in terms of work time flexibility as this many employees are interested in this form of FFP. It further sets out to investigate how interested are the employees with regards to some of the modes of family friendly policies offered by the employers. Finally, the paper concludes with discussions on possible challenges faced by the employer and implications and benefits the employees get from a more family friendly workplace.

## **LITERATURE REVIEW**

Studies have shown that an organization which values its employees and recognizes the importance of work life balance stands to win in terms of staff morale and commitment (Nadeem & Hendry, 2003; Liddicott, 2003). FFPs such as flexi time if used with quality practices at the work place can actually become the core of human resource management and lead to good work performance and higher productivity (de Menezes, L.M. & Wood, S. (2006); Irene Hau S.C & Irene Chew K.H. (2006)). As argued by Liechty & Anderson (2007), FFPs are beneficial for both

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employers and employees and now highly valued by parents who have their own children working under some working arrangements.

There are several approaches and models to define “labour flexibility”, depending on the different work, social and personal variables/parameters/perspectives one may take into account. Goudswaard and De Nanteuil (2000) emphasise that “flexibility emerges as a heterogeneous concept, mixing two series of variables, quantitative/qualitative and external/internal, with consequent several possible combinations”, which include “numerical flexibility” (e.g. permanent/temporal contracts, work on demand), “geographical flexibility” (e.g. subcontracting, outsourcing), “functional flexibility” (e.g. job enrichment, team work, project groups), and “temporal flexibility” (e.g. night and shift work, part-time, overtime, compressed work week).

Hakansson, Dahlin-Ivanoff, and Sonn (2006) in their focus group study of 19 women, who had experienced stress-related disorder, showed that meaningful occupation is desirous for people to achieve balance in everyday life. Matuska and Erickson (2008) note that women realize the importance to avoid stress due to its link to health and place a great emphasis on achieving a balance between work and rest, leisure activities and time for self as means for a balanced lifestyle. Matuska and Christiansen (2006) reviewed four approaches to understand lifestyle balance – time use, life roles, need satisfaction and biological rhythms and their influences on behavior. Matuska and Christiansen (2008) assert that sustained patterns of occupation that meet biological and psychological needs within the individual’s environments can lead to reduced stress, improved health and well-being, and greater life satisfaction.

The search for ways and methods suitable for increasing the flexibility of the working systems and, in particular, of working times can include several different interventions both in short and long-term periods according to the temporal scales that one may consider. In practical they can deal with: (a) increasing working hours with higher salary (e.g. daily or weekly overtime, delayed retirement); (b) re-arrangement of the same amount of working hours (e.g. variable start and finishing times, compressed work week, annual bank of hours); (c) reduction of working hours at the same level of salary (e.g. bank of paid leaves, week-end work, early retirement); (d) reduction of working hours with reduced salary (e.g. horizontal and vertical part-time, job sharing); and (e) reduction of working hours with transfer of costs to the community (solidarity contracts, pre-term retirement).

The type of intervention depends on the prevailing factors that are present at different times which influence political choices in work and social organization. In the short-term, for example, one may expect that work hours may be altered for limited periods in terms of increased or decreased hours worked per day or week and/or changed position of work hours in order to cope with increasing temporal (seasonal, peak hours, just-in-time production) demands for goods and services, as well as to reduce production costs. In the long-term, the interventions are linked to more complex planning or adjustment of professional career, and to adaptations of working life to living and social conditions, also in the perspective of the progressive ageing of the general and working population.

Over the last decade an increasing interest in “temporal flexibility” can be observed, that leads, on one hand, to a demand for an increase in the number of hours during which the production is possible (company-oriented flexibility) and on the other hand, to a desire for a reduction of individual working hours and/or an increase in the autonomy of their regulation (Individual-oriented flexibility). Also, the society is interested in flexible working hours as many advantages can be derived from a more flexible arrangement of social activities and services.

While countries such as United Kingdom, Europe, United States, Australia and New Zealand have been incorporating workplace flexibility for a very long time, this working arrangement is new in the Malaysian work environment. Malaysian women are historically subject to a patriarchal society holding the ideology of “good mother and good wife”. This ideology is further reinforced with colonialism which established economic structures which led to a gendered division of labour across all cultures. In a study by Kaur, (2004) which aimed to research the comparative understanding of the changing role of women’s economic activities in 7 countries in Asia, it was noted that socio-cultural and religious background played a vital part for Asian women including Malaysian women who participated in the labour market.

Even though FFPs such as flexi time is a more common phenomenon in the western countries compared to Asian countries, some countries such as Hong Kong practice it to relieve traffic congestion. While 58 percent of the country’s working women are married and hold dual roles, majority of the women continue to be involved in a very large proportion of unpaid household chores and caring work. FFPs results in a better working spirit and work performance among employees.

The government agencies and a few multinational corporations and educational institutions in Malaysia have already implemented some form of FFPs and also various forms of flexi working.

As the workforce changes, organizations need to change their workplace policies to have a more holistic view of their employees and also to cater for the demands of the work and non-work responsibilities of their human resource. Evidence suggests that FFPs at the workplaces are beneficial and important for employees. (Liddicoat, L. 2003)

## **METHODOLOGY**

This study is based on a preliminary study to a nationwide survey on family friendly policies at the workplaces in Malaysia. The respondents were identified using the convenient sampling method, giving attention to quota sampling. This was in order to obtain a representative sample of employees in terms of gender, ethnicity, age and income group.

A self administered survey questionnaire was given initially to 50 identified respondents through the e-mail and also face-to-face. Using the snow ball technique, these respondents distributed the questionnaires to their acquaintances and finally 175 questionnaires were collected within a time frame of four weeks. The target group was employees working in the Klang Valley, which is the central business region of Malaysia and is where the capital city, Kuala Lumpur is located.

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A questionnaire was adapted from Sullivan, Sherry E. and Lisa A. (2007) to assess the perceived feelings about family friendly workplace. The questionnaire consisted of 3 parts: Part A consisted of 7 items on the demographic profile of the respondents. Part B consisted of 7 items to assess how truly Family-Friendly is the workplace and the respondents were expected to answer the availability of the policy by ticking “Yes” or “No”. Part C had further 10 items on employees’ satisfaction level of specific family friendly policies in terms of leave entitlements and child care facilities. Part D consisted of 8 items on the modes of family friendly policies to gauge which mode were the employees more interested in. Part E looked at the implications of flexi working among the employees. The objective was to measure the perception of the respondents towards the flexi working hours and the question basically asked “that if they were given a choice to work flexi hours, what might the implications be?” The items were based on literature and was adapted to the Malaysian case. Respondents were given 11 items and answered “yes” or “no”.

Descriptive statistics and inferences from the study were used to provide adequate scope for drawing logical conclusions on the availability of family friendly policies at the workplace. Through cross tabulations, it was possible to capture some of the inferences on employees’ perception towards flexi working arrangements in the Klang Valley.

## **FINDINGS AND DISCUSSION**

Table 1 summarizes the demographic profile of the respondents. Majority of the respondents (69 %) were females. Even though the main objective of the study is to assess perception towards FFPs which is generally linked to female employees, males were also given the questionnaire so as to find out their perception about FFPs and to see whether there were any significant differences in their perception towards FFPs. The respondents were quite fairly distributed in terms of age group. Majority of the respondents (31 %) were in the age group of 30 - 39 years. This is the age group which shows a general downward trend in the female labour force participation rates in Malaysia. Another good 26 percent were young employees below 30 years old. In terms of ethnicity, 54 percent of the respondents were Malays, (who are the indigenous people of Malaysia) 31 percent Indians and 11 percent Chinese. A major proportion of the employees were from the private sector which has more rigid working arrangements and stressful working conditions. While the balance 30 percent were academicians from various public and private universities. Majority (65%) of the employees were from large organizations i.e. organizations with more than fifty employees and earning above RM 4000 per month. More than one third of the employees were from the middle level management and the balance one third were university academics. Only a small proportion of 20 % were from the top management.

<b>Table 1: Demographic Profile</b>	
Variables	Percent
Gender	
Female	69
Male	31
Age	
20-29 years	26
30-39 years	31
40-49 years	26
50-59 years	17
Race	
Malays	66
Chinese	11
Indian	21
Others	2
Occupation	
Business Owners	2
Private Sector	43
Government Sector	25
University	30
Income (RM)*	
Below RM 500	2
RM501-RM1000	7
RM1001-RM2000	23
RM2001-RM3000	20
RM3001-RM4000	15
More than RM 4000	33
Size of Workplace	
Small Organisation (0-10 Staff)	6
Medium Organisation (11-50 Staff)	29
Large Organisation (More Than 50 Staff)	65

Variables	Percent
Management Level	
Lower Level Management	6
Medium Level Management	37
Top Level Management	20
Academics	37
* The conversion rate at time of publication is approximately USD 1 = RM 3.62	

Based on an evaluation scale built by Sullivan, Sherry E. and Lisa A. Mainiero (2007), questions were asked to the employees to determine how family friendly is their workplace. Table 2 which shows employees' perspective of FFP illustrates that majority (more than 56%) of the respondents are working in companies "that are building strengths towards family-friendly environment". It was found that generally the respondents were satisfied with the leave entitlements but most of the companies did not have the desired working arrangements which the employees would have preferred.

Another large proportion of them (27 %) are working in companies which need to improve in terms of family friendly benefits. Only a small percentage of 16 percent of the respondents reported working in a truly family friendly company. Further examination of these respondents showed that they were academicians from the universities which have relatively flexi time and some also have child care centers within the university premises.

Description	No of companies based on respondents feedback	Percentage
>10 yes, truly family friendly company	28	16
5-10 yes, company is building strengths towards family-friendly	99	57
<5 yes, company needs to improve its score by utilising true family-friendly benefits.	48	27
Total	175	100

The respondents were asked to state their preference for different types of FFPs in terms of working arrangements. Based on focus group discussions with women groups and female employees, some of the more common modes of family friendly policies in terms of working arrangements were identified and posed to the respondents. Their responses were recorded and ranked as shown in Table 3.

Modes of Family Friendly Policies	Ranking
Flexible leave	1
More flexible working hours	2
Career break	3
Teleworking	4
Job sharing	5
Work from home	6
Part-time/term time working	7
Compressed work weeks	8

Some of the more common modes of FFPs which were requested and are in demand by the working females in Malaysia range from flexible leave to various flexible working arrangements such as flexi time career break, teleworking, job sharing and part-time employment.

Flexible leave was available more to employees in the private sector but career break and job sharing was more common among higher executive levels of occupation and not often heard among medium level or lower level positions. In terms of working policies, the table reveals that flexible leave was more popular compared to flexi time. The most common mode of working arrangement among the respondents was flexible leave where 40 percent of the employees were given this choice at their workplace. Career break, whether less than 5 years or more than 5 years is rarely practiced in Malaysia, except among academics who take no pay leave for their studies.

As for part-time employment, it seems to be the second least common mode which is practiced in Malaysia with less than 35 percent of the employees having this policy at their workplace. In Malaysia, part time employment is considered more as “casual labour” and is common among academics or students who need extra income. It is generally a working arrangement when employees need extra income and is not provided by companies to their permanent employees. The least favoured form was compressed work weeks, possibly as this carried the implication that this involved a heavier work load and a stress filled job.

Even though FFPs and flexi working arrangements has implications on all employees, the study finds that female employees are more interested in flexi working hours than their male counterparts. The male employees in this study were more interested in skill development programmes, socializing, clubs and corporate wellness programmes.

The respondents were also asked what the types of family friendly benefits available in their company and if they were satisfied about it. Their responses are as shown in Table 4.

The table below shows that majority of the respondents are most satisfied about their annual leave scheme, emergency leave and unpaid leave arrangements, but not about provision for elderly care centre, nursing area and child care facilities. Child care facilities is gaining a lot of recognition



from the government with the Ministry of Women, Family and Community Development's allocation of child care incentives and crèches at work place, but this seems to be very slow in implementation in the private sector. Elderly care, in terms of facilities or work time flexibility is also highly neglected as the Malaysian population was always considered a "young population". However, the number of elderly people are rising in Malaysia and it is difficult and expensive to hire a nanny, hence this is another area which clearly needs immediate improvement.

Description of Benefits	Mean	Ranking
Annual Leave	1.1429	1
Emergency Leave	1.1686	2
Unpaid Leave	1.491	3
Maternity Leave	1.4037	4
Paternity Leave	1.485	5
Family Day Activities	1.4458	6
Day Care Centre	1.9221	7
Child Care Facility	1.9091	8
Nursing Area	1.9408	9
Elderly Care Centre	1.8092	10

As shown in Table 5 below, some of the implications which were identified from previous literature were posed in the questionnaire. Majority of the respondents felt that flexi work generally will improve their social networking as they have more time to socialise and visit friends and relatives. More than 98 percent of the respondents felt that flexi work generally will improve their quality of life as well as work life balance. FFPs such as flexi time and part-time gives more time to improve their quality of life as they are able to balance work and home and are happy to work in such a workplace. They also commented that it helps them to be more committed and concentrate on work as home is manageable. Some of the respondents also commented that productivity will be improved as you work in a more conducive environment. Even though lifelong studying has become a norm for many employees, it was not very crucial among the respondents and this could be due to the age category of the respondents.

**Table 5: Impact Of FFPs on Work Life Balance**

Some implications of FFP	Mean	Ranking
a) it might enhance my social networking	1.2398	1
b) it might improve my quality of life	1.2832	2
c) it might help me to improve my productivity at work	1.5607	3
d) it might help me to have a better work life balance	1.5872	4
e) it might help me to further my studies	1.6588	5
f) it might encourage me to have more children	1.7574	6

The respondents noted that with the implementation of FFPs, employers would likely be challenged with problems of absenteeism followed by more complicated employer issues and not keeping up with date lines. This is more so with FFPs such as flexible working arrangements. But the respondents noted that the rate of truancy and lower productivity were the least of the challenges the employers might face. This implies that flexible working hours does not lower one's work performance and productivity. In fact, this method is desired by some employers as it allows for staff to be more relaxed and yet produce output effectively.

**Table 6: Challenges faced by the Employer**

Potential problems due to flexible working hours	Mean	Ranking
a) Absenteeism	1.6802	1
b) More complicated employer issues	1.7919	2
c) Not keeping up with date lines	1.8058	3
d) Not turn up for work but report as attended	1.8538	4
e) Lower productivity	2.0407	5

### CONCLUDING REMARKS

As more families end up as dual career families in Malaysia, especially when women are increasingly spending more time in paid labour and at the same time having to look into child care and elderly care needs, FFPs and flexi work is very pertinent in the economy. Families that have two streams of income are now considered the norm, and as parents and children construct their socializing together, they want to spend more time together. Despite work life reflecting a more widely shared and inclusive set of issues, childcare and elderly care nonetheless tend to be the responsibility of the women. In a gendered division of labour society, it is always the responsibility for a career woman to sacrifice her career to take care of the home. FFPs such as flexi time and part

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time may provide married women with young children who require the greatest parental time, to balance work and home.

It was found that the decline in the participation of women in the labour force in the United States was concentrated among highly educated married women with young children (Hotchkiss 2006). This was also the main reason why Malaysian women left the labour force. "Spending time with family was one of the main reasons cited by women who stopped working" (Kaur, 2004). The nuclear family with a full-time mother managing the home has been transformed and this requires more crèches or child care facilities which are affordable and reliable.

With no extended family to rely upon, and trying to juggle both the reproductive and non-reproductive roles, many working women resolved to the compelling demand to have somebody to take over the non-economic roles and this created a high demand for foreign domestic workers over the last two decades in the country. It cannot be denied that FFPs and flexi time may be a contributory factor in determining whether more women may be able to participate in the labour market.

FFPs are beginning to get importance in the corporate sector in the country but flexi working hours are still hard to come by in most Malaysian firms. Government policies and good corporate social responsibility practices include achieving an ideal work life balance. At policy level, the Malaysian Government is officially committed to gender equality as articulated in the National Government 5 year plans especially the present one. (Ninth Malaysia Plan) In order to maintain Malaysia's competitive edge in the global economy, there is an urgent need to reduce its dependence on foreign labour and a "brain drain" culture. Policies which promote re-entry of women who have taken time off for child care and more flexibility at the work place need to be implemented by both public and private sectors in a more serious and systematic manner.

The study shows that there are many work places in Malaysia which have implemented FFPs such as various types of leave entitlements but in terms of working hours flexibility, there is still a lack of awareness and urgency among employers. Based on this study, there still exists a gap between employee's practical needs and the availability of family friendly policies.

