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FOREIGN AID VOLATILITY AND ECONOMIC GROWTH: A CASE STUDY OF PAKISTAN
SADIA MANSOOR¹, MIRZA AQEEL BAIG² AND MUHAMMAD JAVID³

ABSTRACT
While the debate on the effectiveness of foreign aid remains inconclusive, recent literature has focused on exploring the possible causes that render such an ineffective. Among others, the volatility in aid inflows is cited as one of the reasons for aid ineffectiveness. Historically, Pakistan has been one of the major aid recipient countries, but it still lags behind in terms of economic development. By analysing the period 1972-2015, we explored the role of aid volatility in explaining economic growth in the case of Pakistan. By developing an index for macroeconomic policy environment, we also investigate the role of prevailing macroeconomic conditions in aid effectiveness. We employed the Generalised Method of Moments (GMM) for estimation because of its advantage in handling the endogeneity of foreign aid. After controlling for traditional determinants of economic growth, our results show that both foreign aid and its volatility are negatively related to economic growth in case of Pakistan. However, we have found that a favourable policy environment results in an increase in foreign aid effectiveness.

Key Words: Foreign Aid, Volatility, Macroeconomic Policy Index, Economic Growth, Generalised Method of Moments, Endogeneity.

INTRODUCTION
The early post-Keynesian model of Harrod and Domar (1954) explains economic growth through developing its relationship with capital stock and the rate of savings. A major corollary of the Harrod–Domar model was that increase in domestic capital stock helps boost economic performance. This capital accumulation in turns depends on the stock of national savings available for investment.

Cheneray and Strout (1966) extend the work of Harrod and Domar through developing an internal-external gaps model, which is often cited as the theoretical foundation of foreign aid. The internal gap refers to disequilibrium between saving and investment, while the external gap refers to trade deficit. The model highlights the importance of low domestic savings or loanable funds. In case of low investments, the economy will also be short of exportable surplus of goods. The economy, as a result, gets stuck is a vicious circle and can only be brought out of it through the help of foreign aid.

Like other developing countries, Pakistan is no exception to a low saving rate. The saving–investment gap has remained largely negative in the case of Pakistan. On average, this gap has represented 2.4% of GDP from 1980 to 2015. According to the World Bank database, the average gross national savings (as a percentage of GDP) is 31.4% for developing countries and 14.5% in the case of Pakistan. As a result, Pakistan’s economy has been heavily relying on foreign assistance to increase capital stock. For instance, the official development assistance (ODA)⁴ was 41.5% of gross capital formation 1972-2015 for Pakistan, compared with 32% in developing countries.

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⁴ According to the World Bank, “Official development assistance (ODA), consists of disbursements of loans made on concessional terms (net of repayments of principal) and grants by official agencies of the members of the Development
THE DYNAMICS OF FOREIGN AID INFLOWS IN PAKISTAN

Pakistan has received different types of ODA. Between 1972 and 2009, Pakistan received US $61.8 billion, out of which US $38.7 billion (53%) was project support aid. In times of natural disasters (i.e. floods, earthquakes and drought), Pakistan received US $6.5 billion (10%) and US $11.5 billion for balance of payment adjustments.

Foreign aid inflows have been quite volatile in case of Pakistan. Unlike other aid-dependent countries, Pakistan’s aid inflows are dependent on geopolitical factors and military considerations. Most of the aid Pakistan received was from a bilateral source, mainly from the US. The US bilateral aid to Pakistan started in 1951 and aid inflows have been volatile and independent of economic needs of Pakistan. For instance, in the early 1960s, Pakistan received almost US $400 million per year, but the first hiccup occurred after the India–Pakistan war (a geopolitical factor) in 1965, when the US suspended aid to Pakistan. Aid inflows during the 1960s and 1970s were a result of Pakistan’s mutual defence assistance agreement with the US in the pre-Cold War era. Similarly, aid inflows during the 1980s can be contextualised by the outlook of the Afghanistan war.

The US imposed “democracy sanctions” and cut foreign aid transfers to Pakistan as a result of nuclear test confirmation in 1998 and military takeover in 1999. However, after 9/11, Pakistan joined a war coalition against terrorism and received the highest average annual aid of approximately US $3 billion during 2010-2014. The majority of the funds were under the heading of reimbursement of the cost of military coalition support in the war against terror. During the war on terror (2010-14), the US promised US $7.5 billion in aid to Pakistan, but only half of this was actually disbursed (EADP, 2015). These stylised facts show that aid inflows have been volatile in Pakistan due to geographical issues and coalition involvement.

The objective of this study is to empirically investigate the impact of foreign aid and its volatility on economic growth of Pakistan. We have also explored the role of sound macroeconomic policies in explaining aid effectiveness. For this purpose, we have constructed macroeconomic policy index by following Burnside and Dollar (2000). The organisation of this paper is as follows. Section 2 provides a literature review on the aid–growth nexus, as well as on the impacts of volatile aid inflows on economic growth. In Section 3, we discuss the construction of the macroeconomic policy index and the econometric model. This is followed by the last section, which presents our results and discussion along with policy recommendations.

LITERATURE REVIEW

An ample literature is available on foreign aid and growth relationship. This section provides a brief review of available literature on foreign aid, volatility of foreign aid, and their relationship with economic growth.

LITERATURE ON THE AID–GROWTH NEXUS

The literature on foreign aid can broadly be divided into three stands. The first strand maintains that foreign aid has significantly positive impact on economic growth and development. According to Rosenstein-Rodan (1961), foreign aid contributes towards increases investment. Chenerey and Strout (1966) also support positive contribution of aid to GDP growth and present theoretical framework in their “two gap” model. Papanek (1973)
also finds positive impact of aid inflows on economic performance in 23 developing countries. Levy (1988) states that foreign aid inflows accelerated investments in African countries. In the case of Pakistan, Chishti and Hasan (1992) find a positive impact of foreign grants on economic performance. Similar conclusions have been drawn by Irving and Abbas (2005), Shabbir et al. (1992) and Khan et al. (1992).

In contrast, some studies deviate from the positive effects of foreign aid and affirm a negative impact of aid inflows on economic growth and development. This strand was initiated by Friedman (1958), who argued that dependency on foreign aid decreases the potential of governments to achieve self-sustainability. Griffen and Enos (1970) empirically establish the negative impact of aid on 27 aid-dependent economies. According to Baure (1979), “Aid is a phenomenon whereby poor people in rich countries are taxed to support the lifestyles of rich people in poor countries.” Likewise, Mosley (1980) confirms the negative aid–growth relationship and states that corruption and misallocation of foreign aid inflows hurt economic growth. Similarly, Hadijmichael et al. (1995), Boone (1996) and Alesina and Weder (2002) affirm that aid inflow does not reduce poverty or increase economic growth, but increases dependency and corruption. Rajan and Subramanian (2005) argues that aid inflows are unfavourable for private sector investment. Sabra and Eltalla (2016) conclude that higher aid inflows accelerate imports and do not foster investment to attain economic growth in Arab countries. Recently, Sabra and Sartawi (2015) attribute aid as hindering factor to economic growth in Palestine by crowding out savings.


The third strand of literature highlights the role of the macroeconomic policy environment of the aid recipient country in the analysis of the aid effectiveness framework. Burnside and Dollar (1997, 2000) construct a macroeconomic policy index and state that aid can be effective in the presence of a sound macroeconomic policy environment. The main argument of this strand is that aid effectiveness is conditional on the policy environment. Collier and Dollar (2001, 2002) add that, along with good policies, the geographical location and allocation of aid to specific sectors are favourable factors for attaining positive outcomes of foreign aid.

Javid and Qayyum (2011) follow Burnside and Dollar (1997) in constructing a macroeconomic policy index for Pakistan, concluding that aid fosters economic growth in the presence of a low budget deficit, positive trade balance and low inflation. Although it appears convincing that aid will be more effective in the presence of favourable policies, Durbarry et al. (1998) empirically find aid to be effective irrespective of the policy environment. Similarly, Hansen and Trap (1999) analyse 131 countries and conclude that aid is effective even in countries with a bad policy environment.

**EMPIRICAL LITERATURE ON FOREIGN AID VOLATILITY AND ECONOMIC GROWTH**

There are several reasons why volatility in aid inflows negatively affects economic growth. First, volatile inflows can result in delay or even suspension in the execution of planned developmental projects. Second, if aid has a humanitarian objective, then volatile aid can force the recipient government to utilise its own resources that had been planned for other purposes. At the same time, it reduces the confidence of the recipient government and the private sector on the donor agency’s future commitment. Volatility in aid inflows can also induce leakages in already received aid flows.

MODEL, METHODOLOGY AND DATA
This chapter presents model specifications and econometric methodology. The foundation of aid-growth model is based on the landmark study of Chenery and Strout (1966), who present a two-gap model. In the case of low domestic savings, we have incorporated foreign aid as an external financial resource to fill the savings–investment gap in Pakistan. Our model is based on the production function, where the real GDP \((Y)\) is dependent on inputs and other explanatory variables:

\[ Y = f (L, K, TO, ODA, FDI, Pol, \varepsilon) \]  

where GDP is dependent on the labour force \((L)\), gross fixed capital formation \((K)\) and trade openness \((TO)\). Moreover, foreign inflows are split into two sets to fill the savings–investment gap, foreign aid \((ODA)\) and foreign direct investment \((FDI)\). Economic policies \((Pol)\) play pivotal role is economic growth so we have added macroeconomic policies in our model. Lastly, the \(\varepsilon\) is a normally distributed random error term.

CONSTRUCTION OF THE INDEX
The theoretical foundation for the formulation of the policy index is based on Fischer (1993), and the methodological structure is based on work by Burnside and Dollar (2000). The objective of the index is to explore the impact of the existing policy environment on aid’s contribution to economic growth. We have extended the macroeconomic policy index for Pakistan, previously constructed by Javid and Qayyum (2011). Like Burnside and Dollar (2000), Javid and Qayyum (2011) constructed the index by using three variables: inflation rate, budget balance and trade openness. We have extended this index by adding money supply to the GDP ratio to represent financial development.

The relationship between macroeconomic policies and economic growth is well established in the literature. A generous literature is available on the well-framed theoretical relationship of inflation, twin deficit and money supply with economic growth (see, Fisher, 1993; Parkin, 1986; Dollar, 1992). As an extension to Burnside and Dollar’s (2000) macroeconomic policy index, we have added money supply to the GDP ratio as an indicator for financial development. We have employed the principal component method to construct the index. The first component of the principal component method explains the maximum variations of the data, while the second and third components explain the remaining variations. We derive the weights of included variables through the first principal component, as it represents the highest correlation. Finally, we get the weights through normalising the values of vector 1. The policy index used in our analysis is based on the following equation:

\[ PolicyIndex = -\alpha_1 (Inflation) + \alpha_2 \left( \frac{BudgetBalance}{GDP} \right) + \alpha_3 (TradeOpenness) + \alpha_4 \left( \frac{Moneysupply}{GDP} \right) \]
where $\alpha_1, \alpha_2, \alpha_3$ and $\alpha_4$ are the weights of first component and the estimated weights are 1.097, 0.726, 1.066 and 0.437 respectively.

We have followed Bulir and Hamann (2003) and Hudson and Mosley (2008) for estimation of foreign aid volatility, and used a Hodrick–Prescott (HP) filter.

**Econometric Methodology**

Hansen (1982) developed the Generalised Method of Moments (GMM) model, which is actually a generalised approach to the method of moments presented by Karl Pearson (1894). Due to its several advantages, GMM has been widely used for estimations in economics and finance. The major advantage of GMM is that it does not require complete knowledge of the underlying data generating process. In contrast to Maximum Likelihood Estimation (MLE), GMM estimation requires specified moments derived from an underlying model.

GMM is particularly useful in estimating the impact of growth volatility in economic growth because of the potential endogeneity of aid. There are various sources of endogeneity in the relationship between aid and economic growth. It is argued that foreign aid is endogenous to growth since donors allocate aid purposively and are likely to react to recipient countries’ growth performance. The methodology of GMM comes in handy in this case because it addresses the concerns of the endogeneity problem (Hansen and Tarp, 2000). To address this concern of aid endogeneity, most studies aimed at the aid–growth relationship have used GMM estimation methodology.7

GMM offers an estimation approach when the numbers of restricted moments in the data generating process are higher than the number of parameters required to be estimated. In contrast to the approach of satisfying one moment condition and violating the other, GMM strategy chooses an estimator that balances each population moment condition against the others, seeking residuals that trade-off violations of one moment restriction against violations of the other moment restrictions.

**Variables and Equations**

To conduct a time series analysis, we have employed data from 1972 to 2015. Mainly we have taken data from World Bank’s World Development Indicators, but we have also used economic survey of Pakistan for data of fiscal sector variables.

We have estimated four equations. Equation (1) tests the impact of foreign aid inflows on economic growth of Pakistan. Equation (2) checks the impact of foreign aid inflows on growth in presence of existing policy environment. We have used foreign aid and policy index interactive terms in equation (3); this equation represents the combined effect of existing macroeconomic policies and aid inflows. Here, we are basically mimicking the work of Burnside and Dollar (1997), as they used this aid-policy interactive term in their analysis.

\[
\begin{align*}
\log(GDP) &= a_0 + a_1 \log(Aid) + a_2 \log(LF) + a_3 \log(GFCF) + a_4 \log(TO) + a_5 \text{(FDI)} + \mu \quad \text{--Eq}(3.2) \\
\log(GDP) &= a_0 + a_1 \log(Aid) + a_2 \log(LF) + a_3 \log(GFCF) + a_4 \log(TO) + a_5 \text{(FDI)} + a_6 \log(Pol) + \mu \quad \text{--Eq}(3.3) \\
\log(GDP) &= a_0 + a_1 \log(Aid) + a_2 \log(LF) + a_3 \log(GFCF) + a_4 \log(TO) + a_5 \text{(FDI)} + a_6 \text{(AID • POL)} + \mu \quad \text{--Eq}(3.4)
\end{align*}
\]

Here, GDP represents gross domestic product per capita, and Aid denotes official developmental assistance as a percentage of GDP. LF symbolises labour force, gross fixed capital formation is GFCF, foreign direct investment is FDI and TO represents trade openness.8

---


8 Data on all variables has been taken on constant prices.
Another important objective of this study is to explore the impact of volatility in foreign aid inflows on economic growth of Pakistan. To capture the impact, we have constructed equation 3.4 based on equation 3.2 (in which we have replaced foreign aid with its volatility (Aid_V) as an explanatory variable):

\[
\log(\text{GDP}) = a_0 + a_1(\text{Aid}_V) + a_2\log(\text{LF}) + a_3\log(\text{GFCF}) + a_4\log(\text{TO}) + a_5(\text{FDI}) + \mu - \text{Eq (4)}
\]

All the variables are taken in natural log form, except FDI and foreign aid volatility.

**EMPIRICAL RESULTS AND DISCUSSION**

Our results show that foreign aid inflows negatively impact economic growth in Pakistan. The estimation results, as presented in Table 4.1 (Eq3.2), show that a 1% increase in aid to GDP ratio leads to a 0.10% decline in GDP per capita. This result is in line with the majority of existing studies in the case of Pakistan (see, Chisti and Hasan, 1992; Iqbal, 1997; Khan and Ahmad, 2007). As cited in the literature, most of the aid inflows in Pakistan come from a bilateral source (i.e., the US) based on the strategic needs of the donor country rather than depending on the economic needs of Pakistan.

The results of equation 3.2 also present the impact of other control variables on economic growth. Gross fixed capital formation and labour force have a significantly positive impact on GDP per capita. However, FDI has a positive but insignificant impact on economic growth in Pakistan. There are several studies that also questioned role of FDI in developing countries (see, Adewumi, 2006).

Empirical results of equation 1 show that a 1% increase in trade openness boosts GDP per capita by 0.32 percent. Our results are in line with Iqbal and Zahid (1998) and Shirazi et al. (2004); they all find trade liberalisation fosters economic growth of Pakistan. The results of Eq3.3 show that a sound policy environment has a significantly positive impact on economic growth. The coefficient of the policy–growth relationship shows that a 1% increase in policy index leads to a 0.01% increase in economic growth. In equation (3.4), we have investigated whether aid is conditional to the macroeconomic policy environment. We have thus used the macroeconomic policy index and foreign aid interactive term. Aid*policy interactive term has a strong intuitive aspect that outcomes from foreign aid utilisation become positive when a country has a sound macroeconomic policy environment. Our results are in agreement with the findings of Burnside and Dollar (1997, 2000) and Javid and Qayyum (2011). We find that aid is effective, conditional on sound macroeconomic policies in Pakistan. Lastly, we have estimated equation (3.5); this equation has captured the impact of volatile aid inflows on Pakistan’s economy.

The findings of this study suggest some policy implication. First, large fluctuations in aid are not desirable, as volatility is found to negatively relate with GDP growth in the case of Pakistan. Second, considering Pakistan receives a major part of the aid inflows from a single country, there is a need to diversify its donor base. There is also a need to insulate aid inflows due to the strategic and political consideration of donor countries. In this regard, a long-term commitment should be obtained and ensured before the start of any aid programme. Lastly, as shown by our results, aid effectiveness can be enhanced through improvements in the macroeconomic policy environment.
<table>
<thead>
<tr>
<th>Variables</th>
<th>Estimated Coefficients</th>
<th>Eq(3.2)</th>
<th>Eq(3.3)</th>
<th>Eq(3.4)</th>
<th>Eq(3.5)</th>
</tr>
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<tbody>
<tr>
<td>Foreign Aid Inflows (as % of GDP)</td>
<td></td>
<td>-0.1086</td>
<td>-0.0780</td>
<td>-0.0870</td>
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<tr>
<td></td>
<td></td>
<td>(-5.832)*</td>
<td>(-4.548)*</td>
<td>(-8.317)*</td>
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<tr>
<td>Gross Fixed Capital (as % of GDP)</td>
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<tr>
<td></td>
<td></td>
<td>(3.594)*</td>
<td>(1.572)</td>
<td>(1.97)**</td>
<td>(2.402)*</td>
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<tr>
<td>Labour Force</td>
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<tr>
<td></td>
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<td>(72.825)*</td>
<td>(66.322)*</td>
<td>(82.494)*</td>
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<td>Trade Openness</td>
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<td></td>
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<td>(3.471)*</td>
<td>(4.353)*</td>
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<td>FDI</td>
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<td>(1.459)</td>
<td>(1.249)</td>
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<td></td>
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<td>(2.410)**</td>
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<td>Foreign aid Inflows Volatility</td>
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<td></td>
<td></td>
<td></td>
<td>(-4.063)*</td>
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<td>Aid*Policy Interactive term</td>
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<td></td>
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<td>(2.777)*</td>
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<td>Constant</td>
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<td></td>
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<td>(9.257)*</td>
<td>(10.066)*</td>
<td>(13.591)*</td>
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<td>R2</td>
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<td>Adjusted R2</td>
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<td>0.1467</td>
<td>0.1649</td>
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Note: All the values of t-Statistics are given in parenthesis. *, ** and *** represents statistical significance at 1 %, 5 % and 10% level, respectively.
REFERENCES


CURATING THE CROWD – TOWARDS A TYPOLOGY OF VALUE-CREATING ONLINE COMMUNITY INTERACTIONS
MICHAEL ROWE¹, JOHN DOUGLAS THOMSON² AND MARTA POBLET³

ABSTRACT
This paper proposes a conceptual model of online community management and development in the context of organisational value creation. It investigates the drivers and limiting factors that contribute to the development of online communities and the appropriation of value from them. A multiple-methods approach to the study of online communities has been used. Qualitative data from semi-structured interviews with subjects actively participating in crowdsourcing activities was obtained over a two-year period. Quantitative methodology included a review of online communities associated with the 2015 Fortune 500 companies, and an additional 167 measurements of eight online communities provided cross-sectional and time-series data. This paper contributes an empirical model that considers two categories of factors: organisational factors – which are controllable by decision-makers within the organisation; and community factors – which shape and limit the nature of the resultant community, and reflect variables relating to the nature of participation.

Key words: Online community, crowdsourcing, community participation, crowd, value creation

INTRODUCTION
Social media has created a new paradigm where thoughts, attitudes and beliefs can be instantly captured and shared across networks of other participants around the world (Kietzmann, Hermkens, McCarthy and Silvestre, 2011). While the movement of content in the social media universe may be perceived simply as a form of diversion or entertainment, the underlying technology provides users with the opportunity of forming cohesive online communities (OCs), a fact increasingly being taken into account by business and government (Turban, Strauss and Lai, 2016). OCs have been defined as “social networks in which people with common interests, goals, or practices interact to share information and knowledge, and engage in social interactions” (Chiu, Hsu and Wang, 2006). The potential associated with the leverage of OCs can be seen not simply as a by-product of an organisation’s social interactions, but potentially a characteristic central to its use as a creator of value (Sridhar Balasubramanian, 2001).

Understanding the factors that drive formation and development of OCs and which mediate the participation of their membership is an important precondition of recognising how these communities may create value. Specific questions addressed by this research are: what are the drivers and limiting factors that contribute to the development of OCs and the appropriation of value from them, and how might the variables associated with OCs and the interactions between them be modelled?

LITERATURE REVIEW
While the study of community dates back to Aristotle, contemporary studies find that the range of characteristics that need to be satisfied for community membership to occur include

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a sense of belonging, emotional safety and the integration of needs fulfilment for participants (McMillan and Chavis, 1986). Community is seen as a resource utilised by people “for meeting key physiological and psychological needs such as the need for affiliation, power and affection” (Nowell and Boyd, 2010).

Translated into an online context, any definition of community must transcend physical place and instead describe a set of social relationships (Andrews, Preece and Turoff, 2001). Many properties of OCs are consistent with those of their more traditional counterparts (Silva, Mousavidin and Goel, 2006). The interest of each individual within a community is generally better served by individuals acting in concert rather than by each acting in isolation. In translating the exchanges of such a community from a sociological to an organisational context, the best interests of an enterprise may be served through the appropriate harnessing of the interactions of whatever community the organisation may be able to harness. From these roots, the notion of community in relation to organisational performance arises.

Forms of community

If the ultimate objective of enterprise is to satisfy the needs of customers more effectively than alternatives (Webster, 2017), then competitive advantage is the reward that comes with the achievement of that aim (Treacy and Wiersema, 1993). But online customer communities are rarely completely homogenous, and each individual customer is likely to have perspectives and preferences that differ from others in his or her cohort. This has implications for organisations and the approach they take to customer communities – how well a company understands its prime stakeholders (customers among them), and how capable it is in not just addressing the variation in needs, but also in operationally integrating the views of its customers into the attributes of the goods and services it produces (Treacy and Wiersema, 1993).