While this study looked at FFPs at the workplaces, it only concentrated in the Klang Valley region which is the central business region in Malaysia. A wider survey should be done to cover the whole country. This study had employees from the public sector, private sector and also academics from the universities. Another study which concentrates only on the private sector should be conducted so as to get a clearer picture of the FFPs in the corporate sector.

Flexibility in the work place and more FFPs will not only benefit the organizations to access the global economy but also enable better work life balance and lead to a greater labour force participation among women in Malaysia.

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# **IMPORTED PRODUCT ACCEPTANCE WHEN NATIONAL ORIGIN IS NOT AN ISSUE: THE INFLUENCE OF PERSONAL CHOICE IN A LOW CETSCALE ENVIRONMENT**

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## **ABSTRACT**

*The global marketplace and diffusion of exports and imports has lead to high amounts of product availability and acceptance without consideration of national origin. There has been an abundance of research in high-CETSCALE environments with high levels of attachment to, and identity with particular products. Subsequently, there has been relatively little research in low-CETSCALE environments. This research conducted in the State of Mississippi, examined the consumer ethnocentric tendencies of females both in general and toward perfume. This research shows that personal choice overrides consumer ethnocentrism in a low CETSCALE environment.*

## **INTRODUCTION**

Global business depends upon consumer acceptance of imports; products and services originating outside of the nation or region are commonly among the choices available to consumers. The majority of consumer ethnocentric research has been conducted in high CETSCALE environments, in which clearly-defined nationalistic, patriotic and cultural influences impact the success of imports. This research examines the product *perfume* among females exclusively in the State of Mississippi in the United States. The researchers cannot identify any predominance by U.S. brand names in the perfume market that could be said to have captured large swaths of the perfume business. Thus, the cultural identity may exist with other consumer products or services may not exist with perfume. Indeed, the use of chic or classy names for perfume products, even the use of languages other than English on perfume containers has nothing to do with product origin. Thus, at least within this market, for this product, are consumer ethnocentric issues an impediment to imports, or instead, is this an easy market to penetrate?

The literature for ethnocentrism, consumer ethnocentrism, culture, psychology, philosophy and business all indicate that the global marketplace largely must contend with nativist, nationalistic, and patriotic psychosocial tendencies among consumers. When international businesses find markets

that have low amounts of consumer ethnocentrism, there is generally lowered resistance to imports. This manuscript examines the literature, presents hypotheses, then analyzes and discusses the data.

### **ETHNOCENTRISM AND CULTURAL IDENTITY**

It is well-documented that consumer choice is influenced by a number of factors, with imports facing an added, *ethnocentric* dimension of cultural bias. Ethnocentricity, as defined by Ball, McCulloch, Frantz, Geringer, and Minor (2003) is “the belief in the superiority of one's own ethnic group - societies consider their culture superior to all others” (p. 293). Suppliers of goods and services to the global marketplace must contend with localized senses of superiority of one culture over another. Peng (2008) considered ethnocentrism as a mentality of people who consider their own norms to also be morally correct. Beamer and Varner (2008) expanded the understanding of the core beliefs in one's culture as a component of ethnocentrism, which can lead to too much complacency about one's own culture.

Failure to anticipate and comprehend ethnocentric issues can be costly. Hill (2006) warns against the dangers of ethnocentric behavior, as preconceptions of marketers and others may not fit local realities. Moreover, this could lead to an erroneous generalization of other cultures. The influence of ethnocentric tendencies to the business arena has been the subject of research for over a decade, but there are still largely untested areas to be examined. We believe that this provides fertile ground for expanded research.

### **CONSUMER ETHNOCENTRISM**

The term “consumer ethnocentrism” is an economic expression of ethnocentrism, representing “the beliefs held by consumers about the appropriateness, indeed morality, of purchasing foreign-made products” (Shimp and Sharma 1987, p. 280). Festervand and Sokoya (1994) and Luthy (2007) described decisions expressed by buyers with strong consumer ethnocentric traits as having beliefs that buying imports is unpatriotic, causes unemployment and has a deleterious overall effect upon the economy. The theoretical development of consumer ethnocentrism was founded upon an economic form of ethnocentrism, which encompasses personal, nationalistic and patriotic issues. These include issues such as one's fear of economically harming his/her beloved country by buying foreign products, the morality of buying imported products, and a personal prejudice against imports (Balabanis, Diamantopoulos, Mueller & Melewar, 2001; Shimp and Sharma 1987).

### **CULTURE'S INFLUENCE UPON BEHAVIOR – A HISTORICAL PERSPECTIVE**

Despite the fact that mankind has traded internationally since antiquity, we are in the contemporary sense only now beginning to understand the role of culture in our organizations,



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economies and societies (Walker, Walker, Schmitz and Brake, 2003). Cultural competence is more than knowledge of superficial practices of etiquette. It is also more than understanding how cultural values drive assumptions. It involves digging deeply into the culture in question, and doing so with an open attitude and willingness to learn cross-cultural skills.

The ability to recognize and manage the effects of ethnocentrism and cultural ethnocentrism is a vital cross-cultural skill when positioning products in foreign markets. The psycho-social core of ethnocentrism, and ultimately, *consumer* ethnocentrism, closely resembles discussions and writings about the role of perception, and human decisions based upon perception. Throughout the ages, as humanity asserted individuality and self control, philosophers, psychologists asserted that we are all products of our environment, acting and reacting according to our experiences. Perhaps the earliest to document human perception was Plato, the famous Greek philosopher who lived from approximately 424 BC – 348 BC. He delved into many aspects of the human condition. Plato's *Republic*, at the start of Book Seven, includes a detailed description of a cave in which people are restrained, and whose view of perception of reality is limited to images seen as shadows on a wall. The framework of individual perception begins at birth, and was identified as creating the lens through which one's surroundings and encounters are viewed. What we consider the fabric of our core beliefs, our perception of justice, and right and wrong, our tastes, our manners and mannerisms are formed by that which we see, hear, smell, taste and experience from the moment we exit the womb. Philosophers have questioned what would happen if we were to change places and live in radically different cultures.

French philosopher Rene Descartes and behaviorist B.F. Skinner are among those who identified perception as influenced by culture. Descartes, in *Discourse on Method* (1637), considered the "...differences in character which a person brought up from infancy in France or Germany exhibits, from that which the same person would have had he always lives among the Chinese or with savages" (p. 37). The same essential issue was revisited by Skinner in 1971, when he stated "People are extraordinarily different in different places, and possibly just because of the places. The nomad on horseback in Outer Mongolia and the astronaut in outer space are different people, but, as far as we know, if they had been exchanged at birth, they would have taken each other's place" (p. 175).

The convergence of cultural orientation, culture and choice influences consumer behavior. Geert Hofstede (1980) identified four dimensions of culture:

- ◆ Power distance: The degree to which a society feels that an inequality is desirable or undesirable.
- ◆ Uncertainty avoidance: The extent that uncertainty is perceived as a threat, which subsequently leads to concern about the future and the protection of society.
- ◆ Individualism - The extent that individual interests are prioritized over the interests of the group.

- ◆ Masculinity- The extent that achievement and success overshadow caring for others and quality of life.

When we consider the target population of this study, i.e. women in the State of Mississippi, given the historic demographics of the state in terms of education and income, the subject population resembles some of the aspects discussed by Yoo and Donthu (2005). They suggested that previous studies found that consumer ethnocentric antagonistic attitudes are more often characteristics of in older people, females, persons with less education and low income, as well as people who are generally not open to other cultures. Considering the foregoing, we pose the following hypothesis:

*Hypothesis 1: Female Mississippi consumers are strongly consumer ethnocentric.*

Subsequently, it is imperative for international marketers to fully grasp the influences of culture and the cultural mindsets of the people within target markets. The influences that lead consumers in those markets to buy or reject products or services need to be understood and factored into any global business marketing plan.

### **THE ROLE OF INCOME**

Does income play a role in consumer ethnocentrism? Prior studies suggest that it does. In a study conducted in Israel, Shoham and Brenčić (2003) identified three antecedents affecting purchasing behavior by Israelis: income, consumer ethnocentrism, and preference for products produced in Israel. Porter (1980) identified a consumer's rise in income with changes in products demanded. Consumer income influences consumer choice: as income changes, consumer choice changes. Indeed, the field of behavioral decision research, on which behavioral economics has drawn more than any other subfield of psychology, identifies choice as a major research category. Considering the foregoing, the following hypothesis is posed:

*Hypothesis 2: Higher income among women correlates to higher consumer ethnocentric behavior.*

### **INTERSECTION OF BEHAVIORAL, CULTURAL AND ECONOMIC FACTORS IN THE FUNCTION OF CONSUMER CHOICE**

Consumer choice is influenced by a unique mix of factors, not the least of which are behavioral, cultural and economic factors. Camerer and Loewenstein, (2004) considers as integral to choice, the various thought processes used in making decisions.

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Schumpeter (1942) wrote, "In capitalist society, social recognition of performance or social prestige carries a strongly economic connotation both because pecuniary gain is the typical index of success, according to capitalist standards, and because most of the paraphernalia of social prestige -- in particular, that most subtle of all economic goods, Social Distance -- have to be bought" (p. 208). This social distance must play into the elements of the sense of personal pride. According to Acharya and Elliott (2003) "A consumer acting out of a sense of pride will typically consistently evaluate the locally made product as superior to its foreign-made competitors. On the other hand, a consumer acting from a sense of duty will always choose the locally made product, even though he/she may concede that the foreign-made product is superior" (p. 90). Considering the influences of social distance and age, the following hypothesis is examined:

*Hypothesis 3: As women grow older, they are more concerned about social distance in perfume selection than its basic function (providing a pleasing aroma).*

### **RESEARCH METHODOLOGY**

As part of a research assignment in several classes at the University of Southern Mississippi, students were asked to complete ten survey questionnaires during a span of ten days. The questionnaire was developed using validated CETSCALE measures by Orth and Firbasová (2003), which were patterned after the CETSCALE measures by Shimp & Sharma (1987). (M1-M18) and to measures to test rejection of consumer ethnocentrism by virtue of personal choice (M19 & M20). The survey questionnaires were designed using SurveyMonkey.com resources. A five-point Likert-style scale ranging from "Strongly agree (5) to Strongly Disagree (1) provided a way to measure the results of the scale items. Students then used SurveyMonkey.com to enter the data from their surveys. No personal data from the respondents was collected. The researcher had no contact with the respondents, so no bias by the researcher is possible. All of the surveys were of women; males were excluded from the study. Not all students completed 10 surveys. Of the 1014 collected, 1010 were usable. Surveys were rejected that did not conform to the age criteria of the study or which omitted an age of the person surveyed. Partially completed surveys were counted, thus some of the counts in the demographic variable table below do not equal the frequency count. Data was analyzed using MS Excel and SPSS 15.0.

The *N* of 1010 usable surveys is considerably higher than the typical number found in CETSCALE studies. This high number provides an excellent degree of reliability. With a large or unknown population and an *N* of 1010, at the 95% confidence level, the confidence interval is just 3.04, a very low number indicating a high probability in the reliability of the study results. While the survey was conducted in the United States, sampling was primarily in the region of the southern part of the State of Mississippi. This is relevant for several reasons: First, southern Mississippi was

ground zero for the impact of the eye of Hurricane Katrina in 2005, and in 2008 the region is still recovering from the impact and devastation of the event. Second, the Bureau of Economic Analysis of the U.S. Department of Commerce lists the State of Mississippi as 50 out of 50 states in both real and personal GDP: Per cap real GDP: 24,062 and Per cap personal income: 26,535 (Woodruff III, Panek, and McInerney, 2007, p. 115). Table 1 shows the matrix of annual income for the sample. Calculated from the database, with an  $n$  of 1002, the mean of the sample is 2.36, which corresponds to an income of \$15,001 - \$35,000, with the figure weighted toward the lower mid end of the range. This is in keeping with the BEA statistic.

The product examined was perfume. As mentioned earlier in this manuscript, here is no strong national standing of perfumes in the United States insofar as domestic vs. imported product. The researchers of unaware of any prominent (if any) Mississippi companies that manufacture perfume. This product was chosen for that reason of lack of strong national identity.

Sample age spectrum			Education #					Annual Income ##				
Age	Freq	%	1	2	3	4	5	1	2	3	4	5
18-23	467	46.2	7	118	244	93	5	363	72	20	6	6
24-33	236	23.4	6	28	98	78	26	35	56	73	33	35
34-43	103	10.2	4	15	42	30	10	8	8	26	27	32
44-53	124	12.3	3	33	51	22	14	13	18	28	24	39
54-63	55	5.4%	0	11	23	11	10	4	8	13	8	22
64>	25	2.5%	3	9	8	5	0	4	3	9	3	6
			# Education scale					## Annual Income scale				
			1: Did not finish high school					1. \$15,000 or less				
			2. High School Diploma					2. \$15,001-\$25,000				
			3. Some college, did not finish					3. \$25,001-\$35,000				
			4. Four-year college degree					4. \$35,001-\$45,000				
			5. Graduate school or higher					5. \$45,001 & above				

## ANALYSIS

### Reliability of the measures:

In the current study, the Cronbach's Alpha is .921. The Cronbach's Alpha based on standardized items is .920, with N of items 20.

As the Cronbach Alpha scores are quite high, the reliability of the research instrument is subsequently high and all measures (M1-M20) in Table 2 below, all show a strong relationship to each other.

Measure	Mean	Standard Dev $\sigma$	N	Alpha $\alpha$ if item deleted
M1. American's should buy American-made perfume, because charity begins at home.	3.25	1.004	1010	.915
M2. We should buy American-made perfume, first because it is the American way.	3.02	1.007	1009	.914
M3. American-made perfumes smell better than foreign-made perfume.	2.83	.842	1009	.917
M4. The poor shape of the economy is largely the result of Americans buying foreign-made products.	3.13	1.058	1009	.917
M5. Foreigners should not be allowed to put their perfume on our markets.	2.35	.978	1009	.914
M6. Americans should not buy foreign perfume, because this hurts American business and causes unemployment.	2.66	1.013	1008	.913
M7. It is always best to buy American-made perfume.	2.87	.975	1008	.914
M8. Foreign perfume smells better than American-made perfume.	2.82	.785	1009	.928
M9. American-made perfume smells better than foreign-made perfume.	2.87	.792	1008	.918
M10. We must support products produced in our own country for our own survival.	3.56	.955	1007	.917
M11. It is downright unpatriotic to buy anything except American-made products.	2.37	.980	1009	.913
M12. Only those products that are unavailable in the U.S. should be imported.	2.83	.996	1008	.914
M13. American perfumes, first, last, and foremost.	2.73	.959	1009	.913
M14. Purchasing foreign-made products is un-American.	2.34	.940	1008	.914
M15. We should purchase products manufactured in America instead of letting other countries get rich off us.	3.03	1.051	1008	.914
M16. Curbs should be put on all imports.	3.09	.906	1007	.917

**Table 2: Measures and scores**

Measure	Mean	Standard Dev $\sigma$	N	Alpha $\alpha$ if item deleted
M17. It may cost me in the long run but I prefer to support American products.	3.24	.948	1009	.916
M18. American consumers who purchase products made in other countries are responsible for putting their fellow Americans out of work.	2.61	1.017	1008	.914
M19. When receiving perfume as a gift, I am more impressed by what it costs than how it smells.	2.01	1.047	1009	.925
M20. I would prefer to receive as a gift an expensive perfume with an exotic name than one that may smell better but is commonly available.	2.10	1.076	1009	.926

### Factor Analysis

The twenty items of the CETSCALE were examined using principal component analysis (PCA) using SPSS Version 15. Before conducting the PCA, the suitability of the data for factor analysis was determined. Examination of the correlation matrix revealed the presence of many coefficients of .3 and above. The Kaiser-Meyer-Okin measure of sampling accuracy was .940, far exceeding the recommended value of .6 (Kaiser 1970, 1974). Bartlett's Test of Sphericity (Bartlett 1954), described by Pallant (2007), reached statistical significance, supporting the factorability of the correlation matrix.

Principal components analysis revealed the presence of four components with eigenvalues exceeding 1, explaining many four of the values. An inspection of the screeplot revealed a clear break after the second component, using Catell's (1933) scree test (described by Pallant, 2007), it was decided to retain two components for further investigation. This was supported by the results of parallel analysis, which showed only two components with eigenvalues exceeding the corresponding criterion values for a randomly generated data matrix of the same size.

The two-component solution (See Table 3) explained a total of 53.73% of the variance, with Component 1 contributing 44.614% of the variance and Component 2 contributing 9.116%. To aid in the interpretation of these two components, Oblimin rotation was performed. The rotated solution revealed the presence of simple structure (Thurstone 1947) with both components showing strong loadings, and all variables loading substantially on only one component.