Within this context, the role of the brand community can be considered. In his paper introducing the concept, Muniz defined brand community as “a specialised, non-geographically bound community based on a structured set of social relationships among admirers of a brand” (Muniz, Jr. and O’Guinn, 2001). He noted that brands with a strong sense of community are of more value to a marketer than brands with a lesser focus or understanding of their community.

An additional category of OC might be called “communities of interest” (Armstrong and Hagel, 2009). Internet technologies enable the members of a community of shared interests to associate with relative ease. Geographic, language, cultural and status barriers are significantly reduced in an online context, and this enables the formation of communities that are potentially both demographically truly diverse, and also quite narrow in their focus.

Nexus with crowdsourcing

Crowdsourcing is defined as a “type of participative online activity in which an individual, an institution, a non-profit organization … proposes to a group of individuals … via a flexible open call, the voluntary undertaking of a task” (Estelles-Arolas and Gonzalez-Ladron-de-Guevara, 2012). For value to be created through crowdsourcing, three criteria must be met. First, the subject of the task being crowdsourced must be modular in nature, i.e. elements of the subject must be able to be changed without compromising the integrity of the whole. Second, there must be structural capability within the organisation to be able to both engage the crowd and utilise the output from the crowd in a manner that creates value. Finally, an authentic community must be engaged (Rowe, Poblet and Thomson, 2015). The manner in which these communities may be engaged, and the variables associated with mediating that involvement, are critical determinants of successful leverage of OCs by organisations.
The study of crowdsourcing must therefore take into account the dynamics of the crowd. Here arises a definitional constraint, as many of the crowds engaged in crowdsourcing do not satisfy the accepted preconditions of community. In other words, while all communities are comprised of crowds, not all crowds are communities. Participation in crowdsourcing may be by individuals unmotivated by commonality of interest with like-minded others. Consider the individual that voluntarily submits information about the location of potholes to their local council using an app similar to “Street Bump”. This individual is enabling the local government to crowdsource data in relation to the condition of roads in surrounding neighbourhoods, but the individual is not by any practical means a member of a community for the purposes of this activity.

This paper therefore does not use “community” and “crowd” interchangeably. Rather, it assumes that the characteristics of the OC drive value creation, not the mere access to a crowd.

METHODOLOGY

This research applies a multiple-method approach to the study of OCs. Qualitative data was obtained through semi-structured interviews over a two-year period with subjects actively participating in crowdsourcing activities. In addition, a “digital ethnographic” investigation (including naturalistic involvement in, and observations of, functioning OCs and associated artefacts) was undertaken. Digital Ethnography is a qualitative research methodology which adapts ethnographic research techniques to the study of OCs (Underberg and Zorn, 2013). Quantitative methodology included a review of OCs associated with the 2015 Fortune 500 companies, and an additional 167 measurements of a convenience sample of eight OCs providing cross-sectional and time-series data encompassing 1.1 billion individual posts and contributions.

Many OC forums have been captured in Internet archives, along with metrics that enable the development of these communities over time to be mapped. As an investigation into the nature of the communities these forums attract formed a significant part of this research, taking data from these archives provided a rich source of quantitative data. A selection of candidate sites was obtained, and these were then entered into the Internet Archive site (www.archive.org) to establish the quality of historical data available. Quality of data in this sense refers to the start date of entries into the archive, and the frequency and distribution of updates. Figure 1 shows an example of the reporting available on the site and provides an overview of the data density. Where the data relating to a particular forum was insufficient to provide samples of sufficient frequency and regularity, the site was discarded and the next on the list was submitted.

**Figure 1:** Internet Archive entries for www.rolexforums.com showing commencement of inclusion in the archives, and frequency and distribution of updates (Source: http://web.archive.org/web/*/www.rolexforums.com)

Conceptual modelling has been described as “the activity of formally describing some aspects of the physical and social world around us for the purposes of understanding and communication” (Mylopoulos, 1992). Identifying variables and interactions based around defined categories will enable the development of a model that identifies and explains the actors and structural characteristics associated with value creation from OCs.
TOWARDS A COMPREHENSIVE MODEL

OCs may exist in many forms. They may be directly associated with an organisation, or they may be entirely independent of the organisation and exist only as a result of the individual members’ shared approach to a contingency.

The proposed empirical model considers two dimensions:

1. Organisational dimensions – which are controllable by decision-makers within the organisation; and
2. Community dimensions – which shape and limit the nature of the resultant community, and reflect variables relating to the nature of participation.

Taken together, the proposed model provides both an explanation for observed community interactions, and a diagnostic tool showing alternative configurations that may potentially drive better value creation from an existing community engagement approach.

Organisational dimensions

Organisational dimensions are those that are specifically related to, and under the control of, the seeker organisation. They are distinct from of any particular crowdsourcing process and can be considered independent variables.

1. Strategic Objective: The starting point for development of this model is the assumption that an organisation’s involvement with OCs is intended to contribute to the achievement of the seeker organisation’s strategic goals. “Value” in this context may well be an end-product, but it may also represent the unlocking of insights or a capability (for example) hitherto unavailable to the organisation. Curating or engaging solver OCs in the absence of a clear strategic vision is problematic and will undermine the ability for the benefits of that community to be leveraged.

Figure 2: Organisational dimensions of OCs

2. Business Model – The second organisational factor for consideration is the degree to which the community is integrated into the business model used by the seeker organisation. This factor can assume one of three states. The first is where the capability of engaging the community is a central and essential part of the operational model of the organisation. This is called the “dependent” model, and organisations pursuing this model are incapable of surviving in the absence of community interactions. The second state is where the organisation uses a more traditional business model but captures community inputs as an added-on capability. This is the “augmented” model. Examples of this model
are governments that use crowd-based techniques to assist in policy formation and problem solving. The third state is where the organisation disregards, either through design or neglect, the presence of whatever OC of interest exists around it. This can occur for a number of reasons and is relatively prevalent at the time of writing. This is referred to as the “legacy” model.

Organisations that are “dependent” (such as Amazon, Facebook and eBay) maintain customer communities that are the value creation engine and effectively inseparable from the organisation itself. Other companies (such as AT&T, Hewlett Packard and Nike) maintain active communities that have been developed alongside their primary operations, enabling input to be obtained while the organisation remains operationally independent from its associated communities. Many more organisations – usually ones of significant scale – are too bound by fixed organisational structures, industry regulatory pressures or stock market expectations to engage OCs in any meaningful way. Banks and mining companies are typical examples. As the impact of social media and OCs becomes more apparent, some business-to-consumer enterprises appear to be decreasing their reliance on legacy systems and are starting to provide opportunities within their operating or business models for more significant stakeholder interactions.

3. Online Presence Projected – at this point the model seeks to establish whether the organisation projects an online presence beyond a simple website. The null case here is the organisation whose presence provides no way for interested parties to respond. In these cases, the organisation eschews even the most basic social media presence. American Tower (http://www.americantower.com) is a large transnational enterprise based in the United States. Its website is purely descriptive with no social media presence or any other way for interested parties to interact with the firm beyond a “contact us” page.

Social media is simple and inexpensive to access, and many organisations use social media platforms such as Twitter, Facebook, Pinterest and Instagram as an extension of their website. This may satisfy a technical definition of creating and engaging with an OC, but in reality simply posting content to Twitter and Instagram does not mean an impact is being felt either in respect of forming or contributing to a community discussion. It should be recognised that almost all organisations of scale now project some form of online presence through social media channels. This is a necessary but not sufficient precondition to the formation of a community. The test of whether a community has been formed relates to the extent of response that results from this activity. This kind of irregular and ad hoc activity is a separate category of interaction that (while capable of influencing decision-making within organisations) does not represent a coherent response to community building and is, one might surmise, often unwelcome in relation to the pressure it puts on management. It is, however, an important community interaction, and one with the potential to create value for the organisation.

4. Platform Stewardship – This factor reflects the relationship between the organisation and its community. This is an important decision for an organisation – it can foster the creation of its own OC (management of the community is a function internal to the organisation), or it can monitor but otherwise have a hands-off relationship with a community that has been created outside the auspices of the organisation (management is external to the organisation). Some organisations may be unaware of both the existence of an associated community, or of the potential to leverage this community for advantage (not considered by the organisation).

Web 2.0 technologies that enable interaction are ubiquitous and accessible to all. The degree of perceived authenticity of these interactions is likely to have the effect of mediating the quality of the contribution by the stakeholder. For example, independently
moderated, spontaneously evolving communities are likely to elicit a more open, honest and unfiltered set of responses than those from sites established, curated and overseen by the organisation being commented upon. In this case the obvious presence of the observer is likely to influence the contribution of the community (Vaezi, Torkzadeh and Chang, 2011).

This review of companies comprising the 2015 Fortune 500 list in the United States found that, of those that could be considered B2C (i.e., operating in consumer markets) (n=226), only 44 or 19.5% hosted their own easily accessible OC. Of those with a primarily B2B focus (n=274), 31 or 11.3% maintained online stakeholder communities. In contrast, every one of the Fortune 500 companies was the subject of discussion and comment among online forums external to the company. Many of these interactions centred on the investment potential of the companies under discussion. Others consisted of contributors seeking information about employment opportunities and experiences from other community members who had had dealings with the company. Independent and spontaneous communities discussing products, strategies and topical concerns related to the companies were also prevalent.

5. Community Type: Categorisation of type of community utilises two dimensions: the scope of interests covered in the interactions of community members, and the extent of diversity of interaction enabled by the platform.

Some communities form around very specific topics – they are single-interest driven and often quite specialist in nature. A community dedicated to the restoration of a particular model of automobile is unlikely to sustain discussions about politics. Other communities arise in response to a broader range of interests. These might be aligned to a particular brand or cause, or be more general in nature. Members of these communities, such as Quora and Straight Dope Message Board, typically start and propagate discussions and encourage the contribution of different perspectives and viewpoints from their community across a range of topics.

“Diversity of interaction” in this model reflects the degrees of freedom of participation afforded to the community. Interactions can range from one-sided to many-sided. A one-sided community will have a flow of information that moves from a source to an audience. In a typical one-sided system, the audience is either unable to contribute back to the source, or can do so only in a piecemeal fashion without the formation of conversational threads and free-ranging interactions with other audience members being feasible. Some organisations may seek to limit the diversity of interaction to minimise the potential risks associated with open and unconstrained communication. Moving beyond this token activity can be challenging for the organisation. It requires it to develop capabilities of managing a more plentiful and diverse range of interactions. However, there are numerous examples where organisations have benefitted from a broad and diverse range of interaction. This can be achieved by allowing stakeholders to independently and autonomously create new topics and opportunities for interaction between each other and the organisation itself.

Four community types arise from the scope/diversity interaction. Where the scope of interest is low and the diversity of interaction is also low, the community form is a blog (originally called a “weblog”). The blog’s author (blogger) is typically an individual or representative with some professed interest or expertise in a particular area, communicating to a community that shares that interest. The number and extent of responses is insignificant compared to the number of viewers of the content. Contrast this to a situation with low diversity of interaction but high scope of interest. This form may be found in online markets such as eBay, or Alibaba where the range of topics (i.e.,
categories of items for sale) is potentially unlimited, but participants generally relate only within the context of the individual vendors in the market.

The third form is found where the scope of interest tends to be focused while the diversity of interaction is much greater. Online forums – sites enabling users to participate in topic-driven discussions – are perhaps the most visible and therefore accessible example of this and lie at the basis of the formation and development of many OCs. The final categorisation occurs when the scope of interest is large and the diversity of interaction is similarly large. Under these circumstances, a number of separate communities (based on a common theme) form an ecosystem around a particular organisation or cause. The subsequent interaction is complex. An example of an ecosystem topology is Lego, which engages with a diverse range of communities around the world.