**Table 3: Factor Analysis**

Pattern and Structure Matrix for PCA with Oblimin Rotation of Two factor Solution of CETSCALE items					
Item	Pattern Coefficients		Structure Coefficients		Communalities
	Component 1	Component 2	Component 1	Component 2	
M6	<b>.797</b>	.048	<b>.796</b>	.041	.636
M13	<b>.794</b>	.015	<b>.794</b>	.008	.631
M11	<b>.777</b>	.187	<b>.776</b>	.180	.637
M7	<b>.775</b>	-.008	<b>.775</b>	-.015	.600
M2	<b>.772</b>	-.085	<b>.773</b>	-.092	.604
M15	<b>.763</b>	-.019	<b>.763</b>	-.025	.582
M14	<b>.760</b>	.222	<b>.758</b>	.216	.624
M5	<b>.757</b>	.135	<b>.756</b>	.128	.589
M12	<b>.745</b>	.086	<b>.744</b>	.080	.562
M18	<b>.729</b>	.156	<b>.728</b>	.149	.554
M1	<b>.724</b>	-.146	<b>.725</b>	-.153	.547
M17	<b>.684</b>	-.114	<b>.685</b>	-.120	.483
M3	<b>.650</b>	-.070	<b>.650</b>	-.075	.428
M10	<b>.635</b>	-.220	<b>.637</b>	-.225	.455
M4	<b>.629</b>	-.053	<b>.629</b>	-.058	.399
M16	<b>.625</b>	.008	<b>.625</b>	.003	.391
M9	<b>.606</b>	-.018	<b>.606</b>	-.024	.368
M20	.113	<b>.892</b>	.105	<b>.891</b>	.807
M19	.173	<b>.871</b>	.165	<b>.870</b>	.787
M8	-.113	.226	-.115	.227	.064
<i>Rotation converged in 3 iterations</i>					
Major loadings for coefficient items are <b>BOLDED</b>					

Data examination for the three research hypotheses

*Hypothesis 1: Female Mississippi consumers are strongly consumer ethnocentric.*

The means for M1 through M18 in Table 1 provided the scores based upon responses to the study's five-point Likert-style scale measures. These measures most closely conform to CETSCALE literature and the mean of the means is a method of evaluating the any tendency of the sample

population. The mean for measures M1 to M18: 2.867. The mean of the standard deviations for measures M1 to M18: .956.

Considering the weak CETSCALE score, with the results centered upon “neither agree nor disagree,” Hypothesis 1 is not proven. Considering the responses not only to specific questions involving the commodity *perfume*, but also to measures that did not mention *perfume*, the findings of this study are in contrast with previous studies that indicate CETSCALE scores as discussed in Yoo and Donthu (2005).

*Hypothesis 2: Higher income among women correlates to higher consumer ethnocentric behavior.*

Table 4 below contains the matrix of income ranges used in this study, the number of respondents within each income range and the CETSCORE for each range. The CETSCALE score was calculated by grouping the responses in each income category, calculating the mean for each of M1-M20, then calculating the mean of the means. The range of CETSCALE scores was 2.7 to 2.93, indicating that the subjects surveyed were very indecisive about consumer ethnocentric issues in all of the income categories. These results contrast with the results from previous studies that showed that as consumers have higher income, there is greater discretion in their purchasing decisions.

Considering the resulting CETSCALE scores, with the results weighted toward “neither agree nor disagree,” and with the results being slightly anti-consumer ethnocentric, Hypothesis 2 is not proven. Considering the significant differences in income in each category, yet the existence of a nearly uniform indecisive response, the findings of this study contrary to most prior CETSCALE studies.

Income Category	Income Range	N**	CETSCALE Score
1	1. \$15,000 or less	427	2.7
2	2. \$15,001-\$25,000	165	2.7
3	3. \$25,001-\$35,000	169	2.93
4	4. \$35,001-\$45,000	101	2.87
5	5. \$45,001 & above	140	2.90

\*\* Excludes eight responses without ages provided

*Hypothesis 3: As women grow older, they are more concerned about social distance in perfume selection than its basic function (providing a pleasing aroma).*



To test this hypothesis, Table 5 below contains a matrix of responses grouped by age. The *N* of each category, the Mean and standard deviation were performed for survey measures M19 and M20. These measures are not standard CETSCALE measures, and stand apart as such from standard CETSCALE measures during factor analysis. These measures were constructed to measure why females like perfume and how they expect perfume to perform. The responses to M19 and M20 show that women in all categories are more concerned about how a perfume smells rather than its cost or its perceived exotic origins. Subsequently, Hypothesis 3 is disproven. In fact, women from ages 34 – 63 are profoundly opinionated about these two questions, in sharp contrast to the responses garnered from M1-M18. The results shown in Table 2 for the entire survey sample shows that M19 and M20 have the strongest opinions expressed across all age groups, which reinforces the information in Table 5.

Age Group	Age Range	M19. <i>When receiving perfume as a gift, I am more impressed by what it costs than how it smells.</i>			M20. <i>I would prefer to receive as a gift an expensive perfume with an exotic name than one that may smell better but is commonly available.</i>			Correlation between M19 and M20
		N	Mean	$\sigma$	N	Mean	$\sigma$	
1	18-23	467	2.05	1.079	467	2.21	1.108	.709**
2	24-33	236	2.08	1.047	236	2.13	1.050	.761**
3	34-43	103	1.90	.924	103	1.99	1.012	.729**
4	44-53	125	1.95	1.054	125	1.97	1.070	.793**
5	54-63	54	1.54	.794	54	1.43	.602	.815**
6	64>	25	2.44	1.083	25	2.12	1.054	.536**

\*\* Correlation is significant at the 0.01 level

## DISCUSSION

Although it is a well-known fact that as a whole the standard of living is high among developed nations, this study shows that in poorer portions of a developed nation, consumers may behave to some extent like those in developing nations. Consumers in developed nations have greater amounts of disposable income and subsequently can afford to make choices based upon social distance instead of raw functionality. This study shows that while consumers in an economically disadvantaged portion of a developed country still demand a luxury product like perfume, they place more importance upon its performance than the social distance that a designer brand may offer. This

social distance-influenced decision process is seen in Table 5 as strongest in age groups 44-53 and 54-63. As this study was limited to female participants, one might surmise that as they approach the age when their children reach maturity and no longer require support from their parents, women have more disposable income with which they can be more selective about a non-essential purchase like perfume.

## CONCLUSION

This research illustrates that at least for this survey sample which was limited to the female gender in southern Mississippi, consumer ethnocentrism is not a factor in the selection of perfume. They are more interested in perfume's functionality: smelling good. At least in this sample population, social distance does not them – functionality does. Importers and marketers of perfume seeking to penetrate global markets, would do well to target locations with this mix of *acceptance of imports* and *functionality* as the criteria for selection. This reinforces Shoham and Brenčič (2003), who stressed that international firms seeking new markets should focus upon areas with low consumer ethnocentrism, and no preference for locally produced items.

The identification of such open markets is a challenge for international business. Upadhyay & Singh (2006) wrote: "Ethnocentrism does not find much ground in developing countries" (p. 60). This study shows that at least for non-essential consumer goods, consumer ethnocentrism may not find much ground in poorer sections of developed countries either.

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# GLOBALIZATION AND REGIONALIZATION: FOUR PARADIGMATIC VIEWS

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## ABSTRACT

*Any adequate analysis of the relationship between globalization and regionalization necessarily requires fundamental understanding of the worldviews underlying the views expressed with respect to the nature of the relationship between globalization and regionalization. This paper is based on the premise that any worldview can be associated with one of the four basic paradigms: functionalist, interpretive, radical humanist, and radical structuralist. It argues that any view expressed with respect to the relationship between globalization and regionalization is based on one of the four paradigms or worldviews. It, therefore, discusses four views with respect to the relationship between globalization and regionalization which correspond to the four broad worldviews. The paper emphasizes that the four views expressed are equally scientific and informative; they look at the relationship between globalization and regionalization from a certain paradigmatic viewpoint. Emphasizing this example in the area of the relationship between globalization and regionalization, the paper concludes that there are opportunities for each paradigm to benefit from contributions coming from the other three paradigms.*

## INTRODUCTION

Any adequate analysis of the relationship between globalization and regionalization necessarily requires a fundamental understanding of the worldviews underlying the views expressed with respect to the nature of the relationship between globalization and regionalization. Four general views with respect to the relationship between globalization and regionalization, corresponding to four broad worldviews, are discussed. These four views with respect to the relationship between globalization and regionalization are equally scientific and informative; each looks at the relationship between globalization and regionalization from a certain paradigmatic viewpoint.

Social theory can usefully be conceived in terms of four key paradigms: functionalist, interpretive, radical humanist, and radical structuralist. The four paradigms are founded upon different assumptions about the nature of social science and the nature of society. Each generates theories, concepts, and analytical tools which are different from those of other paradigms.

Each theory can be related to one of the four broad worldviews. These adhere to different sets of fundamental assumptions about; the nature of science (i.e., the subjective-objective dimension),

and the nature of society (i.e., the dimension of regulation-radical change), as in Exhibit 1. (See Burrell and Morgan (1979) for the original work. (Ardalan, 2001, 2003; and Bettner, Robinson, and McGoun, 1994; have used this approach).

The aim of this paper is not so much to create a new piece of puzzle as it is to fit the existing pieces of puzzle together in order to make sense of it. Sections II to V, first, each lays down the foundation by discussing one of the four paradigms. Then, each section presents the relationship between globalization and regionalization from the point of view of the respective paradigm. These different perspectives should be regarded as polar ideal types. The work of certain authors helps to define the logically coherent form of a certain polar ideal type. But, the work of many authors who share more than one perspective is located between the poles of the spectrum defined by the polar ideal types. The purpose of this paper is not to put people into boxes. It is rather to recommend that a satisfactory perspective may draw upon several of the ideal types. Section VI concludes the paper.

### **FUNCTIONALIST PARADIGM**

The functionalist paradigm assumes that society has a concrete existence and follows certain order. These assumptions lead to the existence of an objective and value-free social science which can produce true explanatory and predictive knowledge of the reality “out there.” It assumes scientific theories can be assessed objectively by reference to empirical evidence. Scientists do not see any roles for themselves, within the phenomenon which they analyze, through the rigor and technique of the scientific method. It attributes independence to the observer from the observed. That is, an ability to observe “what is” without affecting it. It assumes there are universal standards of science, which determine what constitutes an adequate explanation of what is observed. It assumes there are external rules and regulations governing the external world. The goal of scientists is to find the orders that prevail within that phenomenon.

The functionalist paradigm seeks to provide rational explanations of social affairs and generate regulative sociology. It assumes a continuing order, pattern, and coherence and tries to explain what is. It emphasizes the importance of understanding order, equilibrium and stability in society and the way in which these can be maintained. It is concerned with the regulation and control of social affairs. It believes in social engineering as a basis for social reform.

The rationality which underlies functionalist science is used to explain the rationality of society. Science provides the basis for structuring and ordering the social world, similar to the structure and order in the natural world. The methods of natural science are used to generate explanations of the social world. The use of mechanical and biological analogies for modeling and understanding the social phenomena are particularly favored.

Functionalists are individualists. That is, the properties of the aggregate are determined by the properties of its units.

Their approach to social science is rooted in the tradition of positivism. It assumes that the social world is concrete, meaning it can be identified, studied and measured through approaches derived from the natural sciences.

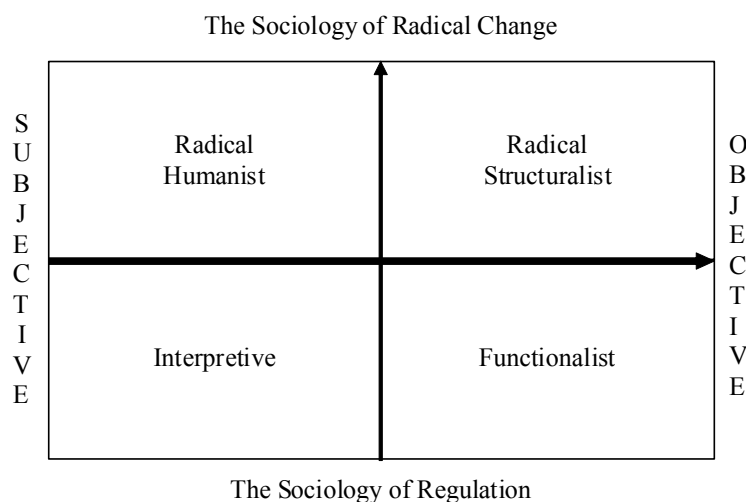
Functionalists believe that the positivist methods which have triumphed in natural sciences should prevail in social sciences, as well. In addition, the functionalist paradigm has become dominant in academic sociology and mainstream academic fields. The social world is treated as a place of concrete reality, characterized by uniformities and regularities which can be understood and explained in terms of causes and effects. Given these assumptions, the individual is regarded as taking on a passive role; his or her behavior is being determined by the economic environment.

Functionalists are pragmatic in orientation and are concerned to understand society so that the knowledge thus generated can be used in society. It is problem orientated in approach as it is concerned to provide practical solutions to practical problems.

In Exhibit 1, the functionalist paradigm occupies the south-east quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum. From right to left they are: Objectivism, Social System Theory, Integrative Theory, Interactionism, and Social Action Theory.

#### Exhibit 1: The Four Paradigms

Each paradigm adheres to a set of fundamental assumptions about the nature of science (i.e., the subjective-objective dimension), and the nature of society (i.e., the dimension of regulation-radical change).



Functionalist paradigm's view with respect to the relationship between globalization and regionalization is presented next. For this literature see Anderson and Blackhurst, 1993; Baldwin et al., 1999; Bhagwati, 1993; Bhagwati, Krishna, and Panagariya, 1999; Bhalla and Bhalla, 1997; Cable, 1994; De Melo and Panagariya, 1993a, 1993b; Dunning and Robson, 1987; Ethier, 1998a, 1998b; Henderson, 1992, 1994; Krugman, 1993a, 1993b; Lal, 1993; Lawrence, 1996; Lipsey and Lancaster, 1956-1957; Lloyd, 1992; Meade, 1955; Mistry, 1995; Tober, 1993; and Viner, 1950. This section is based on Cable, 1994; and Henderson, 1994.

The attempts to form regional arrangements have been based on theories that start with the well-known customs union theory, which emphasizes both the economic efficiency gains from regional trade liberalization and its ambiguous overall benefit due to trade diversion. Later, the idea of economies of scale was added to the theoretical analyses because of the creation of larger regional integrated markets. These building blocks have recently been supplemented by theoretical insights gained from imperfect competition and growth theory. These theories discuss the gains that accrue to participants as a result of economic integration, in general, and regional economic integration, in particular.

Liberalism has become popular across the world since the beginning of the last quarter of the twentieth century. In all the OECD (Organization for Economic Cooperation and Development) countries, economic policies have favored market mechanism, mostly through deregulation, privatization, tax reform, and reducing the size and improving the efficiency of the public sector. In the international arena, although the extent of their trade liberalization during this period has – with a few exceptions – been very limited, their liberalization with respect to capital flows and private direct investment has been far-reaching. Outside the OECD area, a large and still growing number of countries have abandoned the idea of a command economy. They have engaged in programs of reform directed towards reducing the extent of central command and expanding the role of competitive markets in their economic systems. They have taken substantial steps to establish freer trade and investment regimes. They have, in effect, decided that they should join the world economy.

These developments have opened up the prospect of a continuing evolution towards closer integration of the world economy through progressively greater freedom for cross-border trade and investment flows virtually among all countries. This would lead to substantial gains in world prosperity, which would be widely shared by residents in both rich and poor countries. The benefits from further systematic liberalization would not only lead to world prosperity, but also would lead to a more orderly world that is less subject to frictions because it is based on the principle of non-discrimination in international transactions.

This process of change involves all channels of policy and, therefore, new or enlarged regional integration agreements would form part of the continuing liberalization. In assessing this process in the world, consideration has to be given to the following two categories of agreements: first, the two predominant “blocs,” i.e., the EU and the NAFTA (North American Free Trade Agreement); and, second, the other various smaller agreements.



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With respect to the second category, there is reason to believe that the existing and newly established regional integration agreements on balance serve to make the system as a whole more liberal. The main point here is that the motive for a country now to either join an existing agreement or to become involved in the creation of a new one is its desire to consolidate and proceed further with a program of market-oriented reform. Membership in the regional integration agreement reduces the future risk that political pressures from interventionists in the member country will cause a reversal of the liberal reform process. Such a motive was behind the decision of Spain and Portugal when they applied for the membership of the European Community, and both countries substantially liberalized their trade and investment regimes. The same held true when Mexico decided to seek entry into the U.S.-Canada Free Trade Agreement. Similarly, in the Mercosur (Mercosur is the acronym for El Mercado Comun del Sur that means Common Market of the South America) agreement, where the participating countries wish to establish a new arrangement as part of a wider reform process, the newly created “bloc” is not protectionist. This is because the same underlying reason that led the member countries to reduce or even eliminate barriers within their region would provide the rationale for a wider opening of markets. In other words, the key motivation for an excluded country to join an existing regional integration agreement is its desire to pursue outward-oriented development policies that make a positive contribution to the liberalization of global trade and investment.

With respect to the first category, the external policies of the two predominant “blocs” – and within the NAFTA, the trade and investment policies of the United States – to a large extent determine the future of the global system. The new member countries that join either EU (European Union) or the NAFTA will have to adapt to the already existing trade regime of the “bloc” concerned. It is unlikely that these new member countries, even if they are themselves liberal (as in the case of the Czech Republic in Europe, or Chile on the American continent), will influence in a liberal direction the policies of either the EU or the U.S. When Spain and Portugal joined the EC (European Community), it was thought that the liberal trade regime of the European Community would be affected only slightly but negatively. After they joined EC, liberalization did in fact take place, but it was liberalization within the EC, and in the trade and investment policies of Spain and Portugal, not in the EC’s relations with the rest of the world.

That is, the external policies of the EU and the United States have the most influence on both the way in which the world trade and investment system now evolves, and on the extent to which international economic integration will proceed further. This is not so much because they are “trade blocs,” but rather because they are, by a wide margin, the largest and the most influential trading entities. As such their decisions are most influential. At the same time, these decisions are influenced by other national governments and trading entities.

There are important differences between the European Union and the United States, which arise chiefly from their differing political and constitutional status. Nevertheless, their trade regimes have much in common, and within them the present balance between liberal and interventionist

elements is similar. Over the years, both the European Community and the United States have taken unilateral steps towards liberalization, and both have participated in and fully supported successive GATT/WTO (General Agreement on Tariffs and Trade/World Trade Organization) rounds and liberalization which has been implemented within the OECD. Both are formally committed to further progressive liberalization, and to providing support for strengthening the open multilateral trading system. At the same time, they are both interventionist in similar ways and for similar reasons and both criticize each other for protectionist policies which they follow. Both follow two main forms of protectionism: (i) the special regimes which have been created for “sensitive” products – in particular, textiles and clothing, motor vehicles and steel, and (ii) the systematic use of anti-dumping actions. Both follow interventionist policies in agricultural products, such that the similarities between the EC and the U.S. (United States of America) are more striking than the differences. Both have similar well-established systems of selective protection; and both have exerted official pressure on third parties, in particular on Japan, in order to induce specific trade flows. In both, ideas are being canvassed for further regulation of international trade, which would increase the extent of disintegration within the international system; and in both, public opinion, within official circles as well as the public, is influenced by pre-economic conceptions of what is involved and what is at stake in international transactions.

Recent developments may reinforce the interventionist elements and tendencies in EC and U.S. The amazing and sustained economic success of a group of East Asian economies, including the Republic of China, and their rapidly growing participation in international trade. In both Europe and North America (i.e., U.S. and Canada), businesses increasingly need to take into account the opportunities and threats which these changes have been bringing with them. In reaction to these challenges, both European and North American businesses may support an increasing pressure to not only maintain existing forms of selective protection against imports from East Asia, but also to develop new ones. During the past several decades, both West European countries and the United States have had difficulty in adjusting and accommodating the economic transformation of Japan. As a result, their governments have followed a range of illiberal policies. If the East Asian dynamism is maintained, further interventionist pressures and new protectionist initiatives are to be expected.

It is therefore possible that in the “big two” the trend towards more liberal trade regimes, which has broadly prevailed over the past half-century, could be stopped or even reversed. If the EU and the U.S. retain and extend their existing modes of selective protection, they would affect the balance between liberalism and interventionism in the world as a whole. It would also affect the extent to which future regionalism goes with liberalization. In that case, the new members of the EU and NAFTA would join agreements with less liberal orientation. The countries remaining outside the two “blocs,” including those in other regional agreements, would have less to gain from external liberalization and would follow more protectionist policies.

However, in both the EU and the United States there have been ideas and interests that lend support to free trade. The governments have maintained their official commitment to liberalization.

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As in the past, the liberal and interventionist forces interact such that the balance may not always tilt consistently in one direction.

The policies and actions of the “big two” are also influenced by the conducts, arguments, and pressures of other countries or groups of countries within the system. Their influence would tend to increase as a result of (i) the growing relative economic importance of these countries, and (ii) their closer integration into the world economy. Therefore, much would depend on the way in which international economic policies evolve in the rest of the world – in particular, in Russia, the leading Latin American economies, the now advanced and still fast-growing smaller economies of Asia, and the three largest Asian economies, namely China, India, and Japan. Their commitment to liberal policies and to strengthening the multilateral trade system (and the WTO, i.e., World Trade Organization), would enhance trade liberalism within the EU, the United States, and the NAFTA. Economic liberalism leads to closer integration. Therefore, the liberal path outlined above would also be the path to a liberal international economic order. This would be the 21st-century counterpart of what prevailed during the half-century preceding the outbreak of the First World War. This second liberal order would be more securely founded than its predecessor because of the widely held – and still penetrating – belief that the key to prosperity is not in the occupation or control of territory. This would lead to keeping international economic policies effectively separate from the exertion of state power.

In a liberal order, regional integration agreements have a well-recognized and well-accepted place. More specifically, groups of countries with close political and cultural ties can make arrangements to provide (i) for the free movement of people within the region, while giving restricted rights of entry to outsiders, and (ii) extended residency and citizenship rights opportunities in each member country for the nationals of other member countries, as distinct from non-member countries. Although such arrangements are discriminatory, they are compatible with a liberal trade and investment regime. Such arrangements reflect the long-established and well-reasoned principle that questions of entry, residency, and citizenship fall within the competence and jurisdiction of national sovereign states.

The creation or extension of regional integration agreements can actually form part of the liberalization process with respect to trade and capital flows. Such agreements would embody liberal norms, which imply that the removal of barriers within the region should be extended to the rest of the world. That is, liberal norms within the region would go together with (i) a readiness to liberalize beyond the region and with respect to the rest of the world, and (ii) the understanding that trade and capital flows across international boundaries, similarly to their counterparts within each national state or region, should be guided by legal norms rather than be subjected to coercive government interventions.

Regionalism can be compatible and be an expression of liberalism when it is based on general acceptance of liberal principles in international economic relations. Whether regional agreements

conform to these principles would depend on developments within the main national states and trading entities.

The multilateral trade and investment system – international economic integration – is mainly dependent not on the extent to which regional integration agreements become more prevalent, but rather on the extent to which liberal versus interventionist influences affect the formation of international economic policies of the leading national states and trading entities – including in particular, though not exclusively, the European Union and the United States. Regional agreements largely reflect this balance. Regional agreements do not determine this balance either at the national level or in the world as a whole. “Open regionalism” is possible and desirable but progress towards open regionalism should be combined with comparable and parallel progress towards strengthening multilateral disciplines. In the current debate, the position that portrays regionalism and liberalism – multilateralism – as warring principles is misguided. The fundamental antithesis is between liberalism and interventionism.

### **INTERPRETIVE PARADIGM**

The interpretive paradigm assumes that social reality is the result of the subjective interpretations of individuals. It sees the social world as a process which is created by individuals. Social reality, insofar as it exists outside the consciousness of any individual, is regarded as being a network of assumptions and intersubjectively shared meanings. This assumption leads to the belief that there are shared multiple realities which are sustained and changed. Researchers recognize their role within the phenomenon under investigation. Their frame of reference is one of participant, as opposed to observer. The goal of the interpretive researchers is to find the orders that prevail within the phenomenon under consideration; however, they are not objective.

The interpretive paradigm is concerned with understanding the world as it is, at the level of subjective experience. It seeks explanations within the realm of individual consciousness and subjectivity. Its analysis of the social world produces sociology of regulation. Its views are underwritten by the assumptions that the social world is cohesive, ordered, and integrated.

Interpretive sociologists seek to understand the source of social reality. They often delve into the depth of human consciousness and subjectivity in their quest for the meanings in social life. They reject the use of mathematics and biological analogies in learning about the society and their approach places emphasis on understanding the social world from the vantage point of the individuals who are actually engaged in social activities.

The interpretive paradigm views the functionalist position as unsatisfactory for two reasons. First, human values affect the process of scientific enquiry. That is, scientific method is not value-free, since the frame of reference of the scientific observer determines the way in which scientific knowledge is obtained. Second, in cultural sciences the subject matter is spiritual in nature. That is, human beings cannot be studied by the methods of the natural sciences, which aim to establish

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general laws. In the cultural sphere human beings are perceived as free. An understanding of their lives and actions can be obtained by the intuition of the total wholes, which is bound to break down by atomistic analysis of functionalist paradigm.

Cultural phenomena are seen as the external manifestations of inner experience. The cultural sciences, therefore, need to apply analytical methods based on “understanding;” through which the scientist can seek to understand human beings, their minds, and their feelings, and the way these are expressed in their outward actions. The notion of “understanding” is a defining characteristic of all theories located within this paradigm.

The interpretive paradigm believes that science is based on “taken for granted” assumptions; and, like any other social practice, must be understood within a specific context. Therefore, it cannot generate objective and value-free knowledge. Scientific knowledge is socially constructed and socially sustained; its significance and meaning can only be understood within its immediate social context.

The interpretive paradigm regards mainstream academic theorists as belonging to a small and self-sustaining community, which believes that social reality exists in a concrete world. They theorize about concepts which have little significance to people outside the community, which practices social theory, and the limited community which social theorists may attempt to serve.

Mainstream academic theorists tend to treat their subject of study as a hard, concrete and tangible empirical phenomenon which exists “out there” in the “real world.” Interpretive researchers are opposed to such structural absolutism. They emphasize that the social world is no more than the subjective construction of individual human beings who create and sustain a social world of intersubjectively shared meaning, which is in a continuous process of reaffirmation or change. Therefore, there are no universally valid rules of science. Interpretive research enables scientists to examine human behavior together with ethical, cultural, political, and social issues.

In Exhibit 1, the interpretive paradigm occupies the south-west quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum. From left to right they are: Phenomenology, Phenomenological Sociology, and Hermeneutics.

Interpretive paradigm’s view with respect to the relationship between globalization and regionalization is presented next. For this literature see Atkinson, 1998; Dent, 2003; Duina, 2006; Gibb and Michalak, 1994; Gilpin, 2001; Hart, 1992; Hay, 2000; Hirst and Thompson, 2000; Jayasuriya, 2004; Mace and Belanger, 1999; Nye, 1971; Rozman, 2004; Rugman, 2001; Ruigrok and van Tudler, 1995; Sandholtz, Borrus, Zysman, Conca, Stowsky, Vogel, and Weber, 1992; Thurow, 1992; Wyatt-Walter, 1995; and Zysman, 1996. This section is based on Hirst and Thompson, 2000. The world economy has a long way before it reaches the genuine global stage. Currently, trade, investment, and financial flows are concentrated in the Triad of Europe, Japan, and North America which most likely will continue for a long time in the future.

Trade blocs represent a vital intermediate economic institution between the world economy, such as the WTO (World Trade Organization), and the national economies. At present, the Triad

dominates the world economy and in all likelihood it will continue to account for a major portion of the world manufacturing output and FDI (Foreign Direct Investment) in the foreseeable future. Therefore, the Triad can manage the future direction of the world economy if it acts in concert. Trade blocs that are loosely organized and have incompatible interests can only run the existing world institutions and get involved in some crisis-avoidance measures. Directing the world economy towards ambitious goals – full employment in the advanced countries and raising output and incomes in the developing countries – requires a high level of coordination among the members of the Triad. If they make such a commitment then they can impose a new tripartite “hegemony” on world financial markets, international regulatory bodies, and other nation-states similar to that of the U.S. during 1945-1973. When the Triad makes such a commitment then, for instance, it will no longer be the case that any attempts to further regulate the international financial system will be undermined by the “flight” of capital to “offshore” locations, because the offshore locations will be immediately black-listed through the political will of the Triad. The necessary conditions for such coordination are: that the three blocs of the Triad are roughly equal in economic power, that they have a common doctrine, and that each bloc has the internal consistency for external action.

A strengthened trilateral relationship between North America, the EU (European Union), and Japan can support a minimal multilateralism in the world economy. Multilateralism is the most economical and least costly form of relationship for international economic stability. It is the most effective framework for the recognition and enhancement of liberal national sovereignty within the international state system. Multilateralism has never existed in a pure form, but it prevailed when it was underwritten by British hegemony between 1870 and 1914 and American hegemony between 1945 and 1973. Presently, multilateralism depends on the control of a Triad of the major economies.

The current structure of multilateralism is a classic liberal embedded multilateralism with the new trilateralism at its core. However, the three components of the Triad are not similar. The EU is the key component. The EU is the most ambitious project of multilateral economic relationships, which is yet to be completed. The EU is internally fragmented and therefore has major problems with respect to internal articulation and concerted external action. NAFTA is dominated by the U.S.; and Japan’s bloc is based on a nation-state. That is, both have characteristics of traditional nation-states, in the sense that they can agree on an agenda and each can obtain internal support for it. The EU consists of fifteen national entities, whose commitment to the full EU ideal is ambiguous. In the EU, it is difficult to reconcile divergent interests in developing its institutions. Therefore, the evolution of the EU plays a crucial role in the formation of the structure of multilateralism in the international economy as a whole.

The EU’s effective economic role depends on the development of its political institutions. Such development faces difficulties because there are substantial differences in economic performance, social standards and political interests among the constituent countries. The EU is not and will not become a large-scale nation-state. It has neither a single and sovereign source of law nor

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does it have a central executive that is democratically accountable through a single channel to the representatives of the people.

The EU's power is mostly based on the treaties among the member states. Its legislation is mostly dependent on both the common frameworks of the member states and the executive branches of the member states that implement common policies. Its decision-making mostly depends on agreements among national governments and the nationally unaccountable Council of Ministers. EU's nation-states retain many governmental functions, and have distinct languages, cultural traditions, and legal systems that prevent complete integration. That is, the EU will never become a political entity like a nation-state.

The possibility of a fully federal state in the EU is very remote. This is because currently most European politicians are concerned with the ultra-nationalist and regionalist forces. In addition, most national leaders and parliaments are reluctant to give up their power to Brussels. The EU was founded in 1957 and then it was run by parties ranging from centre-right to centre-left. More recently there has been a shift towards the ultra-right, populist, nationalist, and regionalist parties. As a result the established national parties tended to defend the state and resist giving more power to the EU. The possibility of an economic depression throughout EU is another factor which might prevent the full integration of the EU. In such a case, the pressures towards national protective measures would mount. These would be directed towards increasing state support to domestic industries, and towards greater independence in fiscal and monetary policies. Established political parties would have to compromise with political forces of the far right and regionalists. Therefore, national states would protect their own economic bases and the EU would start to disintegrate.

The EU has nevertheless proceeded far politically. It has replaced the national states in several areas. The states are not "sovereign," as they used to be. The European Parliament performs important legislative and accountability functions. The Commission initiates legislation, consults on policy issues across EU, and regulates and supervises certain activities at the national level. The EU legislations that are related to the single market gain priority over national legislation. Peoples living in the EU have certain supranational rights guaranteed and overseen by a supranational judiciary.

The EU is thus an association of states with certain governance functions given to a common supranational power. It consists of common institutions, member states, and peoples. This structure has both strengths and weaknesses. Its strength is that it minimizes the conflicts that arise when forming an overall set of institutions. Its weakness is that its complexity slows down the development of common governance functions.

The EU cannot become a scaled up nation-state. It will most probably become successful if it enhances the decision-making procedures of the association of states, rather than replacing national-level institutions. Both the EU and its constituent nations can gain politically if they cooperate and coordinate. This is because sovereignty is not a fixed amount that what one party gains must be at the expense of another.

The EU's national states are vital for the political legitimacy and democratic accountability of the EU. Rapid development of EU's institutions might put in jeopardy their legitimacy and lead to justified perception of remote, technocratic, and unaccountable institutions.

Strong government is not necessarily centralized and exclusive government. Strong government can be obtained by consultation, coordination, and division of labor. The threat to the EU is the competition and conflict among nation-states with respect to their common policy. The European single market and its integration of production need to be managed neither by nationally-based policies nor by the workings of unregulated markets. EU's economic management needs to be strengthened, but not by creating a super-state. Rather, it will happen through a division of labor among national and regional governments, cooperating with the EU's institutions with considerable power but limited functions.