Community dimensions

Community dimensions flow as a direct consequence of the type of community that mediates the interaction between seeker and solver. As noted previously in this paper, the mere fact an organisation participates on a platform does not mean the activity generates responses, and so the engagement or otherwise of potential communities needs to be established in advance of categorising the participation mode. In those cases where an organisation for example hosts a forum but there are few if any responses to the content it posts, no engagement has taken place and there is effectively no community.

**Figure 3: Community dimensions of OCs**

6. Participation Mode: While the configuration of the platform is an important enabler of various scopes and diversities of interactions, the actual performance of the community will be significantly impacted by the style of interaction or participation mode demonstrated by the users. When assessed on an empirical basis, the following five states are observed:

- **Latent**: where the individual in a crowd has not yet become part of a community. The condition precedent necessary for the individual to be motivated to connect has not yet occurred. An example of this is residents in earthquake zones. Their participation in social media may be entirely recreational until a quake hits. The exogenous shock caused by the quake coalesces the latent actors into a cohesive community – the resources of which can then be used by authorities in rescue and remediation efforts.
Captive: where interactions between platform and community are a result of there being no practical option. Participation is not through choice but through necessity (for example, Telstra, Commonwealth Bank of Australia);

Passionate: where participation is the result of a free choice to engage on behalf of the members of the community, and contributions come from the participants’ desire to be heard and to make a positive contribution to the community (Straight Dope Message Boards, Rolex Forums);

Balanced: where participation becomes a way of life, not driven by compelling external stimuli but by the incorporation of the platform into the participant’s daily routine. Need to participate is often justified as functional rather than driven from a particular need to address issues. An example of this is recreational participation on platforms such as Facebook and Twitter; and

Uncommitted: where the bond between platform and community member is weak and irregular – if it exists at all. The platform owner is offering access to the platform through a sense of obligation or to be seen to be contemporary. The potential user may perceive the pages to be a contrivance with little substance and limited ability to actually provide influence (for example The Clorox Company, and their “Heritage Community”).

The style of interaction is an important consideration because it contributes to the degree of authenticity and engagement present in the interaction. The standard of contribution arising from authentic and engaged participants is more useful than that of individuals participating on a platform through obligation or lack of choice. An organisation seeking to leverage the insights of its community may be disappointed by responses when that community is delivered to the organisation through overly moderated or controlled platforms.

7. Anticipated Outcome – A final element of the comprehensive model relates to the nature of outcome sought. The classical dichotomy of goods and service (tangible/intangible) can be extended here to include two additional classifications of outcome; information and capability. Turning to a community for information is self-explanatory – the information may relate to guidance on potential new products and services, to better understanding the priorities of consumers, or to establishing a clearer picture of the organisation’s reputation and brand in the eyes of the market. When an organisation turns to a community to either get it to perform tasks on its behalf or to solve problems, the community is effectively providing that firm with a capability it did not have previously. Community-based capability building extends the resource-based view of the firm (Barney, 1991) to include the valuable, rare and imperfectly imitable contributions of a community of individuals, each with a perspective and some degree of willingness to contribute.
EMPIRICAL END-TO-END MODEL

Figure 4: End-to-end model of OC interaction

By combining these organisational factors and community factors, an empirical end-to-end model can be constructed that accounts for the range of modalities in which community interaction may be accessed by an organisation.

This model serves two purposes. It accounts for the range of management decisions contributing to the formation of an interactive online presence, and it provides a framework for troubleshooting when performance of online presence has not matched management expectations. By identifying how each of the model’s categories are configured by an organisation, opportunities for modifying or enhancing the constituent elements to achieve outcomes more consistent with the strategic objectives of the organisation can be undertaken. Attempting to obtain crowdsourced ideas through an augmented model using internal ownership in blog form is unlikely to be successful. Migrating communities from captive to passionate through relinquishing ownership of a platform may seem like a lessening of commitment, but will likely lead to more authentically engaged communities and better outcomes. Understanding that the elements in this framework have a variety of settings, and that each of those settings is a management controllable has the potential to provide greater access to enriched outcomes as a result of community interactions.

CONCLUSION

The purpose of this research is to propose a conceptual model of OC development and management in the context of organisational value creation. OCs demonstrate distinct characteristics, and a deterministic and predictive model can be developed through integrating these typologies with other critical decision points in relation to choice of business model, platform stewardship, community type, participation mode and desired outcome.
FUTURE RESEARCH

The model developed by this research is conceptual in nature. Future research directions may include a more formal investigation of the nature and characteristics of the linkages between agents, and their impact on performance of the organisation seeking to utilise communities in value creation. There is now an abundance of data accessible with relative ease through new data mining techniques. Artificial Intelligence (AI) algorithms are already enabling meaning to be extracted from large and diverse datasets with relative ease (Kozinets, 2010). As new forms of community evolve, investigations may reveal a metacategorisation of sociological importance across a range of disciplines.

At the heart of these investigations lies the basic human drive for connectedness. Perhaps the most important dimension of this is the authenticity with which relationships form and are carried forward. Just as the notion of community is losing its geographic dependence and becoming more abstracted over time, so the challenge of keeping the trust and the humanity in the relationships becomes a more important factor. Future research directions accounting for aspects of authenticity in distributed relationships may provide a stepping off point for a means of further leveraging the potential that exists wherever communities operate.

REFERENCES


SME MARKETING MIX STANDARDISATION IN THE B2B MARKET
JUERGEN WIELAND

ABSTRACT
The purpose of this paper is to examine price and product policy interdependencies in relation to a standardised use of a marketing management approach in SMEs. The methodology is based on four site cases with consulting companies and internal marketing departments of German SMEs, realised through 14 semi-structured in-depth interviews and correlated documents. The findings of the research reveal that no model for the management of price and product policy interdependencies was available. In particular, the organisation, implementation and management of interdependencies for successfully implementing policies within the marketing mix was lacking. This study shows that a coherent, structured marketing mix is the basis for marketing-mix-management success. Marketers have to be aware that management’s culture or orientation may reflect the stakeholders’ perception of their firm. Features linked to companies’ capabilities, such as international business experience, modes of market entry and dynamic organisational characteristics, make their marketing-mix-management more successful. This study suggests how to identify mix policies and their interdependencies and how to manage a structured marketing mix successfully, illustrating these topics using a subcontracting sub-activity model, whereas earlier studies have focused on a step-by-step plan.

Keywords – Marketing mix, marketing strategies, B2B, SME

INTRODUCTION
The emergence of marketing-mix-management, where methods and procedures are developed for executing the marketing mix, has been a topic for researchers and practitioners for many decades (Grönroos, 1994). The aims of marketing-mix-management are to plan, organise, and control the marketing mix, to meet stakeholders’ requirements, to increase revenue generation, and to improve resource allocation. The lack of an in-depth account of the manner in which a marketing mix is realised, however, has a complicated effect on the implementation of this style of management. German small and medium-sized enterprises (SMEs) in the business-to-business (B2B) industry have received little attention from researchers in this context (Kleinaltenkamp and Saab, 2009; O’Dwyer et al., 2009), notwithstanding the fact that 89.6% of German industry consists of SMEs (IFM, 2013). Although the literature on these firms’ marketing practices is well-developed (Spence and Essoussi, 2010), only a few specific studies relating to marketing-mix-management have yet been published (Spence and Essoussi, 2010; Mitchell and Hutchinson, 2012). On the other hand, a considerable amount of research has been done on marketing mix management models in the context of the coordination and arrangement of international policies (Richter, 2012).

The potential for the arrangement of an integrated marketing mix that includes firms’ interdependencies is enormous and associated with high stakeholder satisfaction, making it a crucial aspect of success in the German market (Kleinaltenkamp and Saab, 2009). The behaviour of small companies follows patterns that differ from those of larger companies with regard to a structured marketing-mix-management approach (Gabrielli and Balboni, 2010). Thus, because SMEs in the German B2B industry are subjected to increased

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competition in the so-called D-A-CH region (which includes Germany, Austria, and Switzerland), these companies are compelled to seek opportunities that cater increasingly to stakeholders’ needs to bolster stakeholder loyalty and to improve their service (ODwyer et al., 2009). An integrated marketing-mix with clearly-defined interdependencies represents the ultimate response in the effort to manage these various aspects of marketing management (Kleinaltenkamp and Saab, 2009).

German B2B enterprises are challenged by rising competition in the globalised and fast-changing market, by increasing price competition, quality standards, and customer expectations, as well as by changing market demands. Only those organisations can survive that are able to establish an acceptable price while maintaining high standards of quality and increasing their customer orientation, which is made possible through a structured marketing-mix-management approach (Vignali et al., 2012). Small and medium-sized B2B enterprises represent Germany’s ‘industrial elite’, employing 46,000 specialists and ranking first among high-technology machinery producers worldwide (CAEF, 2013). To conduct a comprehensive and applicable marketing-mix is a mandatory component of the overall marketing strategy for German B2B enterprises (Bruhn, 2003). According to the scarce literature on SMEs’ marketing-mix-management and the inherent need for an all-embracing marketing mix, the following research gap is formulated:

RG: To explore the extent to which limited resources and high competition in the German B2B industry of SMEs impact the adoption of a structured marketing-mix-management approach with integrated interdependency management.

For the analysis of this research gap, a comparative overview of the main concepts of marketing-mix-management and an analysis of market behaviour of perceived high competition are presented. Afterwards, the methodology is explained and the interviews are analysed. Finally, the implications of the study findings for marketing managers and researchers are discussed.

LITERATURE REVIEW

The benefit of a valuable marketing mix
The benefit of a valuable marketing-mix-management lies in the fact that it helps meet the requirements of different types of stakeholders, boosts sales and generates higher profits (Pepels, 2013). A highly structured marketing mix refers to a mix with a high impact on stakeholder loyalty (Brooks and Simkin, 2012), particularly when marketing activities are clearly communicated to the stakeholders. A well-suited marketing-mix-management programme is quickly accepted and permits stakeholders to personally identify with the marketing-mix programme. This leads to stakeholder loyalty and satisfaction and sometimes to their active engagement (Vrontis et al., 2009). The basis for this relationship is the thorough analysis of the sub-instruments the stakeholder needs, building interdependency relationships between those sub-instruments and arranging them within the mix (Pepels, 2013). This basis allows marketers to gain synergies from a standardised product portfolio and to convey this marketing concept to stakeholders who are open to its significance and attitudes (Kimery and Rinehart, 1998). Interferences within the marketing-mix possibly lead stakeholders to respond negatively to marketing activity (Green, 2008). Consequently, a re-conceptualised marketing-mix-management concept involves the identification of sub-instruments, effective management of interdependencies and the development of a valuable marketing-mix-management model.

Marketing-mix-management
Recent studies on marketing-mix-management focus on relevant processes and factors in SMEs’ and LOs’ management of marketing-mix and interdependencies. Depending on the industry and the target of the marketing plan, marketers will take approaches to each of the 4
Ps in terms of planning, organising and controlling them (AMA, 2014). Recent studies on marketing-mix-management add that the marketing mix is a set of various tools that can be controlled in combination with interdependency management (Chenhall, 2007; Desmond, 2004; Skitmore, 2009). Given these facts, these processes are analysed and compared.