The EU needs to develop a balance of powers among the regional, national, and the EU levels. Cooperation among states in the EU gains importance when there is a strong common basis for action. In the past, such cooperation in the EU reached its highs when the EU was involved with its external environment and negotiations, rather than when it was focused inwards on internal developments. External involvements make the nation-states within the EU more cohesive and more cooperative. This happens, for instance, when the EU pursues a strategy aimed at promoting cooperation among the major economic players in the world towards common goals.

In the international system and among the members of the Triad, the U.S., as the dominant force, pursues and gains its interests too easily and too often. If the EU expresses its disagreement then it would help define the global system more clearly and enable the EU to consolidate its internal position further – since external conflict adds to integrative pressures.

As one of the components of the Triad, the EU helps shape the emerging multilateral economic relations, for instance by its participation in the GATT/WTO negotiations. This international orientation at the same time helps its internal unity. The EU would not only gain from such reregulation of the international economy but also could gain internal coherence.

With the EU's single economic space come the economic and social issues. These lead to the need for common programs and show the difficulty of attaining them with existing institutions. When the EU has a single market it must not only have the rules to ensure market openness but it must also have rules to compensate for the asymmetrical regional effects of the market. The market tends to put firms and capital markets beyond national control, such that they impose social costs without paying for them. EU politicians are mostly dissatisfied with pure economic liberalism and adhere to Christian democratic or social democratic principles. They support the highest level of market liberalization that is consistent with long-run social efficiency. This translates into the maintenance of common European standards through regulation – in environmental protection, in company law, in the regulation of capital markets, in social, health, and safety legislation. Existing EU institutions perform these functions legitimately. The EU creates both a common framework for legislation and a common structure of rights and regulations based on which economic actors operate with a measure



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of certainty throughout Europe. However, problems arise where programs involve major spending. Not all nations and regions can equally afford major spending and would leave EU divided.

Similar problems arise in other areas of policy, such as the EU's regional policy that aims to improve the efficiency of weaker regions through substantial investment in infrastructure, education, and training. These economic revitalization are ultimately of benefit to the richer regions too. This is because the success and growth in weaker regions would add to the effective demand necessary for the advanced industrial region. However, richer regions and states are not willing to spend on fiscal redistribution and social harmonization. If this attitude is not changed, then the economic disparity between stronger and weaker regions might lead to EU's disintegration.

There would be a divided and weakened EU, with its eastern half living in poverty, and its western half facing economic migrants that would lead to repressive measures against immigrants. The problem is that current EU politicians in the national states and in the richer regions follow self-protective policies because they only see the costs and not the benefits of such programs. As the largest trade bloc of the world, the EU would only develop if its nation-states and its central institutions take advantage of opportunities that their combined sovereignty and resources provide. Unfortunately, it is highly unlikely that the EU would move quickly towards such common objectives. But even if it were to do, there would have to be substantial political coordination among the EU and national and regional levels. But even if the EU's central institutions gained considerable citizen support and political legitimacy, they could not substitute central social coordination for the more complicated ones at the national and regional levels. Nations and regions have social solidarity, which are far stronger in coordinating the social interests.

The EU faces difficulty in creating institutions for orchestrating consensus for macroeconomic policy at supra-state level. European labor, through its supranational federations, may be willing to enter into a dialogue but the employers refuse to cooperate. Moreover, European labor federation is unable to discipline its member unions in the nation-states. In the end some nation-states become the main actors in constructing a political basis of consent for the macroeconomic policies of the EU and for their own fiscal, regulatory, and industrial policies.

The EU needs to be concerned with the creation of the necessary institutions to ensure that its economic integration is irreversible. As a primitive single market its integration is probably irreversible. But this is not the case for the management of the single economic unit. This is because it hinges on future historical events such as a sustained depression, which ignites the rightist pressures, with the explosive issue of immigration.

The EU has not resolved the issues of the balance of power among the EU, national, and regions in Europe. The EU is very unlikely to become a continent-wide single unified state, such as a federal state. This cannot be accomplished by force because it leads to the disintegration of the EU. In all likelihood, the EU's power and capacities continue to be based on the treaties among the nation-states and the decision-making processes in which the nation-states play the major role.

A single market requires its corresponding unit of regulation. The main limiting factors in Europe are political and point to the ability of Brussels to mobilize citizen support for policies regarding major continental fiscal commitments and political risks.

### **RADICAL HUMANIST PARADIGM**

The radical humanist paradigm provides critiques of the status quo and is concerned to articulate, from a subjective standpoint, the sociology of radical change, modes of domination, emancipation, deprivation, and potentiality. Based on its subjectivist approach, it places great emphasis on human consciousness. It tends to view society as anti-human. It views the process of reality creation as feeding back on itself; such that individuals and society are prevented from reaching their highest possible potential. That is, the consciousness of human beings is dominated by the ideological superstructures of the social system, which results in their alienation or false consciousness. This, in turn, prevents true human fulfillment. The social theorist regards the orders that prevail in the society as instruments of ideological domination.

The major concern for theorists is with the way this occurs and finding ways in which human beings can release themselves from constraints which existing social arrangements place upon realization of their full potential. They seek to change the social world through a change in consciousness.

Radical humanists believe that everything must be grasped as a whole, because the whole dominates the parts in an all-embracing sense. Moreover, truth is historically specific, relative to a given set of circumstances, so that one should not search for generalizations for the laws of motion of societies.

The radical humanists believe the functionalist paradigm accepts purposive rationality, logic of science, positive functions of technology, and neutrality of language, and uses them in the construction of “value-free” social theories. The radical humanist theorists intend to demolish this structure, emphasizing the political and repressive nature of it. They aim to show the role that science, ideology, technology, language, and other aspects of the superstructure play in sustaining and developing the system of power and domination, within the totality of the social formation. Their function is to influence the consciousness of human beings for eventual emancipation and formation of alternative social formations.

The radical humanists note that functionalist sociologists create and sustain a view of social reality which maintains the *status quo* and which forms one aspect of the network of ideological domination of the society.

The focus of the radical humanists upon the “superstructural” aspects of society reflects their attempt to move away from the economism of orthodox Marxism and emphasize the Hegelian dialectics. It is through the dialectic that the objective and subjective aspects of social life interact. The superstructure of society is believed to be the medium through which the consciousness of

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human beings is controlled and molded to fit the requirements of the social formation as a whole. The concepts of structural conflict, contradiction, and crisis do not play a major role in this paradigm, because these are more objectivist view of social reality, that is, the ones which fall in the radical structuralist paradigm. In the radical humanist paradigm, the concepts of consciousness, alienation, and critique form their concerns.

In Exhibit 1, the radical humanist paradigm occupies the north-west quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum. From left to right they are: French Existentialism, Anarchistic Individualism, and Critical Theory.

Radical humanist paradigm's view with respect to the relationship between globalization and regionalization is presented next. For this literature see Amin, 1999; Bernard, 1999; Boas, Marchand, and Shaw, 1999, 2005; Dicken, 1998; Frank, 1998; Gamble and Payne, 1996; Geyer and Bright, 1995; Gill, 1998; Griesgraber and Gunter, 1997; Grinspun and Cameron, 1993; Grinspun and Kreklewich, 1994; Held and McGrew, 2002a, 2002b; Hettne, 1994, 1997, 1999; Hurrell, 1992; Marchand, Boas, and Shaw, 1999; Mittelman, 2000; Scholte, 2000; Soderbaum and Shaw, 2004; Strange, 2002, 2007; and Thomas and Tetreault, 1999. This section is based on Hettne, 1999.

The two dynamic processes of regionalization and globalization are dialectically, rather than linearly, related within the larger process of global structural change. The outcome in the form of a new world order depends on the relative strength of contending social forces involved in the two processes and cannot be extrapolated or forecasted.

Globalism is regarded as programmatic globalization, that is, the world is borderless and territory is dominated by functionalism. Current regionalization relates to globalization as response to challenge. Globalization is an integrative process consisting of both objective (compression of the world) and subjective (planetary consciousness) processes.

To understand globalization and the emerging world order, a suitable theoretical framework is the tradition of materialism that identifies three consecutive modes of the international division of labor:

1. The old division of labor, based on comparative advantage of countries;
2. The new international division of labor, based on the spatial reorganization of production; and,
3. The global division of labor, based on the penetration of domestic economies by a qualitative deepening of the process of globalization.

Societies consist of not only economic systems but also communities of people. The changes taking place within the global division of labor are intertwined in a complex manner and they constitute the contradictions within the globalization process.

The globalization processes bring with them global awareness which include negative impressions and reactions with a view to halt or reverse the processes of globalization through a

counter-process of de-globalization. This may be achieved by the new regionalism in order to bring the globalization processes under some political-territorial control. The new regionalism can also help globalism, which is a different globalism than what is the direct outcome of the state-centered Westphalian system. Westphalian interstate system has the following characteristics: each state is sovereign and independent; each state follows its national interests; the interstate system is regulated by a balance of power among the principal powers. The process of globalization has its counter-processes, and together they lead to mixed outcomes, one of which is regionalism. In the new regionalism both the content and the context of regionalization have changed.

Regionalization is a diverse phenomenon. As a response to globalization, regionalization varies both over time and across different cultural areas of the world. However, it homogenizes the regional space, and reduces the sovereignty of nation-states and changes their roles. Globalization, on the other hand, homogenizes the global space. The developmental logic of the current regionalization process is territorial which is in sharp contrast to the developmental logic of the globalization which is functional.

The old regionalism and the new regionalism are different in the following ways:

1. The old regionalism was created in the bipolar world of cold-war, but the new regionalism is being created in a multi-polar world order. Even though the former superpowers have military superiority, they are losing their power and becoming regional powers such that they are competing with other emerging regional powers. The superpower organization of the world was a premature globalization so that the decline of superpowers has led to de-globalization.
2. The old regionalism was created from above by the superpowers, but the new regionalism is being created from below by the states and increasingly other actors from within the region.
3. The old regionalism was economically inward-oriented and protectionist, but the new regionalism is often open and fits an interdependent world economy. However, in the new regionalism there is some preferential treatment within the region.
4. The old regionalism had specific objectives – security-oriented or economically-oriented, but the new regionalism is a more comprehensive and multidimensional process – trade and economic, environment, social policy, security, democracy, accountability, and legitimacy.
5. The old regionalism was only based on formal relations among sovereign nation-states, but the new regionalism is partly based on non-state actors who play important roles at several levels of the global system, which is undergoing structural transformation.

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The new regionalism is better understood within the world order concept rather than from the point of view of the single region. This is because any particular regionalization process has systemic repercussions both within the region and among regions throughout the world. This is currently shaping the organization of the world, which is most likely towards creating core regions with their peripheral regions, where the core regions have their own centre-periphery relationships. The old regionalism and new regionalism co-exist in time. There are relatively few new regionalization processes in effect. Some of the existing regions continue their identity, but others widen their relationship from security to development and vice versa.

The process of regionalization from within is based on a shared, non-coercive project among the members of the region. The process of regionalization involves historical attempts to create a transnational level of governance that reinforces shared values and minimizes shared perceived dangers. The formation of regional identity is historically specific and often involves conflicts. Regional formations have a subjective quality of “imagined communities.”

The new regionalism has an underlying logic. This is multi-dimensional and some key dimensions are cultural identity, degree of economic and political homogeneity, security order, and conflict resolution.

The new regionalism is also based on the growth of a regional civil society, which attempts to find regional solutions to some local, national, and global problems. This means that not only economic, but also informal social and cultural networks develop more quickly than the formal regional political projects. In this connection, five degrees of regionness may be considered:

1. Region as a geographical unit. The borders of the region are defined by natural physical barriers and ecological characteristics. This first degree of regionness may be called “proto-region,” or “pre-regional zone.”
2. Region as a social system. This means trans-local relations among human communities. In these relations the security of the communities in the region as well as the overall political stability of the regional system gains importance. The region, as well as the international system, is anarchic. This second degree of regionness may be called “primitive” region.
3. Region as co-operation in the cultural, economic, political, or military activities. The region is defined by the membership of the regional organization. This could be called the “formal” region.
4. Region as civil society. This is formed through social communication and convergence of values in the region as a whole. The multidimensional quality of regional co-operation and the emerging societal characteristics is of crucial importance. This could be called “regional anarchical society.”
5. Region as acting subject with a distinct identity, actor capability, legitimacy, and structure of decision-making. Of prime regional importance are both the resolution

of conflict between and within former states; and the welfare in terms of social security and regional balance. This could be called “region-state.”

The new regionalism aims at the higher degrees of regionness. Whereas the degrees of regionness may mean an evolutionary logic, they are not meant to suggest a stage theory. They can act as a frame of reference for comparative analysis.

The various dimensions interacting within the process of regionalization must be understood in turn within different levels of the world-system within the context of globalization.

The most important dimensions that the process of regionalization tends to homogenize are: culture, security, economic policies, and political regime.

Cultural homogeneity of certain degree is necessary for regionalization and over time the culture becomes more homogenized very slowly. But cultural affinity of states and social groups does not stop them from fighting each other.

Security is also necessary for the creation of regional systems. Security regions imply economic regions such that a fundamental change in the security arrangement implies a new regional economic co-operation.

Economic policies which are compatible are also necessary for regionalization. Currently, a shared commitment to the market principle plays this role. However, free-trade regions consisting of unequal countries generate tensions that erode the regional arrangement.

The political regime favored by current global forces is democracy at the national level. Regionalization requires the transfer of power to supranational authorities and therefore transnational democracy.

Different levels that simultaneously form the ground for the complex process of regionalization are: the structure of the world system, the interregional relations, and the internal characteristics of the region: the region, the nations, the sub-nationals, and transnational micro-regions.

The structure of the world system currently allows regional actors to maneuver, and regionalism produces global structural change towards multi-polarity. Current regionalization is a reflection of the world hegemonic decline. Under the bipolar Cold War world system, the quasi-regions reproduced the global division within their regions. The new regionalism is incompatible with a bipolar hegemonic world system. The current hegemonic regionalism is based on neoliberal regionalism which is different from the earlier embedded liberalism.

Interregional relations imply that the behavior of one region affects and is affected by the behavior of other regions. European regionalism promoted regionalism by providing a model and constituted a protectionist threat, as result of which NAFTA and the East Asian regionalism emerged.

The Region is the basic dimension of homogenization of culture, security, economic policies, and political system. Currently distinct regional interests are not yet articulated. This is because regions are sometimes used for competing national interests, and regions are at other times used for

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combining national interests to increase their control over global forces, which helps the creation of a regional actor. Therefore to understand the current process of regionalization it is necessary to identify, compare, and analyze individual national options.

The sub-national forces have triggered regionalization through different forms of disintegration. This is because the structure of the world order is changing by loosening the extreme stabilizing controls of the old world order of the cold war era. The increase in the number and power of ethno-national movements will increase the role of the region. Regionalization in turn strengthens micro-regions, because the transformed geopolitical environment creates new ways to align forces to approach the world economy for the sub-national regions. There can be “open micro-regionalism” with a global orientation; and “secluded micro-regionalism” with macro-region orientation.

The domestic and the external processes are closely related. The loss of political power at one level revives an existing latent power struggle at a lower level. This provides opportunities for sub-national and micro-regional interests to express themselves. The regional institution with a conflict resolution framework can intervene. A new social power and political authority on a higher level of societal organization will emerge.

The new regionalism has a dialectical relationship with globalization. The current world system promotes regionalization and at the same time the increase in regionalization leads to structural change in the world system towards a regionalized world order. Regionalism promotes the “political” in a globalized world. Globalism represents interests that do not express universally shared concerns, rather it represents interests that are strong enough to penetrate and transform all or most parts of the globe. Globalism represents the neo-liberal ideology and expresses the interests of powerful economic actors on the global market and emphasizes the values of efficiency and competitiveness. This would lead to counter-movements such as regionalization. The new regionalism represents a multidimensional process of regional integration that includes economic, political, social, and cultural dimensions. It tends to establish territorial control and regional coherence while protecting regional civil society in a multi-polar global context. The two processes of regionalism and globalism are crucially different in their development logic, the former is territorial and the latter is functional. The outcome depends on the dialectical relationship between the two logics, i.e., the forces of market expansion and the need for political control.

New multilateralism may be normatively defined as a strong belief in having dialogue among political, social, economic, and cultural forces in order to resolve conflicts and to design institutional processes. Regionalized rather than globalism would facilitate such pluralism.

The regionalization process constitutes a step towards new multilateralism and acts as a barrier to war among civilizations. This more symmetric dialogue can only be implemented within a protective regionalism.

## RADICAL STRUCTURALIST PARADIGM

The radical structuralist paradigm assumes that reality is objective and concrete, as it is rooted in the materialist view of natural and social world. The social world, similar to the natural world, has an independent existence, that is, it exists outside the minds of human beings. Sociologists aim at discovering and understanding the patterns and regularities which characterize the social world. Scientists do not see any roles for themselves in the phenomenon under investigation. They use scientific methods to find the order that prevails in the phenomenon. This paradigm views society as a potentially dominating force. Sociologists working within this paradigm have an objectivist standpoint and are committed to radical change, emancipation, and potentiality. In their analysis they emphasize structural conflict, modes of domination, contradiction, and deprivation. They analyze the basic interrelationships within the total social formation and emphasize the fact that radical change is inherent in the structure of society and the radical change takes place through political and economic crises. This radical change necessarily disrupts the *status quo* and replaces it by a radically different social formation. It is through this radical change that the emancipation of human beings from the social structure is materialized.

For radical structuralists, an understanding of classes in society is essential for understanding the nature of knowledge. They argue that all knowledge is class specific. That is, it is determined by the place one occupies in the productive process. Knowledge is more than a reflection of the material world in thought. It is determined by one's relation to that reality. Since different classes occupy different positions in the process of material transformation, there are different kinds of knowledge. Hence class knowledge is produced by and for classes, and exists in a struggle for domination. Knowledge is thus ideological. That is, it formulates views of reality and solves problems from class points of view.

Radical structuralists reject the idea that it is possible to verify knowledge in an absolute sense through comparison with socially neutral theories or data. But, emphasize that there is the possibility of producing a "correct" knowledge from a class standpoint. They argue that the dominated class is uniquely positioned to obtain an objectively "correct" knowledge of social reality and its contradictions. It is the class with the most direct and widest access to the process of material transformation that ultimately produces and reproduces that reality.

Radical structuralists' analysis indicates that the social scientist, as a producer of class-based knowledge, is a part of the class struggle.

Radical structuralists believe truth is the whole, and emphasize the need to understand the social order as a totality rather than as a collection of small truths about various parts and aspects of society. The financial empiricists are seen as relying almost exclusively upon a number of seemingly disparate, data-packed, problem-centered studies. Such studies, therefore, are irrelevant exercises in mathematical methods.



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This paradigm is based on four central notions. First, there is the notion of totality. All theories address the total social formation. This notion emphasizes that the parts reflect the totality, not the totality the parts.

Second, there is the notion of structure. The focus is upon the configurations of social relationships, called structures, which are treated as persistent and enduring concrete facilities.

The third notion is that of contradiction. Structures, or social formations, contain contradictory and antagonistic relationships within them which act as seeds of their own decay.

The fourth notion is that of crisis. Contradictions within a given totality reach a point at which they can no longer be contained. The resulting political, economic crises indicate the point of transformation from one totality to another, in which one set of structures is replaced by another of a fundamentally different kind.

In Exhibit 1, the radical structuralist paradigm occupies the north-east quadrant. Schools of thought within this paradigm can be located on the objective-subjective continuum. From right to left they are: Russian Social Theory, Conflict Theory, and Contemporary Mediterranean Marxism.

Radical structuralist paradigm's view with respect to the relationship between globalization and regionalization is presented next. For this literature see Baran, 1957; Baran and Sweezy, 1966; Barratt Brown, 1963; Bukharin, 1918; Frank, 1969; Hilferding, 2006; Kautsky, 1964; Lenin, 1917, 1939; Luxemburg, 1951; Magdoff, 1969; Mandel, 1968, 1975; Mattick, 1969; Onwuka and Shaw, 1989; Picciotto and Radice, 1971; Radice, 2007; Richards, 1997; Rowthorn, 1971; and Trotsky, 2007. This section is based on Mandel, 1975.

The move towards European economic integration is one of the consequences of capitalist concentration on an international scale. It is a capitalism way of reconciling the growth of the productive forces and the increasing degree of industrial concentration with the survival of the nation-state. Through European economic integration, commodities, capital, and labor circulate freely so that the industry is released from tariffs and short-sighted economic nationalism.

It has been for some time that the growth of productive forces has surpassed the boundaries of the national states in Europe. International cartels and international holding companies have spread their control over significant parts of the European economy. German industry, for instance, needs to expand beyond the boundaries of the German nation-state in order to survive. It is by its very nature expansionist. This expansionism either takes the violent and military path towards the East – as it did during the First and Second World Wars – or it takes the commercial path towards the West – as it did after the Second World War – depending on the configuration of the political and military relationships of forces in Europe.

While the European economic integration is a product of capital concentration, it acts as an important driving force for capital concentration in Europe and beyond. Initially, most of the large-scale Western European enterprises supplied their products mainly in their national market. These enterprises included the main branches of manufacturing production, such as the large machine-building and durable consumer goods sectors.

After the Korean War of 1958, Western European economies experienced an economic boom for a few years. During this period, the relative size of the producing units did not matter because demand outpaced supply and there was no serious cut-throat competition. Therefore, there was no strong process of concentration and expansion of cartels. While employers' associations formed cartels and covered all industries, they did not have to take any measures of either market division or production restriction.

After 1962, Western Europe entered a new phase in the development of the European economic integration, when problems started to arise. During the prior general economic boom, productive capacities had surpassed demand in various key sectors. Overcapacity led to fierce economic competition with the resultant rationalization and concentration. The logic of capitalist concentration led to the setting up of companies to produce not for any national market, but for the whole integrated European economy.

Three possible forms of capital concentration all have actually occurred in the process of European economic integration.

The first is the fusion of national companies. The major examples are as follows: in Italy, the merger of two chemical trusts Edison and Montecatini; in France, the merger of two chemical trusts Kuhlmann and Ugine; and in West Germany, the agreed cooperation between two automobile trusts Volkswagen and Daimler-Benz.

The second is the fusion or the absorption of national companies in Europe by large American companies. The major example is the absorption of Machines Bull and Olivetti by General Electric.

The third is the fusion of national companies in Europe into new units, whose capital is not national but is spread over a few European countries, such as the U.K., Switzerland, Sweden, and Spain. The major examples are: the merger between the two most important trusts of photographic equipment and material the Belgian Gevaert and the West German AGFA; the merger between the steel trusts the Dutch Hoogovens Ijmuiden and the German Dortmund Horder-Hutten-Union and Hoesch; the merger between two financial groups the French Schneider and the Belgian Empain; and the agreed cooperation between two chemical trusts the French Rhone-Poulenc and the German Bayer.

The entrance of American capital into Europe – whether in the form of new subsidiary company investments, or through merger with or absorption of existing European companies – shows that American capital has taken away part of the European market from the European capital (except for cases that new products are introduced into that market, and that these new products are not substitutes for European products). In the context of the intensification of international capitalist competition, the amalgamation of European and American companies means a defeat of European capital. It is reasonable to assume that European capital will react and defend itself against this process.

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Meanwhile, there are three reasons why the amalgamation of financial and industrial companies does not consist mainly of the merger of existing national companies, but it consists of the establishment of new companies based on an international interpenetration of capital.

The first is that due to the nature of some industries the required amount of capital investments and the rate of technological obsolescence are so high that getting involved in such industries with private national capital becomes impossible. Two major examples are from the aircraft industry: one is the joint Anglo-French ventures (Concorde, for instance), and the other is the space industry, which depends on the collaboration between all European capitalist powers. A third example is the development of the nuclear industry, which has required not only the private capital but also the state initiative and state financing. These examples show that the growth of productive forces has surpassed the boundaries of both the private property and of the nation-state.

The second is the principle of spreading risks and overhead costs that logically leads to international amalgamation. This is facilitated by the customary common consultation on all major problems facing any particular industry in Europe. Adherence to this principle would be a necessity for the preparation of European capitalism for the vigorous international competition – especially with respect to North American capital – that involves a rapid pace of technological innovation. The amounts and risks of investments are so high that any incorrect decision might result in the loss of the entire financial reserves of the national holding companies or national investment banks, that is, something that the national finance groups cannot afford.

The third is the economies of scale, which Europe can achieve through the international amalgamation of capital. In international arena, the U.S. capitalism enjoys tremendous competitive benefits from the economies of scale. To counter these advantages, European companies need to multiply their size. Again, in order to be able to compete with the giant American monopolies, Europe needs to create companies with such proportions that are beyond the reach of any national capital.

With the growth of the international interpenetration of capital and the international capital concentration among European countries, new forces have been at work that have brought about qualitative changes in many arrangements including the following two important fields.

The State is the main instrument of power of the bourgeois class. The State not only defends private property against the working classes, but also guarantees monopoly profits in case of severe economic crises. When the capital invested in the industries of a country is mainly national, the State is mainly the instrument of the national capitalist class. When the capital invested in the industries of a country is mainly foreign, the State of this so-called semi-colonial country mainly defends the interests of the foreign capitalists.

But in Europe, the most important financial and production industries are financed neither by national nor by foreign capitalists, but by an amalgamation of the capitalists from within Europe. In this case, the State is the instrument of the combined European capitalists. The growth of capital interpenetration within Europe represents the material basis for having the supra-national state power

organs in Europe. The deeper is the capital interpenetration, the stronger is the force for transferring certain powers from the national European states to the European supra-national units. This is because it is not possible to efficiently defend the interests of the amalgamated European capitalists within the framework of only, say, the Italian or the Dutch state. For instance, a recession that is turning into a severe crisis in Europe cannot be countered by monetary, fiscal, or economic policy measures of the Italian or the Dutch government alone. It should be encountered only by simultaneous monetary, fiscal, and economic policies of all European countries.

The location of industries also changes as a result of the growth in the free movement of commodities, capital, and labor among European countries. Industries tend to be located closer either to the main group of consumers or to ports from where products are shipped to or received from overseas.

The international concentration of capital within Europe would have a stronger momentum if the current intense competition and isolated national recessions in Europe last longer. When there is a general recession in Europe, the moment of truth for the European economic integration arrives. Either it will be disintegrated under the guise of national self-defense by respective national bourgeois classes through some forms of economic nationalism, protectionism, etc.; or it will be further united and take anti-recession measures on the European scale through supra-national institutions that will take away some more of the main monetary and fiscal functions from national states, e.g., a single European taxation system would be the outcome. This would show that the European bourgeoisie believes that the supra-national state power is more efficient in fighting recession than the national state. The outcome of these two tendencies will depend on the relative strength of the bourgeois forces favoring or opposing the international capital amalgamation at that particular time. It is impossible to make predictions about which of these tendencies will ultimately prevail.

There are major historical examples in which European bourgeoisie was in a situation whether to decide in favor of European supra-nationality to protect itself from American competition.

De Gaulle's objectives were to preserve France's sovereignty; and to establish its supremacy in Europe and against supra-national European entities; while maintaining his anti-American position.

In 1965, Europe encountered an agricultural crisis. The initial plan of the European Commission was to allocate to the European supra-national entities the important funds which were to be obtained from the collection of special duties on agricultural imports from countries outside Europe. Generally, the budgets of the supra-national entities were financed through European national governments' subsidies. However, if the European Commission's initial plan had been successful, then the supra-national entities would have collected sufficient funds and would have become financially independent of the European national governments. This independence was what de Gaulle did not want to happen.

Therefore, de Gaulle approached the crisis in Europe from the point of view of the issue of the financing of the common European agricultural policy and opposed the European Commission's

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plan. His choice was not based on the importance of the peasantry in the French electorate rather it was based on the decisive importance that he gave to what he saw as a qualitative strengthening of the European supra-national entities.

However, de Gaulle's objectives – to maintain France's sovereignty and to establish its supremacy in Europe – appear contradictory. This is because his opposition to the amalgamation of European countries prepares the ground for the defeat of Europe by America.

Starting in 1964, the supra-national European Commission began to bring to the attention of European capitalists the important differences in scale between the main American and the main European companies.

In addition, there was a difference in the scale of outlays and employment for research. This has been of crucial importance in the competitive age of continuous technological improvement.

Therefore, the European Commission encouraged amalgamation and concentration not only through propaganda, but also by actively preparing the legal framework for the creation of companies on the European level. This meant the creation of a new commercial law applicable to European countries as a whole, and for which the Court of Justice of Europe would become the supreme legal authority. At the same time, Bankers' Federation of Europe advocated the creation of a European financial market. Thus the legal superstructure was adapting itself to the changes taking place with respect to property relationships, which moved from the national state level to the European continent.

The representatives of the capitalist class simultaneously direct efforts towards amalgamation and concentration. In 1965, the official Employers' Association of Europe issued a memorandum to the European Commission in which it encouraged legislation that facilitates the international amalgamation of firms, and clearly stated that the increase in the size of companies should be one of the essential objectives in Europe. In 1966, another memorandum with the same content was issued. In 1965, the International Chamber of Commerce issued a declaration advocating the elimination of all legal and fiscal barriers to concentration or to joint ventures among companies.

The above is the historical analysis of the formation of the European region and the same underlying forces are still at work and shape the developments in current world affairs.

## CONCLUSION

This paper briefly discussed four views expressed with respect to the relationship between globalization and regionalization. The functionalist paradigm views open-regionalism as a stepping-stone to liberal globalization; the interpretive paradigm views regional organizations as being developed not by universalistic rationality but within several localized ones; the radical humanist paradigm views regionalization as an integral part of globalization processes and should be analyzed through historical, multi-level, and multi-dimensional perspectives; and the radical structuralist

paradigm views regionalization as a product of the natural tendency of capital for accumulation, concentration, competition, and expansion.

The diversity of theories presented in this paper is vast. While each paradigm advocates a research strategy that is logically coherent, in terms of underlying assumptions, these vary from paradigm to paradigm. The phenomenon to be researched is conceptualized and studied in many different ways, each generating distinctive kinds of insight and understanding. There are many different ways of studying the same social phenomenon, and given that the insights generated by any one approach are at best partial and incomplete (For instance, the academic fields of Economics and Finance limit their perspective to the functionalist paradigm. On this matter see Ardalan, 2001, 2003) the social researcher can gain much by reflecting on the nature and merits of different approaches before engaging in a particular mode of research practice.

Knowledge is ultimately a product of the researcher's paradigmatic approach to this multifaceted phenomenon. Viewed from this angle, the pursuit of knowledge is seen as much an ethical, moral, ideological, and political activity, as a technical one. Academia can gain much by exploiting the insights coming from other paradigms.

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# **POLITICAL SOURCES OF INTERNATIONAL BUSINESS RISK: AN INTERDISCIPLINARY FRAMEWORK**

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## **ABSTRACT**

*An interdisciplinary, analytical framework is proposed to assist managers in identifying and tracking political sources of international business risk. Risk is regarded as an adverse impact on a firm's profitability or expected returns. The framework fuses the Political Science concept of political system with Managerial Science's notion of sequential risk flow. With identification and early warning of political risks, managers may be more proactive, not merely reactive, in formulating and executing their risk management policies. Proactive policies may be managerial responses to unfavorable business conditions, politicized events and credible threats before actual risks emerge.*

## **INTRODUCTION**

Chavez is elected president of oil-rich Venezuela, HIV/AIDS infection rates rise in South Africa, a caricature of Mohammed appears in a Danish newspaper cartoon: all examples of relatively isolated events within the human experience, which overtime, became politicized and resulted in significant International Business risks for firms. Outcomes included nationalization of assets, escalation of production costs and decline in productivity, and a devastating consumer boycott. However, these events did not occur within a vacuum. There was a perceptible evolution of issues, which if identified and tracked, would have provided an astute manager with risk management options to mitigate or, even, to defuse negative impact. The inability of managers to foresee these developments is largely due to a fragmented, rather than integrated, approach to risk identification and risk management.