**Marketing mix planning**

Marketing managers need to account for interdependencies among the 4 Ps and marketing mix planning, particularly when determining the appropriate level of budget and its allocation to marketing strategies and the practical implementation of marketing-mix targets (Naik et al., 2005). Marketing mix planning is, in particular, the synchronisation of all operational sub-instruments to achieve a perfect combination to meet corporate and marketing objectives (Brooks and Simkin, 2012).

Within SMEs, the marketing mix managers are the functional persons who plan the marketing-mix and allocate resources and products on the market (Cespedes, 2012). Banterle et al. (2013) further note that the marketing-mix plan has to be aligned according to the overall business strategy. Within the marketing mix, only objectives which can be definitively realised and objectively measured should be planned (Banterle et al., 2013).

**Marketing mix organisation**

Marketing mix organisation can be linked back to marketing mix planning, as it focuses not only on target derivation, strategy definition and practical implementation of derived targets, but is also based on the practical implementation of marketing mix targets (Robins, 1991). Robins (1991) stresses that the marketing team should give individual and detailed attention to each element of the marketing mix, the evaluation has to be continuous and the marketing mix organisation should be more rigorous. The crucial step in deriving targets is to plan alternative actions that are achieved through a thorough marketing mix plan (Helbig, 2009). Gatignon and Hanssens (1987) note that LOs tend to measure the effectiveness of mix variables with time series or cross-sectional data. In the case of SMEs, marketing mix effectiveness is measured by focusing only on a small subset of marketing mix variables and not on the entire mix (Herche, 1994). Furthermore, in SMEs, the organisation of the entire marketing mix is handled in a less formalised manner than in LOs (Dickinson and Ramaseshan, 2004). Wilthorn et al. (2013, p. 4) state that in practice there exist differences in large organisations compared to smaller ones with regard to the organisation of the marketing mix, “where it is argued that small-sized enterprises typically are family owned or entrepreneurial organisations with a more collegial and less formalised internal system”. Gatignon and Hanssens (1987) add that, in SMEs, the key elements regarding the organisation of the marketing mix widely differ from those used in large operations.

**Marketing mix control**

The marketing mix which SMEs and LOs introduce must be subject to control. Clearly quantifiable and measurable objectives are the main factor for marketing managers to focus on when controlling the marketing mix. This requires control over budget expenditure, performance of each mix variable and the monitoring of interdependencies (Lidstone, 1987). LOs of the German B2B industry develop internal fluid sets of guidelines for action that require constant innovation in the light of changing circumstances (Holloway, 2004). To maximise the effort of marketing mix control, different control systems are used by large enterprises: they use performance control, create strategic control, carry out financial control or develop quality control mechanisms (Holloway, 2004). In practice, it is often difficult to discern how control of the marketing mix is achieved, as there also exist differences between sales-driven and relationship-driven marketers (Merrilees et al., 2011). Comparing LOs and SMEs of the German B2B industry, the former tend to be relationship-driven and listen more to the needs of stakeholders, and may adapt the marketing mix accordingly (Merrilees et al.,
2011). The latter are much more sales-driven and make adjustments to marketing reasons to boost sales and increase profit margins (Swoboda and Olejnik, 2013). Needless to say, a sales-driven SME of the German B2B industry is able to use their niche market power to set differential price margins across different markets. Merrilees et al. (2011) find that relationship-driven firms may not necessarily make greater adaptations to their marketing mix to meet stakeholders’ requirements, but will exercise more control over it.

Interdependency management

It is suggested that interdependency management can be viewed as a strategic process for preparing, implementing and optimising mix-variables and their interdependencies and embedding this within a marketing-mix-management approach within the overall organisational structure (Patanakul and Milosevic, 2008). According to Naik et al. (2005), marketing-mix-management can only be successful if interdependencies between mix variables are used in a synergic manner. A few papers study interdependency management in SMEs, and their results show that it is an integrative part of marketing-mix-management (Codita, 2010). Jagpal et al. (1982, p. 401) state that identifying and defining marketing-mix interdependencies “allows more effective control of marketing instruments”. This explicitly enhances productiveness “of a given marketing instrument to depend on the time path of the entire marketing mix”. Looking forward and reasoning backward increases an SME’s own optimal decisions in response to the best decisions made by all other competitors (Naik et al., 2005). In conclusion, SMEs do not seem to have been attracted by the advantages of interdependency management in the past, but have changed their opinion due to increased competition and fast-changing stakeholder requirements. A summary of this discussion can be found in Table 1. The literature review and the contradictions found there lead to the following research questions:

- How is marketing-mix-management standardisation realised by SMEs in the German B2B industry?
- What are the key drivers in the interdependency management of SMEs in the German B2B industry?
- What processes do SMEs follow in interdependency management, and how are these processes different from those of LOs?

Table 1: Comparison of marketing-mix-management in SMEs and LOs

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<th>SMEs</th>
<th>LOs</th>
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<td>Marketing mix planning</td>
<td>Limited and reductive concept with functional purpose.</td>
<td>Fully integrated concept within the marketing-mix-management approach. This concept is aligned with the overall business strategy.</td>
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Marketing mix organisation

Intuitive organisation of marketing-mix-management objectives based on stakeholder requirements and developed by the entrepreneur. Product portfolio sometimes exceeds the capabilities of the SME.

Fully developed objectives that are easy to measure. Objectives are clearly communicated to all involved parties. Objectives are deduced from wealthy product portfolio. The aim is to maximise market coverage in a highly competitive market.

Marketing mix control

A limited number of strategies are used by an accountable person. Objectives of marketing control are maximising profit and minimising market overlaps. Different levels of control strategies have been identified. These are sales-driven.

A variety of processes are used on both a regional and international level. The aim is to measure clearly quantifiable objectives. Fluid set of guidelines in performance control, strategic control, financial control and measurement of stakeholder expectations. Marketing mix control is part of the overall business strategy and is relationship-driven.

Interdependency management

Increasing interest since 2011 regarding the identification and definition of behavioural interdependencies. Do not possess the necessary knowledge for carrying out interdependency management. A range of processes are imitated from LOs.

Aware of interdependency management and in many cases have company standards on how to identify and define interdependencies, mainly between price and product. Emphasis is on optimal resource allocation, low cost tactics and strategic foresight.

METHODOLOGY

For this study, a qualitative design of multiple case studies was selected to illuminate the set of decisions to be made by SMEs in the German B2B industry to apply a structured marketing-mix-management approach and to find out which key drivers in interdependency management are necessary to apply such an approach successfully. This applies particularly to processes which have to be understood rather than measured. Several studies have used this approach for measuring successful marketing-mix-management within SMEs (Frank, Sommer and Haug, 2007).

For this study, 14 cases of SMEs within the German B2B industry were selected (Frank, Sommer and Haug, 2007). Marketing-mix-management in the German B2B industry is important because of its influence on cost saving due to standardisation, better resource allocation and higher satisfaction of stakeholder expectations. According to present estimations, in the German B2B industry, particularly in SMEs, no more than 60 specialists are employed in Germany (CAEF, 2013). The 14 cases selected for this study thus provide a representative sample. The sample size of 14 was determined by the number of interviews required to achieve relative theoretical saturation (Bryant, 2014). The criteria for the selection were: SMEs with fewer than 250 employees, enterprises which produce B2B machineries in Germany, and enterprises which employ marketing managers who are accountable for marketing mix decisions to be made. Only SMEs of the B2B industry were selected. All firms were contacted via the Chamber of Commerce and Industry and the Federal Association of the German B2B industry. Only SMEs with an internal marketing department were selected where marketing-mix decisions are made by marketing managers working in these departments. This research is considered as exploratory, because “not much is known
about the situation at hand or no information is available on how similar problems or research issues have been solved in the past” (Sekaran, 2006, p. 95). The qualitative nature of this research yielded semi-structured in-depth interviews with the three different interviewee types to obtain insights. This cross-sectoral, single-respondent and multi-size approach has been used for similar studies in German B2B companies by Hofstede et al. (2010), who observed the marketing processes of German SMEs. The questions of the semi-structured in-depth interviews, which are open-ended, are summarised in the case study protocol. All interviews were audio-taped and transcribed verbatim. The questions which the participants were asked ranged from realisation of marketing-mix-management, main drivers in interdependency management, main objectives of marketing-mix-management and realisation of control to the impact of limited resources/high competition on such an approach. The characteristics of the interview subject population and company are summarised in Table 2.

Table 2: Characteristics of the interview subject population

<table>
<thead>
<tr>
<th>Number of participants</th>
<th>14</th>
</tr>
</thead>
</table>
| Job level              | 2 chief executive officers  
                         | 4 senior marketing managers  
                         | 2 chief marketers  
                         | 4 consultants  
                         | 2 principal marketing-mix-management experts |
| Job role               | 3 company administration (overall business administration)  
                         | 6 planning and organisation of marketing mix  
                         | 2 control of marketing-mix-management activities  
                         | 1 assisting in marketing-mix-management activities |
| Status                 | 4 external consulting companies  
                         | 5 staff  
                         | 5 chief executive officers |
| Experience in marketing-mix-management | 4 with 10 or more years  
                                           | 8 with 8 or more years  
                                           | 2 with 5 or more years |

INTERVIEW ANALYSIS

Origins of marketing-mix-management, its planning and organisation

Of the interviewees, four provided profound knowledge about marketing-mix-management, particularly about planning and organising the marketing mix. With regard to using a standardised approach for identifying and defining sub-instruments, eight interviewees believed that such an approach impacts the successful application of a structured marketing mix. The other interviewees believed that such an approach was not necessary, or mentioned that particular knowledge in identifying and defining sub-instruments is not available. These interviewees developed their marketing-mix based on a macro- and micro-environmental analysis, not focusing on particular sub-instruments or their interdependencies. Of the interviewees, two mentioned that identifying sub-instruments is cost- and time-consuming. The core variables of product policies are product features, attributes and service. With regard to price variables, pricing and abatement are used most. Development of pricing strategies has been realised over many years and is thus time- and cost-intensive. The impediment of grey imports and parallel imports has been mentioned as a core benefit of a
standardised pricing strategy. Of the interviewees, two mentioned that in standardising the price mix internal issues such as goals and objectives of the company, research and production have to be taken into account. In planning a structured marketing mix, the activities have been focused on analysing, particularly competition-, macro-, micro-, and organisational factors. All interviewees used common analysis tools for examining the current situation. SWOT analysis, BCG-analysis, PLC, Porter’s five forces were mentioned most often. Few interviewees used marketing-mix-management approaches, particularly brand aid-models, mix-mapping methods and stratics models to plan and organise mix variables. Interestingly, four interviewees mentioned that they plan to use a structured marketing-mix-management approach in the future.

Marketing mix control
SMEs in the German B2B industry have developed several strategies to undertake marketing mix control to measure the performance outcome of mix variables, budget expenditure and stakeholder satisfaction. The interviewees mentioned that clearly quantifiable and measurable marketing mix objectives are the main factor in successfully controlling a marketing mix. This proposition is clearly underlined by the current literature, which states that mix variables have to be quantified to be successfully measured (Lidstone, 1987). In practice, SMEs use a wide range of decisions outlining the marketing mix strategies to be adopted and the tactics to be employed to achieve the plan’s objectives. Of the interviewees, seven mentioned that they used marketing cost analysis and management by objectives as marketing control tools. All respondents further noted that competitor analysis and stakeholder analysis are requirements for controlling marketing-mix targets. SMEs in the German B2B industry base their marketing mix control on long-term figures of market share, revenue, profit and return on investment. The issue on controlling is communicated via a clear and rigorously defined process to all involved parties. Of the interviewees, four emphasised marketing mix mapping and market segmentation approaches as valuable long-term control tools. Relationship-driven companies control their activities more successfully, as they have greater access to information about stakeholders’ wants, marketplaces and competitors. These findings are confirmed by Merrilees et al. (2011), who state that relationship-driven firms exercise their marketing mix control to meet stakeholder needs and have more control over this process than sales-driven companies. The interviewees further noted that long-term control is the basis for exceeding stakeholder expectations. It seems that relationship-driven companies possess much larger information bases for carrying out control issues than sales-driven companies. The interviews show not only that clear controlling guidelines and the commitment of all involved parties are essential, but also that it is necessary to integrate the controlling task within the marketing-mix-management process and overall business strategy. By doing so, a structured marketing-mix-management process is ensured.