International Business as a field of inquiry is essentially interdisciplinary by nature. Explanatory theories and insights are drawn from diverse disciplines such as economics, finance, management, strategy, philosophy, political science and other social sciences. (Buckley and Lessard, 2005; Shenkar, 2004) However, the study of risk, especially political risk, in International Business suffers from a deficit in interdisciplinary analysis. Too often, risk analysis is compartmentalized into distinctive risk types associated with specific disciplines such as political risk, macroeconomic risk, legal liabilities, social risk and financial risk. (Miller, 1992; Miller and Waller, 2003; Van Wyk, Dahmer and Custy, 2004; Eiterman, 2001; Van Wyk and Baerwaldt, 2005)

The challenge by Brewer (1983) remains valid in that the political context of international business risk is still poorly understood by business managers. A useful approach may be to explore

the political sources of international business risk that will by-pass the above limitations of risk analysis. Earlier studies refer to sources of risk. Simon (1984) argued that the sources of risk may originate in political events that occur in the institutions of host countries, home countries and the international environment. Such events may directly or indirectly have an adverse impact on the operations of a firm. Robock (1971) outlined a conceptual framework consisting of sources of political risk, actors who generate political events, and the affects of political risk on firms. Sethi and Luther (1986) identified political, economic and social-cultural sources of political risk in both home and host countries. Howell and Chaddick (1994) insightfully defined political risk as “the possibility that political decisions, events or conditions in a country will affect the business environment such that investors will lose money or will have a reduced profit margin.” Risk raters, such as Business Environmental Risk Intelligence SA, do refer to symptoms and causes of risk as well as government policies that create risk exposure. However, such ratings are more concerned with imposing rigid quantitative metrics on illusive social phenomena and arriving at aggregated risk scores than with tracking the emergence and growth of risk. The guidelines of these authors necessitate a more comprehensive analysis of the political context from which business risks emerge.

In an effort to augment an interdisciplinary approach to the study of risk, this paper will combine a political system approach drawn from the field of political science with the sequential flow of risk in management studies in order to track the emergence and growth of risks for firms operating in the international environment. Accordingly, this paper will be organized into three parts: discussing the political system framework of analysis relevant to the comparative study of politics in any society, linking the sequential flow of risk to the functions of the political system, and proposing proactive and remedial risk management policies to deal with risk formation.

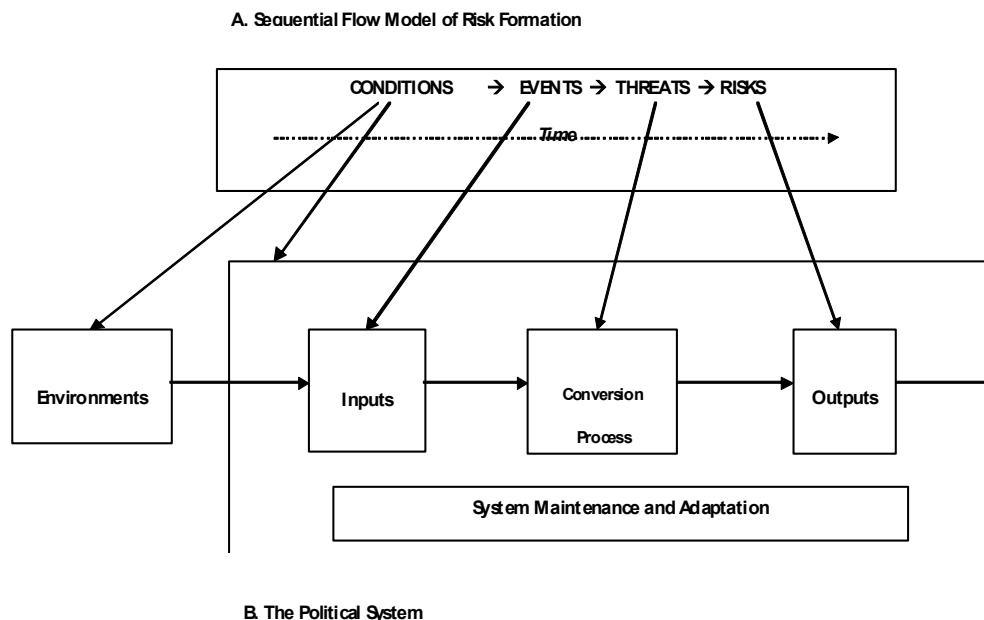
### **THE POLITICAL SYSTEM FRAMEWORK OF ANALYSIS**

The concept of political system refers to the political activities and processes of a society. The political system is a functional macro view of a polity and is less constrained by the legal and institutional limitations of related concepts such as state, nation or government. (Andrian, 1994; Wiseman, 1966) Common to most definitions of the political system is its association with the use of legitimate coercion in society. Easton (1953) speaks of the authoritative allocation of values; and Dahl (1963) of power, rule and authority. This implies that the political system has legitimate sanction: the rightful power to enforce, to compel or even to punish. Although coercion is the distinctive quality of the political system, it will not solely rely on force or compulsion to set rules of society. In political systems, with high levels of legitimacy, the government will rule with the consent of the ruled.

Almond and Powell (1966) distinguish three levels on which the political system functions. (See Fig. 1) The first function is internal to the system: conversion processes occur when inputs are transformed into outputs. Easton (1965) distinguishes two classes of inputs into the political system, namely demands and supports. Demand inputs may be for goods and services (e.g., health care), regulation of behavior (e.g., product safety), participation (e.g., to petition government policy), and symbolic inputs (e.g., display of the political systems’ commitment to values such democracy, market capitalism). Support inputs are essential resources needed to convert demand inputs into outputs.

Support inputs include material support (e.g., allocation of public funds), participation (e.g., political activism such as joining organizations, communication about politics), and obedience to laws and regulations. The sources of inputs may come from political elites inside the political system, from boundary-crossing activities of societal organizations (e.g., NGOs, firms) or from the international community (e.g., international organizations, foreign governments, MNEs, IGOs). From the perspective of international business, inputs may originate in the host or home country of an international firm.

Figure 1 Framework for Risk Formation



In every political system, there is a set of political structures or institutions which initiates and processes inputs and converts them into outputs. (Almond, 1965) The demands entering the political system are articulated; aggregated or combined; converted into policies, rules and regulations; and applied, enforced and adjudicated. The articulation of interests or demands is performed by NGOs and lobbies. Interest aggregation is the function of political parties. The conversion of policy proposals into authoritative or binding rules is the function of government rule-makers (e.g., legislatures, executives). The application of general rules to particular cases is the function of the government's bureaucratic agencies. The adjudication of rules in individual cases is the task of the judiciary. Through the process of political communication, information about inputs and outputs are disseminated throughout the political system.

The second level of functioning involves the political system as a whole interacting with its environment. The boundary between the political system and its environment is flexible and may expand or contract as levels of political participation shift. As this level, performance and capabilities

may be judged based on the outputs of the political system. Lasswell (1936) depicts it as “who gets what, when and how”. Parsons (1960) describes capabilities as the mobilization of societal resources and their commitment for the obtainment of collective goods, and for the formulation and implementation of public policy. Almond and Powell (1966) distinguish among five categories of system capabilities or outputs: extractive, regulative, distributive, symbolic and responsive. The extractive capability refers to the political system’s ability in drawing material and human resources from the domestic and international environment (e.g., taxes). The regulative capability refers to control over individual or organizational activities. The distributive capability refers to the allocation of goods, services, honors and opportunities to individuals, groups or organizations within society. The symbolic capability indicates the ability of the political system to affirm the values of society and elites. The responsive capability is a measure of the political system’s success in converting legitimate demands into appropriate policies.

The third function of the political system entails maintenance and adaptation. In a political system, the incumbents of various roles (e.g., legislator, judge, bureaucrat) must be recruited to these roles and socialized to perform them. In democracies, elections are the primary recruitment function to fill the important decision-making roles in the political system. In nondemocratic systems, more opaque recruitment methods are employed (e.g., appointment, cooptation, rigged elections). Political socialization is the process of induction into the political culture of a society. Agents of socialization include families, schools, work places, religious organizations and identity groups. System maintenance and adaptation are embedded in a political culture of a society. Political culture consists of attitudes, beliefs, values and emotional feelings toward the political system. (Kim, 1964). Political culture may capture notions of political and economic ideologies regarding the desired nature of government and the economy. In plural or divided societies, there may be competing political cultures which may be a source of fragmentation and conflict. Almond and Verba (1963) distinguish among three broad types of culture: parochial, subject and participant. In parochial systems, individuals manifest marginal awareness or participation in national political life. Other identifications (e.g., ethnicity, regionalism, religion) may supersede a sense of national identity or dictate the functioning of the political system. In subject political cultures, individuals have awareness of the political system and the impact which its outputs have upon their lives, but they are not oriented or are restricted to participate in meaningful input demands. In participant political cultures, individuals and organizations are oriented to the inputs structures and processes of the political system. They engage or view themselves as potentially engaging in the articulation of demands and the making of decisions.

Disfunctionality may affect the functioning of the political system and its ability to address input demands. Rule-makers may react in different ways to disfunctionality: adapt their behavior and acquiesce to such demands; reject demands; display indifference or even deny the seriousness of demands; or react in a substitutive manner (e.g., outputs are directed at more pressing demands). (Almond, 1965) The literature of agenda building pays particular attention to such disfunctionality. (Cobb, Ross and Ross, 1976; Cobb and Elder, 1971; Grindle and Thomas, 1991; Jones, 2001) A distinction may be made between a public agenda and formal agenda. A public agenda entails issues which have achieved a high level of public interest and visibility. A formal agenda is a list of issues which decision-makers have formally accepted for serious consideration. Agendas manifest in three



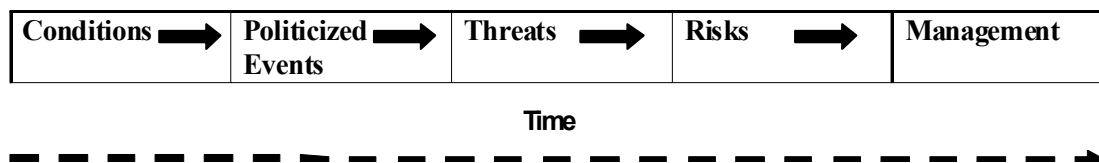
patterns: outside initiatives, mobilization and inside access. The outside initiative pattern involves demands by interest groups and political parties outside the formal governmental structures. For such groups, to move demands from the public to the formal agenda requires crossing major obstacles: formulating grievances into specific demands; expanding their support base to other influential groups and the general public; and in doing so, attracting serious attention from decision-makers. In the mobilizing pattern, demands are initiated by political elites, but interest groups and the general public are mobilized to shift the issue from the public to the formal agenda. In the inside access pattern, decision-makers initiate demands. Due to the power of such elites, expansion to the public agenda is not required and the issue automatically ends up on the formal agenda. In democracies, all three patterns of agenda setting are normally available. In nondemocratic systems, agenda setting is dominated by inside initiatives and mobilization. In systems that lack regime legitimacy, outside initiatives, particularly by opposition groups to move demands from the public to the formal agenda, also encounter serious impediments.

### THE SEQUENTIAL PROCESS OF RISK FORMATION

The notion that risk is the result of a sequential process is well established in various management literature streams. Business continuity planning, according to Zsidisin, Ragatz and Melnyk (2005), focuses on multiple drivers of threats and vulnerabilities; the impact of such threats in the form of risk exposure of the firm; and managerial policies to mitigate risk, e.g., awareness creation, prevention, remediation and knowledge management. In scenario planning, the sequential development of risk is plotted. By combining factual data, experience and creativity, managers may identify the emergence of risk and the opportunities within scenarios, and explore possible future alternatives of risk management. (Schoemaker, 1991; Schoemaker, 1993) Miller and Waller (2003), by combining scenario planning with real options, argued that such an approach may assist managers in identifying, categorizing and tracking uncertainties and risk through the scanning of a continuum of environmental contingencies. Howell (2002) identified three steps in risk formation: resources, events and losses. The sources have some similarity to other societal systems embedded in the environment of the political system. (See Fig. 3) Howell's notion of events lacks nuance of the input and conversion processes of the political system. His notion of losses may be compared with outputs of the political system. (See Fig. 1)

The sequential flow of risk is closely linked to the various processes and functions of the political system. (See Fig. 1)

Figure 2. Simple Flow Model of Risk Formation

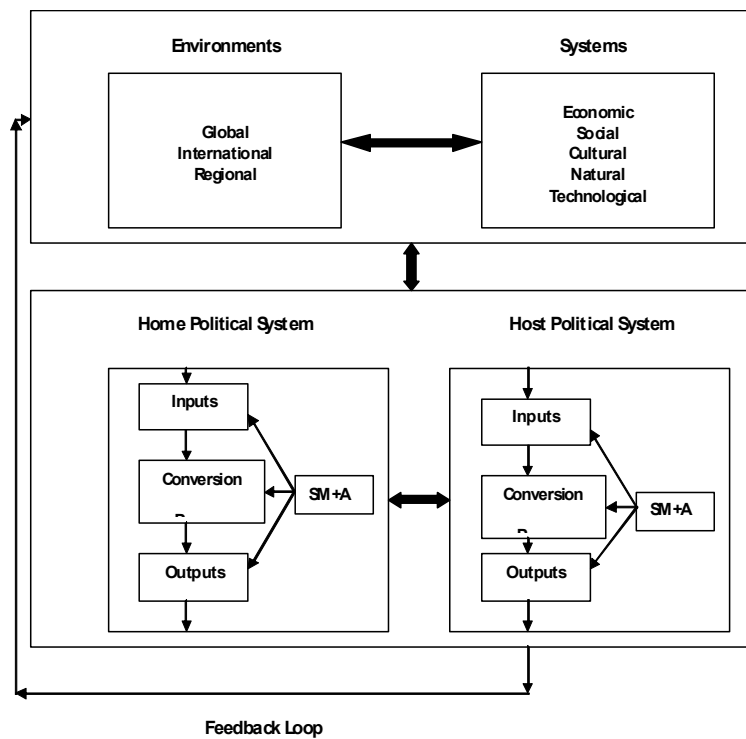


The sequential process is a form of risk mapping which provides a framework to track the origins and growth of risk producing activities. This sequential flow is an unfolding process that may be perceived as moving from conditions to politicized events to threats and, finally, to risk. The formation of risk occurs over time which may provide a window of opportunity for managers to develop viable and timely policy responses to the formation process before it actually results in a business risk.

### CONDITIONS FOR RISK FORMATION

Risks typically emerge from conditions which brew primarily inside the political system or its embedded context (e.g., environments, systems). Simon (1984) indicated that the flow of the political sources of risk may originate in domestic or external environments or systems. The flow may follow a direct or indirect sequential path until it adversely impacts on the profitability of a firm or industry. However, such flows may be more multifaceted than a mere one or two step process due to the globalized nature of international business, the internationalization of domestic politics, and the transnational activity of organizations such as firms, NGOs, IGOs and governments. McAdam (1998) refers to a multilevel game involving MNEs, states, NGOs, and the transnational protest movement.

**Figure 3. Environmental Conditions as Sources of Risk Formation**



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Relevant issues emerging from the above conditions may eventually appear on the public agenda or even the formal agenda. By way of illustration, activism against globalization and global warming grew from low key, under-the-radar protests to a full scale transnational movement that succeeded in placing these issues on the formal agenda of many governments. According to O'Neill (2004), the transnational protest movement is composed of wide ranging and diverse groups such as domestic interest groups (e.g., farmers, landless workers, indigenous peoples, labor unions) and professional transnational NGOs. These groups use a variety of mechanisms (e.g., street protests, litigation, lobbying, mass media socialization) to oppose the forces of global capitalism propounded by MNEs, IGOs, and governments; to influence and to shape debates and agendas early in "issue life-cycles"; and to promote alternatives to market capitalism and the state system. According to Doh and Teegen (2003), NGOs may act as stake-givers or stake-takers in their relationships to firms. Stake-givers provide prestige, legitimacy and the aura of neutrality and moral authority to firms' strategy in areas as diverse as human rights, ethics and corporate social responsibility. However, NGOs acting as stake-takers may damage the reputational and profit base of corporations. NGOs, both in host or home countries or acting transnationally, are formidable forces that impinge upon, attack, alter, amplify or distort the once bargaining relationship between businesses and governments.

### **POLITICIZED EVENTS**

The second stage of the development of risks moves from the perceptual or dispositional to the behavioral level, i.e., conditions are transformed into events. This may be regarded as the politicization of an issue by a political structure such as an interest group, NGO, political party, parliamentary faction or bureaucratic agency. In this stage, demands are made on the political system and support resources are sought in an effort to convert an input into an output. The event or behavioral phase may occur due to boundary-crossing inputs or "withinputs" which occur inside the political system. A boundary-crossing activity may involve an interest group (e.g., trade association, labor union) that crosses the boundary of the political system by demanding that the government introduce protectionist regulations to save jobs in the face of strong competition from international firms. (Kobrin, 1979) Another example of boundary-crossing activity is that political groups in the home country of a firm may demand that such a firm divest from its business operations in its host country with an unsavory human rights record. Actions may include protest marches, consumer boycotts and even legal action. This form of interest aggregation may also gather support from sympathetic NGOs operating in the international or global environments.