Interdependency management
The interviewees suggested that a relational model is used to support the strategic process for preparing, implementing and optimising mix variables, and for embedding this process within a structured marketing-mix-management approach. The participants mentioned that such a relational model is a radical innovation and enables the marketer to add value to the marketing mix and to increase the chance of successful application. Of the interviewees, seven mentioned that such a framework leads to repeat purchase and enhances stakeholder satisfaction. This argument is supported by the fact that identification of interdependencies helps the marketer to optimise mix variables. This in turn enables the definition of such variables according to stakeholder requirements. The interviewees stated that such a framework is dictated by German B2B trends, because these SMEs launch up to two new
product lines a year. They also mentioned that the companies have to offer training to enable such innovations. For the successful application of a marketing-mix-management framework, mix variables have to be used in a synergic manner, as this allows for the effective application of marketing instruments, reduces time and saves money. German SMEs standardise their products to a high degree, which also ensures production efficiency. By managing interdependencies in a synergic way, productiveness is increased and unnecessary waste of resources is reduced. Of the interviewees, six stated that they know many marketers do not possess the necessary knowledge for managing interdependencies; two said they know marketers who have never heard of this issue.

DISCUSSION
In comparison to Los, where marketing-mix-management is created via measurable objectives by the controlling department to answer the needs of stakeholders, increase business performance and enhance resource allocation, marketing-mix-management in German B2B SMEs is based on the overall business strategy of the general management. The marketing mix creation should concentrate on much more focused contexts such as product launch, attributes and features, as realised by German B2B SMEs. Consistent with the literature on marketing-mix-management in LOs, the general management of SMEs has to concentrate on a manageable product portfolio with no more than four product lines (Kauf and Kniess, 2014). Over the years, marketers in SMEs have gained knowledge about how to measure the effectiveness of mix variables (Hofstede et al., 2010). Research shows that German B2B SMEs use less formalised internal systems than LOs to plan, organise, and control a structured marketing mix and to identify price and product policy interdependencies. This leads to the first proposition:

P1 In German B2B SMEs, less formalised marketing-mix-management approaches are used because of missing knowledge.

This study confirms the findings by Coviello et al. (2002) that firms plan their marketing mix based only on a small subset of marketing mix variables, not on the entire mix. Studies show that handling the whole marketing mix in a formalised manner leads to higher stakeholder satisfaction (Dickinson and Ramaseshan, 2004). LOs make full use of primary macro- and micro-economic data. This enhances the integration of price and product policy interdependencies into the marketing mix and the exploitation of synergic effects. The contribution of this article, therefore, is that marketing mix variables have to be developed in a synergic and formalised manner. The measurement of the effectiveness of price and product variables serves as a basis to enhance marketing-mix-management in SMEs. Since these firms have limited resources for marketing mix creation and interdependency management, measurable marketing mix objectives increase German B2B SMEs’ chance of applying the marketing-mix successfully, hence the following research proposition regarding marketing mix control in German B2B SMEs:

P2a In German B2B SMEs, clearly quantifiable marketing mix objectives are a relevant factor of success to be used for marketing mix control.

P2b For German B2B SMEs, clearly quantifiable marketing mix objectives provide a low cost enhancement of marketing-mix-management.

It was also found that functional and systematically outlined marketing mix objectives were used in the development of a strong marketing mix to achieve planned objectives, thereby supporting a number of studies (Lidstone, 1987). Clearly outlined responsibilities, direct communication and staff responsible for taking corrective actions and management by objectives seem to prevail, enabling higher profits and providing a solid long-term basis for enhancing marketing-mix-management success. This leads to the third set of propositions:
In German B2B SMEs, functional and systematically outlined marketing mix objectives contribute to the development of a strong marketing mix.

In German B2B SMEs, functional and systematically outlined marketing mix objectives provide a basis for long-term success. As suggested by Gatignon and Hanssens (1987), a functional interdependency framework helps provide optimal resource allocation and increased efficiency in pricing strategies. In sum, functionally outlined marketing mix objectives provide segment standardisation statements. The functional interdependency framework is an integral part of the marketing-mix-management approach. To support the integration of the interdependency framework, as well as the integration of price and product policy standardisation, the introduction of prioritisation, classification, mapping and controlling of interdependencies as separate steps enhances marketing mix success and helps lower cost while raising efficiency. On this basis, two propositions are made:

P4a  In German B2B SMEs, interdependency management increases marketing mix success, particularly regarding higher efficiency and lower costs.

P4b  In German B2B SMEs, an integrated interdependency framework and standardised identification strategy of policies are essential in supporting marketing-mix-management.

Managerial implications
This study demonstrates that the use of a structured marketing-mix-management approach in German B2B SMEs provides positive results. Marketing mix managers have to be aware that the way they identify and define price and product policies and their interdependencies strongly impacts both stakeholder satisfaction and resource allocation. Defined mix variables therefore have to be synergic in their behaviour. Among standardised product features, attributes and pricing strategies which have to be standardised before structuring the marketing mix enhance marketing-mix-management at low costs. Aligning marketing-mix-management strategies with overall business strategies reduces risk while creating new product lines and penetrating new markets. A clear procedure of managing price and product policy interdependencies both enhances marketing-mix success and serves as a knowledge tool for marketers. Finally, a strict focus has to be kept on a manageable product portfolio, which should include no more than four machineries. Clear communication between all involved parties might be ensured with a standardised request for information.

Limits and future research
This study was limited to 14 marketers specialising in the B2B industry and can, therefore, only be generalised with caution. Only one key marketer from each organisation was interviewed, which is justified by the fact that SMEs generally employ no more than one marketing mix manager.

Nevertheless, future research may improve the generalisability of the exploratory findings presented in this research within the application of a structured marketing-mix-management approach and across other markets. The findings of this study provide further topics to be investigated in the field of marketing-mix-management. By answering the following questions, further insights could be provided:

To what extent is the use of price and product policies standardised by German B2B SMEs?

Under what conditions are price and product policies identified and defined?
Which change management strategies are efficient for marketing-mix-management in German B2B SMEs?

REFERENCE


DO ORGANISATIONAL CULTURE AND STRUCTURE ENHANCE INTERNAL CONTROL EFFECTIVENESS? EVIDENCE FROM MALAYSIAN SOCIAL COOPERATIVES

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ABSTRACT

Similar to the private and public sector, internal control in social cooperative plays an important role on the success of the organisation and is a mirror to effective governance. Nonetheless, little is known about the effectiveness of internal control of cooperative in Malaysia, as current practice does not require the organisation to follow any prescribed standard of internal control or to report it in their annual report. Hence, this study will shed some light on the factors that influence the effectiveness of internal control in cooperative. This study examines the impact of the cooperatives’ organisational culture, organisational structure and the age of the cooperative on internal control effectiveness. Data was collected using questionnaires, which were distributed to ‘Top 100 Cooperatives’ for the year 2014. Based on the analysis of the 56 responses received, regression analysis revealed that only organisational culture and cooperative age shows a significant relationship with internal control effectiveness in Malaysian cooperatives.

Key words: Internal control effectiveness, cooperative, social enterprises, contingency characteristic

INTRODUCTION

The establishment and movement of cooperatives globally have been driven by ideas of democracy founded on a socioeconomic philosophy that suggests an expansion of decision-making power from small minority shareholders to a large majority of public shareholders. The formation of a cooperative fulfils the need and demand of economically deprived community by pursuing social and economic goals, involving the provision of services and the community’s economic revitalisation (Leviten-Reid and Fairbairn, 2011). The International Cooperative Alliance (ICA) defines the term cooperative as “an autonomous association of person united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly owned and democratically controlled enterprise.” Cooperative principles are based on the strong orientation towards the general interest of public, in contrast with most traditional private companies. Cooperatives, which pool together their collective resources, assist less fortunate people in reducing the risk of vulnerability and in rising out of poverty. These social problems can be alleviated through a collective approach towards social protection as a practice by cooperative (UN, 2003; Hagen, 2004).

The cooperative is different from traditional private firms and traditional non-profit organisations. They not only combine the social goals of the traditional non-profit organisation with the commercial characteristics of a corporation, but also have a unique ownership and membership structure. The cooperative members have full control over the firm, but not over its profit; cooperatives are allowed to distribute part of the profit, but their assets are normally locked (Hansman, 1996). The cooperative has a multiple stakeholder membership, including its governance, and different actors participate in the production process, including workers, volunteers and customers (Thomas, 2004). Based on its

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principles and structure, a cooperative can be seen as a type of social enterprise, and it represents one of the most developed and successful models of such an enterprise (Borzaga et al., 2014).

Cooperatives have similar requirements to other business organisations in achieving business goals and performance, although they are different in organisational characteristics, thus outlining the need and importance of internal control effectiveness in cooperative organisations. O’Connor (2003) stated several reasons why corporate governance is difficult in cooperatives compared to other organisations. One of the problems is the absence of effective oversight (control) by the owners (directors) of cooperatives. Additionally, compared to directors of public companies, cooperative directors typically have less expertise and thus less incentive in providing effective corporate governance. Understanding that effective internal control is a function of corporate governance, problems within the corporate governance also indicate problems in its internal control. Cooperative without effective internal control can lead to financial misappropriation by the person in charge within the management.

Although the professional literature on internal control has made progress in discussing internal control and its effectiveness, the amount of research within this area is scarce (Jokipii, 2009), particularly on Malaysian cooperatives. There are several studies on internal control in the private sector (e.g. public listed companies and small-medium enterprises), the public sector and non-profit organisations in Malaysia (Fadzil, Haron and Jantan, 2006; Haron, Rahman and Hanid; Ghazali, 2010; Mohamad-Nor, Shafie and Wan-Hussin, 2010; Mohd-Sanusi, Mohd- Omar and Mohd-Nassir, 2015), but studies on internal control and internal control effectiveness within Malaysian cooperative organisations context are very limited. Very little literature focuses on the relationship between organisational culture, organisational structure and the effectiveness of internal control. Hence, this study will examine the influence of cooperative characteristics (organisation culture, organisation structure, environmental factors and organisational age) on the effectiveness of internal control.

THE DEVELOPMENT OF COOPERATIVES IN MALAYSIA

In Malaysia, the cooperative movement started in the early 20th century (SKM, 2014). The idea of cooperatives was introduced to solve problems faced by rural farmers, who were oppressed by middle-men or business mediators under the “padi kunca” system, and also to solve problems of indebtedness by low-wage workers and civil servants in the city. In 1922, “Sharikat Bersama-sama Kerja Bantu Membantu” was established in Taiping, Perak; at the same time, the Cooperative Societies Enactment 1922 was enacted to supervise the “sharikat kerjasama”, now known as “koperasi” (cooperatives). In the first year of the movement, six rural credit cooperatives, three civil servants’ cooperatives and two cooperative stores were established (SKM, 2014).

The Malaysian Cooperative Societies Act 1993 (Act 502) defined a cooperative as an organisation built for the purpose of improving its members’ participation in economic and social activities. Owned by a group of individuals, a cooperative is formed based on the cooperative principles: open and voluntary membership, democratic management, limited return based on members’ contributions, a fair distribution of profits, promotion of education on cooperatives and active cooperation among registered cooperatives (SKM, 2014). Today, under the administration of the Ministry of Domestic Trade, Cooperatives and Consumerism (MDTCC) and under the regulation of the Malaysia Cooperative Societies Commission (MCSC), Malaysian cooperatives are regulated by the Cooperative Societies Act 1993 (Akta Koperasi 1993) (ACT 502) and the Malaysia Cooperative Societies Commission Act 2007 (Akta Suruhanjaya Koperasi Malaysia 2007) (SKM, 2014).
The National Cooperative Policy (NCP) was launched in 2002 with the aim of re-developing cooperatives. It was introduced to outline several strategies to be implemented to enable cooperatives to play an active role in business development, along with the public and private sectors. The authority structure of cooperatives was also improved through the NCP between 2002 and 2010 by having cooperatives monitored under the MDTCC and placed under the sole authority of Malaysian Cooperative Societies Commission (MCSC).

The Malaysian government regards cooperatives as a platform for economic development (Othman, Mohamad and Abdullah, 2013). It is taken as a tool in helping to eliminate rural poverty and unequal income distribution, and in enhancing development in both rural and urban areas. As a result of the local government transformation plan, cooperatives have emerged into efficient businesses from being only small and rural, and providing only basic services to their members (Mohamad, Othman and Mohamad, 2013). The role of cooperatives in uplifting the economic development of rural and urban areas has been described under the New Economic Model (NEM): although on an individual basis cooperatives may seem small, when combined and pooled together, the collective power of cooperatives is very impressive.

ISSUES OF MALAYSIAN COOPERATIVES

Despite the growth in the terms of numbers of cooperative as recorded by MCSC and Malaysia’s long history of cooperatives over the past 92 years (Raja-Yusof, Devi, Din, Nordi and Saari, 2002), issues such as the absence of good governance and the weak structure in some cooperatives have typically characterised Malaysia’s cooperative movement. These problems have resulted in poor financial performance, poor cash flow and mismanagement and noncompliance with the Cooperative Societies Act 1993 and its related legislation in this sector (Bidin, 2007). These kinds of problems have hindered the movement and the development of cooperatives as inspired by the government.

Issues such as absence of good corporate governance and lack of capital, along with a weak structure, have resulted in poor cash flow and financial performance, mismanagement and financial misappropriation in cooperatives (Bidin, 2007). In Malaysia, an example of an infamous financial scandal involving cooperatives was the Deposit Taking Cooperative, ANGKASA, MOCCIS, Bank Rakyat and the Cooperative Central Bank. The scandal involved a large amount and the loss incurred was reported at more than RM 2 billion. In a statement to the press, Royal Professor Ungku Aziz stressed his disappointment over the scandal and the time it took to settle the investigation.

The scandal was a result of ineffective internal control in the organisation, and created an urgency for regulators to implement better internal control in the organisation. Nonetheless, up to date, it is still not mandatory for cooperatives to implement or to report on their internal control in their annual report.

INTERNAL CONTROL EFFECTIVENESS IN COOPERATIVES

Generally defined, internal controls are process employed by the board and management to prevent and mitigate fraud, to warrant reliable financial reporting and to stay compliant with rules, law and regulations. From the board to the lower-level employees, all are responsible for the internal controls impacting their jurisdiction. Sponsoring Organisations of the Treadway Commission (COSO, 1992, p. 1) defined internal control as “a process, effected by an entity’s Board of Directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories; effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.” As a process, internal control is dynamic in nature, with constant changes in the organisation’s environment (internal and external), resulting in a cycle where, as past threats are mitigated, new risks will arise.
Internally, internal control helps organisations ensure the reliability of reports, such as financial reports; helps compliance with laws and regulations; encourages and promotes operational efficiency and effectiveness; and most importantly helps in reducing risks (COSO, 1992). Internal control also helps management deal with external opportunities and threats such as the competitive environments, economic volatility and shifting demands and supplies (COSO, 1992). The purpose of internal control is to reduce risk and error and to enhance accountability, as it provides a system of checks and balances, with the potential for reducing theft and fraud. It can also help identify potential areas of errors. In evaluating the effectiveness of internal control, although it depends on subjective judgment, COSO (1992) outlined that effectiveness is determined by meeting three categories of objectives of internal control: effective and efficient organisational operations, reliable reports and compliance with laws and regulations.

Generally, if the organisation’s internal control is free from material control weaknesses and reasonable assurance regarding the achievement of its objectives is provided, internal control is deemed effective (Pfister, 2009). Effective internal control exists when board and management obtain reasonable assurance that achievement on efficiency and effectiveness of operation is gained, and it is crucial for the management to be aware of the level at which these achievements are earned (Pfister, 2009). In addition, board and the management are reasonably assured that internal financial reports and statements are reliably produced. All information in the financial reports needs to be carefully constructed and free from material errors for it to be reliable. Finally, the management and board must have reasonable assurance that the organisation as a whole has complied with the laws and regulations pertaining to the organisations’ operations.

CONTINGENCY THEORY

The theoretical foundation of this study is premised on contingency theory. Donaldson (2001) defined contingency as “any variable that moderates the effect of organizational characteristics on organizational performance.” Klaas (2001) outlined that organisational viability depends on different contingencies such as organisational structure, organisational climate, technology and culture. Thus, it explains how the contingency theory enables a researcher to originate systematically factors in predicting or explaining expected situations (Badara, 2013; Umanath, 2003). The main context of contingency theory is that the success of any management control initiative (e.g., internal control and internal control effectiveness) depends on the contingencies of the company.

Additionally, Hui and Fatt (2007) state that two theories (industrial organisation and resource based theory) discussed in the research argue that a good fit between a firm’s internal characteristics and external forces is crucial to the effectiveness of a strategy. A good fit means tailoring controls to organisations’ characteristics to make them unique, as this will result in better effectiveness in control (Fisher, 1998; Jokipiï, 2009, Ninlaphay Ussahawanitchakit and Boonlua, 2012). Ninlaphay et al. (2012) argue that organisational ability to adapt to internal control system in times of facing external or internal changes is crucial in determining whether the system fits the organisation, and is thus capable of promoting its effectiveness.

A specific proposition of contingency theory is that the dependent variable and two or more independent variables’ relationships are hypothesised and empirically tested (Drazin and Van de Ven, 1985; Badara, 2013). Organisational ability in adapting to internal control systems may be analysed by empirically testing the relationship of organisational contingencies (contingency characteristics and organisational culture) and the effectiveness of the system. In this study, components of contingency theory such as organisational structure, environmental factors and organisational culture will be utilised in explaining
organisational contingencies that could influence the effectiveness of internal control in cooperative organisations.

RESEARCH HYPOTHESES

Organisational Structure
Organisational structure fairly affects elements in internal control, which directly affects effectiveness of internal control and provides a base for the overall internal control system (Standards for Internal Control, New York State Government, 2007). Some of the line-up of organisational structure characteristics in an overview by Vroom (2002) are standardisation, differentiation and coordination, formalisation, centralisation, and configuration.

Otley (1980) states that a mechanistic structure (more centralised, vertically differentiated and formalised) will increase predictability of work behaviour by reducing variability, and thus may facilitate organisations’ internal control. It was later found in the results that organisational structure has a statistically significant positive effect on internal control effectiveness. Erserim (2012) on the other hand finds no significant relationship between centralisation and managerial accounting practices, but finds formalisation to have positive relationship with managerial accounting practices. Additionally, Jokipii (2009) finds no significant results for organisational structure towards internal control and its perceived effectiveness. Thus the following hypotheses are built:

H1a: There is a positive relationship between cooperative’s organisational structure (centralisation) and the effectiveness of internal control.

H1b: There is a positive relationship between cooperative’s organisational structure (formalisation) and the effectiveness of internal control.

Environmental Factors
Environment factors include forces outside organisation that could potentially affect performance (Robbins, 1998). As all environmental elements (i.e., government regulations and competitors) combine and conspire, an unpredictable environment will be produced to a lesser or greater extent (Lashley and Lee-Ross, 2003). Lashley and Lee-Ross (2003) also list some popular techniques in analysing environmental factors, such as SWOT analysis (strengths, weaknesses, opportunities and threats), PEST analysis (political, economic/environmental, social and technological factors) and mnemonics (all appropriate variables are considered).

Chenhall (2003) emphasises the external environment as a powerful contextual variable. Specific external risks may arise towards the industry within which the organisation operates (AICPA, 2006); for example, using technology to ensure efficient organisational operation, or political factors that may impact the organisation (Gupta, 2013; Mahara, 2013), having an impact on the effectiveness of internal control.

H2: There is a positive relationship between environmental factors and the effectiveness of internal control.

Organisational Culture
Organisational culture is a shared values, assumptions and beliefs that exist in the environment of an organisation, which produces a behavioural norm in solving problems (Schein, 1990; Owens, 1987) and guides behaviours within the organisation (Heris, 2014; Ahmad, 2012). Organisational culture influences behaviour and attitudes within an organisation, as it acts as a system of social control, and the values and beliefs that construct culture portray the organisational internal environment (Aycan, Kanugo and Sinha, 1999; MacIntosh and Doherty, 2010), making organisational culture an organisational contingency.

Previous research findings found a significant positive relationship between internal control, internal control effectiveness and organisational performance, and organisational
culture (Aydin and Ceylan 2009; Pfister, 2009). Aydin and Ceylan (2009) state that organisational commitment and employee satisfaction will aid in organisational effectiveness; for example, employee satisfaction will increase involvement in the organisation and thus facilitate organisational effectiveness.

Although reports on direct positive relationships between organisational culture and internal control effectiveness are fairly limited, large significant findings on organisational culture positive relationships with internal control and organisational performance have made the researcher’s point in discovering a relationship between organisational culture and internal control effectiveness relevant. Thus, the following hypothesis is constructed:  

**H3:** There is a positive relationship between organisational culture and the effectiveness of internal control.

**RESEARCH METHOD**

**Design and Research Instrument**

This paper employs quantitative methods by using a questionnaire adopted from prior literature on internal control effectiveness by Jokipii (2009). Questions were also adopted from prior literature on organisational culture by Aftab, Rana and Sarwar (2012). The questionnaires were prepared in booklets and were bilingual (in English and Bahasa Malaysia), and were distributed in both languages separately. The questionnaire was designed in four (4) sections. Section A covered demographic information of respondents: the gender, age and position in the cooperative organisation of each respondent. Section B required respondents to answer questions on the characteristics of cooperatives, namely the cooperatives’ years of operation, their organisational structure in terms of both centralisation and formalisation, and environmental factors.

Section C focused on the organisational culture of the organisation. The section consisted of 31 statements which explained four dimensions of organisational culture. As previously mentioned, these dimensions from Denison’s Framework of Organisational Culture comprise of four traits: involvement, consistency, adaptability and mission. Lastly, Section D consisted of statements that represent the effectiveness of internal control in the organisation. It was elaborated under three elements: operational efficiency and effectiveness, reliability of information and compliance with laws and regulations.