"Withinputs" refer to demands that originate within the political system, usually driven by powerful elites, institutional interest groups in the legislature or bureaucracy, or even by judicial activism of the courts. Such organizations often have inside access to agenda setting, and as incumbents of powerful positions, may dominate the formal agenda setting process. Easton's (1965) notion of politicized events, such as change in political authority or regime, may heighten risk exposure. For example, a new government (political authority) committed to increase protectionism will increase the risk perception of current or potential foreign investors. By the same token, a new government committed to increased trade liberalization will lessen risk perceptions among foreign firms. Change of political authorities but maintenance of regime may not increase risk perceptions.

For example, Italy had 18 changes of government (political authorities) between 1970 and 1995, but that had little impact on business risk because the country's regime (rules of the game) remained intact. The Italian political system displayed high legitimacy despite constant change. (Maher, 2005) In contrast, changes in political authorities may also result in regime changes. The Chavez government in Venezuela after its electoral victory in 1998 also changed the regime by adopting a new constitution. This change did not alleviate regime illegitimacy, but instead led to increased political instability including mass labor strikes, public protests and an attempted coup. (Shifter, 2006; Whalen, 2006)

### THREATS

The third stage of risk development occurs when the actions of political organizations pose a threat to the operations, opportunities or interests of an international firm. At this stage, politically based threats may expose a sense of uncertainty among businesses. The term uncertainty, as used in strategic management and organizational theory, refers to the affect of unpredictability of environmental or organizational variables that negatively impact on corporate performance. It may also refer to the inadequacy of information about these conditions. (Miles and Snow, 1978) According to North (1990), uncertainty is a condition wherein one cannot ascertain the probability of an event and therefore cannot arrive at a way of insuring against such an occurrence. Risk, on the other hand, implies the ability to make an actuarial determination of the likelihood of an event and hence insure against such an outcome. Kobrin (1979) distinguished between certainty, objective uncertainty and subjective uncertainty. Certainty occurs if a single outcome may be unambiguously associated with a given event. Objective uncertainty may be approximated by situations where, while one outcome does not dominate, all feasible outcomes are known, information is readily available and almost all observers agree upon probabilities. Subjective uncertainty means opinions about the relative likelihood of events are based upon perceptions that are a function of the available information, previous experience, and individual cognitive processes which synthesize all into an imagined future.

A threat may be viewed as an expression of intention by a political organization to inflict damage or harm on a business firm. A threat may be motivated as retribution or punishment for something a firm did or left undone (e.g., sweatshop conditions in the workplace, harmful products). A threat may also be an expression of intention to restrict the profitability of a targeted firm or industry due to value changes (e.g., ideology) which have occurred in the political system. Table 1 outlines the nature of business threats as related to the functions of the political system.

Table 1. Threats to Firm Interests

Political System Function	Organization	Threat
<b>Conversion Process</b>		
<b>Interest Articulation</b>	*Domestic & transnational revolutionaries *Domestic NGOs *Transnational NGOs  *Media	*Increased support for violence to address political legitimacy crisis *Protests, labor strikes *Protests against globalization, capitalism, MNEs *Increase in negative reporting regarding firms
<b>Interest Aggregation</b>	*Political parties	*Increase in public support for parties favoring protectionism, state intervention, ideologies other than market capitalism
<b>Rule Making</b>	*Legislatures & Executives	*Formulation & introduction of bills/executive orders to increase state intervention in business *Weak institutions
<b>Rule Application</b>	*Bureaucratic agencies	*Weak institutions *Decline in inefficiency
<b>Rule Adjudication</b>	*Judiciary	*Legal actions against firms *Weak institutions *Judicial activism
<b>Political Communication</b>	*State controlled media *Politicized elites	*Anti-business reporting *Negative rhetoric regarding business (e.g., speeches, public statements, websites)
<b>System Maintenance &amp; Adaptation</b>		
<b>Socialization</b>	*Educational organizations (e.g., state, religious)	*Curricula emphasizing parochialism/fundamentalism/anti-foreign attitudes
<b>Recruitment</b>	*Government change (e.g., constitutional, unconstitutional methods)	*Intention (demand) & potential support (resources) for increased state intervention in business
<b>Political Culture</b>	*All Organizations	*Change in values & norms counter to market capitalism/globalization *Subject political culture

In this stage of the conversion process of the political system, there will be many early warning signals that political organizations have harmful intentions towards companies or industries. Indicators of the probability of future risk may include public statements of intent by political elites (e.g., speeches), threats of industrial action (e.g., strikes, messages, website blogs), media reports on the probability of harmful action, and, most significantly, the introduction of legislation to inhibit business operations. Following the suggestions of Almond and Powell (1966), changes in the style of interest articulation, interest aggregation or rule functions in the political system may indicate that politicized events have degenerated into threats. Such changes may indicate that issues have become part of the public agenda or, even more threatening, have moved to the formal agenda. Markers include

1. A change from latent to manifest behavior: mood clues. i.e., vague grumblings change to explicit demands for action
2. A change from diffused to specific behavior: dissatisfaction with specific means of correction (e.g., “MNEs are bad”), changes to specific requests for legislation (e.g., limits on foreign ownership of national mineral resources)
3. A change from general to particular behavior: general demands couched in class or associational group terms (e.g., reform large estates), change to particular demands entailing specific action (e.g., nationalize large estates)
4. A change from affective to instrumental behavior: affective behavior in the form of a verbal expression (e.g., anger, disappointment, hope) of an interest group may change into instrumental demand such as a threat of support withdrawal (e.g., finance, vote) contingent on a particular action (e.g., acceptance of legislation or policy)

Scenario planners that routinely scan the environment for early warning signals epitomize the benchmark for threat recognition. In SWOT analysis, weakness and threat are similar to the manner in which threat is used here. In general, threats (demands) backed by appropriate support (e.g., government power) should be regarded as credible threats.

### **RISK**

The critical component that changes a threat into a risk is that risks become actions by political organizations which will adversely impact on a foreign firm’s profitability. These risks may occur due to the outputs of the political system (e.g., government intervention in the business environment) or disruptive and destructive actions occurring during the conversion process of the political system (e.g., internal conflict). Business risk occurs when a firm’s profitability is adversely affected by politics. A firm’s profit should not be viewed in isolation, but relative to the activity or investment required to generate such profits. Profitability is a measure of a firm’s overall performance on a relative basis of relating various measures of profit to either sales or investment. (Lewellen, Halloran and Lanser, 2000) Risk exposure, therefore, means variability in profitability that falls short of expected returns such as ROI and ROA. (Butler and Joaquin, 1998; Click, 2005)

In this analysis, international business risk is regarded as similar to strategic risk. (Slywotzky, 2004) From a strategic perspective, Simons’ (2000) classification of risk types offers utility to study risk in a functional manner, rather than the discipline-bound classifications of risk mentioned above. Simons distinguishes between four types of risk: operations risk, asset impairment risk, competitive risk, and franchise and reputational risk. Operations risk stems from the unanticipated costs of system downtime and unexpected variants of production downtime. In general business terms, operations risks are caused by disruptions of a firm’s value creation activities, emanating from the activities of political organizations. Asset impairment risk refers to a significant loss in the current value of an asset or resource owned by a company, including financial and physical impairment and piracy of intellectual property rights (e.g., patents, brand names). Competitive risk refers to changes in regulations which restrict a firm’s competitive advantage and opportunities in host markets. Franchise risks refer to legal liabilities (e.g., pending lawsuits, legal actions) and reputational risks occur when

the value proposition of a firm (e.g., products, brand name, corporate image) are viewed unfavorably by stakeholders such as customers, suppliers, governments, NGOs, and the mass media.

In Table 2, Simons' four types of risk are correlated with the broad functions of the political system. Risk emanating from the conversion process is largely related to political instability. In a political system facing a legitimacy crisis or operating in a fragmented political culture, ensuing input frustrations may not only result in violence, but firms may become targets of civil strife.

By itself, responsive and symbolic outputs do not constitute business risk, but in conjunction with more intrusive outputs (e.g., regulation, extraction, distribution), they add the perceptual or cognitive climate of harmful intent. The examples in Table 2 are obviously not exhaustive, but the matrix provides a framework for wider application, i.e., in a particular country, industry or value creation process (e.g., supply chain management).

**Table 2. Political System Functions as Strategic Business Risks**

RISK → FUNCTIONS ↓	Operations	Asset Impairment	Competitive	Reputational/Franchise
<b>Conversion Process</b>	*Disruption of value creation processes (production, supply chain) due to civil strife, legitimacy crisis or input frustration	*Physical damage &/or seizure of facilities due to civil strife *Large scale theft of inventory	*Precipitous decline in consumer demand & access to suppliers due to political instability (internal conflict, legitimacy crisis)	*Stakeholder hostility (consumer boycotts) due to firm's actions (harmful products, sweatshops) *Political disputes between home & host countries harm firms
<b>Outputs Regulative Capability</b>	*Restriction on expat hiring despite skills shortage *Labor market rigidity *"Red tape" *Decline in business facilitation	*Restrictions on remittances (profits, dividends, investment capital) & transfer pricing	*Limitations on foreign ownership *Trade protectionism *Discrimination in gov't procurement policies *Dominant state owned enterprises (SOE)	*Inefficient enforcement of contracts & property laws *Extraterritorial laws imposed by home country on its firms' foreign operations
<b>Extractive Capability</b>	*Loss of productivity, efficiency, time & resources to meet legal compliance	*Nationalization, confiscation, expropriation of assets (rent-seeking) *Discriminatory taxation & audit *Corruption of gov't officials	*Discriminatory taxation & audit	*High levels of piracy of intellectual property (patents) & counterfeit (brand names) by competitors &/or gov't agencies
<b>Distributive Capability</b>	*Gov't policies of indigenization *IJVs with inefficient SOEs *Poor infrastructure	*Nationalization, confiscation, expropriation of assets (wealth redistribution)	*Higher cost for firms acting as surrogates for gov't in providing public goods (education, health care, infrastructure)	*Laws requiring foreign firms to share intellectual property with local firms *Breach of Contracts motivated by wealth redistribution
<b>Responsive Capability</b>	*Dominance of protectionist groups (NGOs, labor, socialist parties in setting formal agenda for issues (wages, benefits, local content of products)	*Formal agenda setting dominated by inside access & mobilization initiatives to nationalize assets of private firms	*Dominance of protectionist/socialist groups to shape formal agenda on business, trade & competition	*Politicization of courts to undermine interests of firms
<b>Symbolic Capability</b>	*High levels of elite rhetoric in favor of greater state intervention in firms' operations	*High levels of elite rhetoric in favor of state ownership of property	*High levels of negative elite rhetoric to market capitalism in favor of alternative ideologies	*High levels of elite negative rhetoric directed at foreign firms & the protection of intellectual property

## MANAGERIAL IMPLICATIONS

Understanding the functioning of political systems, and the related sequential process of risk formation, may assist firms in developing and executing appropriate risk management policies. Table 3 summarizes a number of policy options available to mitigate risk at various stages of the risk formation process. (Hilbert and Jones, 2004; Lhabitant and Tinguela, 2001; Iankova and Katz, 2003; Minor, 2003; Burmester and Tayeb, 2000; Howell, 2002; Miller, 1992)

**Table 3. Risk Management Policies**

Sequence ? Policy ?	Conditions	Politicized Events	Threats	Risk
Avoid	?	?	?	
Exit			?	?
Offset				?
Anticipate	?	?	?	
Share	?	?	?	?
Remedy			?	?

The prudent approach is based upon early detection and the implementation of appropriate mitigation policies. However, successful execution is contingent upon the efficiency of a firm's internal organization and decision-making regarding its foreign operations, i.e., understanding of politics, knowledge management and strategy. Avoidance of market entry may be an accurate reading of adverse conditions or politicized events in a potential host market. Risk avoidance, however, may be a function of managerial conservatism or inflexibility to exploit highly risky, but profitable opportunities. According to Wernerfelt and Karnani (1987), risk avoidance may take the form of postponement until industry or market uncertainties dissipate.

An exit strategy is the most extreme option available to an international firm. Such action may be caused by various politicized events: consumer boycotts in the home country, e.g., the withdrawal of Barclays Bank from apartheid South Africa; nationalization of assets by host governments, e.g., Exxon Mobil's withdrawal from Venezuela; or sanctions by a home government against a host government, e.g., Halliburton's exit from Iran. (Plummer, 2006; Economist Intelligence Unit, 2008; Simpson and Wilke, 2006) Offset means a firm will absorb the additional costs imposed by risk in a host country. If the value-creation chain is segmented, a firm may focus on profit making in less risky segments and absorb higher costs in more risky segments. (Howell, 2002)



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Anticipation is predicated on a firm's intimate understanding of a political system and its ability to use such superior knowledge to avoid risk. For example, Mudambi and Navarra (2003) find that regions in Italy controlled by center-right parties provide superior facilities, opportunities and low risk to foreign investors. However, regions under control of center-left parties offer inferior facilities and higher risk exposure for foreign investors. Participating in the conversion process of a political system may also prevent or mitigate risk exposure. Examples may include information sharing with political organizations; constituency and alliance building with local businesses, consumer groups and NGOs; incentive based offers benefiting stakeholders; and lobbying government decision-makers to change or to dilute risk bearing policies or system outputs. (Hillman and Hitt, 1999; Van Wyk, Dahmer and Custy, 2004)

Risk sharing through bilateral and multilateral agreements allows firms to reduce the uncertainty of potential profit loss. Risk sharing may involve the strategic management and the financial management of risk. Strategic management may include long term agreements with suppliers and buyers, alliances, and international joint ventures. (Allaire and Firsirotu, 1989; Pfeffer and Salancik, 1978) Financial risk management may include forward and future contracts, and political risk insurance. (Hilbert and Jones, 2004; Howell, 2002) Insurance from the Overseas Private Investment Corporation (OPIC) and the Multilateral Investment Guarantee Agency (MIGA) provide leverage to the USA and the World Bank, respectively, to discourage predatory behavior by host governments, e.g., withholding of future aid or loans. Political risk insurance, however, only covers a limited range of business risks including inconvertibility, expropriation, and damages caused by war and civil strife. (Moran and West, 2005)

Risk remedy is a common management policy since disruption of business operations and reduced profitability may not always be avoidable. Often, a firm's own behavior may cause reputational impairment. For example, British Petroleum's image was tarnished among its stakeholders by events such as environmental pollution in Prudhoe Bay, allegations of tax evasion in Russia, and an explosion at its Texas City refinery. Firms may employ various policies to remedy reputational risk: damage assessment, e.g., harm to product quality or financial performance; reality evaluation, e.g., ability to meet expectations of stakeholders; reputation-reality closure, e.g., improvement in corporate communications and public relations; management of changing beliefs and expectations, e.g., development of metrics to measure success; and appointment of senior manager in charge of risk management, e.g., COO, CFO, or Head of Risk Management. (Eccles, Newquest and Schatz, 2007) According to Zsidsisin, Ragatz and Melnyk (2005), such post-risk audits accentuate the learning curve and assist in the upgrading of existing and contingency plans to improve coping mechanisms in the face of reoccurring risks. Firms may also seek remedy via legal action. Monsanto, for example, filed a lawsuit in European Union courts against Argentine soybean exporters for losses suffered due to the patent infringement of its Roundup Ready technology for the production of genetically modified soybean seed. (Wall Street Journal, 1/27/06: A7) Finally, in risk management, there will likely be tension between defensive and innovative policies. According to Miller (1992), such uncertainty trade-offs may mitigate risk through sharing policies (e.g., IJVs with state-owned enterprises), but may create divergent interests (e.g., contract breaches) due to the change in political authorities or regimes.

## FUTURE RESEARCH

Development of risk, namely the political sources of risk, has been identified as an interdisciplinary subject. An interdisciplinary framework of analysis is proposed, fusing the political science concept of a political system with management science's sequential risk development. Managers may gain a clearer, more integrated understanding of the development of risk and its unfolding impact on the profitability of international firms. Understanding the sequential development of risk also provides firms with the opportunity for the timely identification of politicized events, threats and risks, and the formulation of appropriate policies to defuse or to diminish risk exposure.

The utility of the proposed framework of analysis will obviously require application in individual case studies. Future refinement in terms of risk-generating issues, events and agendas, or risks in particular industries will be a logical progression for knowledge-building in the area of international business risk. For example, the emergence of health pandemics, e.g., HIV/AIDS, SARS, poses a potential risk for companies doing business in emerging markets such as Russia, China, India and South Africa. The obstacles created by rule-makers to move the pandemic from the public to the formal agenda in emerging markets may potentially impose additional costs on firms as surrogate providers of public goods. (Van Wyk, 2007) In the oil industry, the formation of various risks may be tracked more effectively by using the proposed framework. These include challenges presented by the global environmental movement, growing protectionism in industrialized countries, and resurgence of host country nationalization of assets.

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