The questions of every section, except the demographic section, operational years and centralisation (organisational structure) section, were built on a four-point Likert Scale. The respondents needed to select their most appropriate responses to each statement: whether they strongly agreed (SA), agreed (A), disagreed (D) or strongly disagreed (SD). The questionnaire is included in the Appendix section.

**Participants and Procedures**

The targeted respondents for the study were the management of cooperatives, comprising of the cooperatives’ Board Members (Ahli Lembaga Koperasi), executives and non-executives, as the responsibility for internal control lies in each individual in the organisation (Pfister, 2009). Questionnaires were distributed by mail to the selected samples – the cooperatives listed in the Top 100 Cooperatives for the year 2014. Mail was addressed to respected cooperatives as this was the most effective way to reach the respondents and in an attempt to receive more valid responses to the questions. Out of 100 distributed questionnaires, 56 were returned by the respondent. The response rate was equal to 56%.

**RESULT OF THE ANALYSIS**

**Respondent Demographic**
Table 1: Descriptive Analysis of the Participants’ Demographic Factors

<table>
<thead>
<tr>
<th>No.</th>
<th>Item</th>
<th>Overall N = 56</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Frequency</td>
</tr>
<tr>
<td>1</td>
<td>Gender</td>
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<tr>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>66 years old and above</td>
</tr>
<tr>
<td>3</td>
<td>Position</td>
<td>Board Member (ALK)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Executive</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Non-executive</td>
</tr>
<tr>
<td>4</td>
<td>Cooperative Age Distribution</td>
<td>Up to 35 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>36 to 70 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td>71 years and above</td>
</tr>
<tr>
<td>5</td>
<td>Cooperative Region</td>
<td>Pahang</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Wilayah Persekutuan Kuala Lumpur</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Lumpur</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Johor</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Others</td>
</tr>
<tr>
<td>6</td>
<td>Cooperative Functions</td>
<td>Credit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Consumer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Agriculture</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Others</td>
</tr>
<tr>
<td>7</td>
<td>Total Assets of Cooperative – Average</td>
<td>RM 53,848,723</td>
</tr>
</tbody>
</table>

A total of 56 responses were received for analysis. Distribution of gender among respondents shows a total of 25 respondents were male and 31 respondents were female, which accumulated to 44.6% and 55.4% respectively. Despite indicating a balance gender distribution in cooperative organisations' management, a small gap in percentage between genders shows that there was equal willingness to support the study by responding to the questionnaires. Age distributions shows that most respondents were between the ages of 36 to 50, at a rate of 44.6%. The second highest age group were respondents aged up to 35 years old (at 33.9%). Additionally, respondents’ positions were assessed. The highest response rate was received from executives within cooperative organisations, which accumulated to 58.93% of total responses.

As also shown in the table, 44.6% of responses came from cooperatives established up to 35 years ago, which recorded the highest percentage, compared to 35.7% from cooperatives established 36 to 70 years ago and 19.6% from cooperatives established 71 years ago or more. Most responses came from cooperatives in Pahang (25% of total responses). The second and third highest response rates came from cooperatives in Wilayah Persekutuan Kuala Lumpur and Johor, at 23.2% and 17.9% respectively, while another 33.9% came from other regions or states. Credit cooperatives recorded the highest responses received among cooperative functions, with 41.1% of total responses. Consumer cooperatives and agriculture cooperatives recorded 25% and 12.5% respectively, while 21.4% came from cooperatives with other functions. The average total assets from all responses were recorded at RM 53,848,723.

Test of Hypotheses
To determine the relationship between the independent and dependent variables, multiple regression analysis was used. Hypothesis 1a examines whether there is a significant positive relationship between cooperative’s organisational structure (centralisation) and the effectiveness of internal control. The expectation is that the more centralised the organisational structure, the more improved the effectiveness of internal control. Based on regression analysis, the result in Table 2 shows that there is no significant influence between centralised organisational structure and effectiveness of internal control (t= -.310, p= .758). Even the direction of relationship is also negative; thus Hypothesis 1a is not supported. For Hypothesis 1b, it is claimed that a more formal organisational structure would eventually improve the effectiveness of internal control. Based on the results presented in Table 2, it is shown that there is a significant positive relationship between formalised corporate structures and the effectiveness of internal control (t=1.445, p=.155). Hence, Hypothesis 1b is supported. On the other hand, Hypothesis 2 is not supported, as the results in Table 2 show there is no significant positive relationship between environmental factors and the effectiveness of internal control (t=.464, p=.644). Meanwhile, Hypothesis 3 examines whether the organisational culture will significantly influence the effectiveness of internal control. It was expected that an increase in the organisational culture would significantly improve the effectiveness of internal control. Based on the results in Table 2, the proposition of Hypothesis 3 is supported, with a t-value equal to 2.442 and a p-value equal to.018.

With an R2 value of 0.400, cooperative age, formalisation, environmental factors and organisational culture shares 40.1% variance with internal control effectiveness. This indicates that the variation in internal control effectiveness can be explained by these variables. From the results, it can be concluded that the model can significantly predict the dependent variable (internal control effectiveness) at p<0.001 with F-ratio 6.680.

### Table 2: Multiple Linear Regression

<table>
<thead>
<tr>
<th></th>
<th>B</th>
<th>Std. Error</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Constant)</td>
<td>1.688</td>
<td>.381</td>
<td>4.436***</td>
<td>.000***</td>
</tr>
<tr>
<td>Centralisation (Structure)</td>
<td>-.014</td>
<td>.044</td>
<td>-.310</td>
<td>.758</td>
</tr>
<tr>
<td>Formalisation (Structure)</td>
<td>.099</td>
<td>.069</td>
<td>1.445*</td>
<td>.155*</td>
</tr>
<tr>
<td>Environmental Factors</td>
<td>.049</td>
<td>.106</td>
<td>.464</td>
<td>.644</td>
</tr>
<tr>
<td>Organisational Culture</td>
<td>.298</td>
<td>.122</td>
<td>2.442**</td>
<td>.018**</td>
</tr>
<tr>
<td>Cooperative Age</td>
<td>-.003</td>
<td>.017</td>
<td>-2.011**</td>
<td>.050**</td>
</tr>
</tbody>
</table>

\[
R = .633^a \\
R^2 = .400 \\
Adjusted R^2 = .341 \\
P = .000^a
\]

a. Predictors: (Constant), Organisational Culture, Cooperative Age, Formalisation, Centralisation, Environmental Factors

Notes: Significance is based on a two-tailed test; *** represents significant at .001 level, ** represents significant at .05 level and * represents significant at .10 level

**DISCUSSION AND CONCLUSION**

The practice of internal control within credit cooperatives is not fully implemented, although a high level of awareness was recorded in the responses. This was due to the cooperative management, which did not feel confident that there would be enough funds allocated for the implementation of internal control, or to acquire competent people to assist in its implementation. Additionally, it was found that, compared to non-performing cooperatives, performing cooperatives have larger time allocation for control activities, which also
indicates the importance of internal control effectiveness for cooperatives’ performance. All of this has raised questions on the cooperatives’ ability to implement effective internal control.

To determine whether the internal control system fits the organisation to promote effectiveness, organisations need to be able to adapt. The need for effective internal control may vary depending on each organisational context (Jokipi, 2009). Standardised internal control, such as COSO, also suggest that internal control effectiveness depends on organisational characteristics. The effectiveness of internal control is tested to be influenced by organisational characteristics (organisational structure, organisational culture) and also environmental factors. This could indicate that effectiveness of internal control relies heavily on these characteristics. Both organisation structures in terms of formalisation and organisational culture influence the effectiveness of internal control. This indicates that a more formal organisational structure, such as having formal written policies and procedures, will improve the effectiveness of internal control.

Formal organisational structure will work, perhaps by directing and informing the lower-level employees formally on the do’s and don’t’s that would direct the organisation towards more effective internal control. Over time, these formal organisational structures, which inform the tone from the top, would provide unique capabilities for cooperative to remain competitive in the market. On the other hand, the results also indicate that all four dimensions of organisational culture impact on cooperatives’ internal control effectiveness. For example, if cooperatives provide a culture of involvement, which makes the employees feel they are a part of the team and can see the importance of their work in achieving organisational goals, cooperatives could also improve their internal control effectiveness. Involvement serves as an important dimension in explaining commitment and capability development by employees (Ahmad, 2012). Similarly, a highly consistent culture will lead organisations to be effective (Davenport, 1993). Adaptability, culture and mission are also important within cooperatives to improve internal control effectiveness.

A major limitation to this study was the low response rate from the questionnaire survey via mail. Future studies may consider conducting interviews, as they may provide a better understanding of current views and practices of internal control and internal control effectiveness within cooperative organisations. Interviews may also provide deeper perceptions of cooperative organisations’ contingency characteristics, organisational culture and internal control effectiveness. Although previous studies of the relationship between these variables have been carried out primarily on profit organisations, when tested in the context of the cooperative, the results from this study could provide an avenue for more exploration in future on the factors that can influence the effectiveness of internal control. Additionally, the usage of the four-point Likert scale in this study might cause normality problems; it is recommended for future studies to expand the scale. Due to data limitations, exploration on types of cooperative that place great concern on internal control effectiveness cannot be done; future studies may therefore expand the research sample and obtain more information, so that comparisons between each cooperative function might be made. Despite the limitations, it is hoped this study will enhance the understanding of internal control and internal control effectiveness literatures, particularly for cooperatives in Malaysia.

ACKNOWLEDGEMENTS

The authors would like to convey their appreciation to the Ministry of Higher Education of Malaysia for providing the fundamental research grant to undertake this project. Appreciation also goes to the Faculty of Accountancy, the Accounting Research Institute (ARI) and the Institute of Research Management and Innovation (IRMI), Universiti Teknologi MARA, Malaysia for support in this study.
REFERENCES


THE JOINT INFLUENCE OF RELATIONSHIP MARKETING, SOCIAL PERFORMANCE MANAGEMENT AND FIRM CHARACTERISTICS ON CUSTOMER RETENTION BY MICRO-FINANCE INSTITUTIONS IN KENYA

STELLA NYONGESA¹, PROF FRANCIS KIBERA² AND PROF RUTH KIRAKA³

ABSTRACT
Relationship marketing is a widely recognised strategy used to influence a firm’s ability to retain customers for long-term business survival. However, customer retention continues to be the greatest challenge facing many businesses, implying there could be other factors affecting the outcome of relationship building efforts. In particular, a firm’s social performance is increasingly cited as key in influencing business survival, while firm characteristics are assumed to affect outcomes of relationship management. Empirical evidence explaining the nature of combined influence of these variables, however, is scanty. This research tests the hypothesis that the joint effect of relationship marketing, firm characteristics and social performance management on customer retention is statistically significant. Evidence from 55 microfinance institutions in Kenya support this hypothesis, although firm characteristics on their own were found to have minimal influence on customer retention. Social performance management is therefore a desirable practice for customer retention.

Key words: Relationship Marketing, Social performance management, Firm Characteristics, Customer retention

INTRODUCTION
The link between relationship marketing and customer retention is a well-studied topic in the field of marketing (Morgan and Hunt, 1994; Oly Ndubisi, 2007). The issue facing marketing scholars, therefore, is not whether relationship marketing leads to customer retention, but rather to understand and uncover other conditions under which the association between relationship marketing and customer retention may be affected (Ranaweera and Prabhu, 2003). One such condition is the role of social performance management in influencing business performance parameters. There is a developing body of literature on the importance of businesses embracing socially responsible practices (Husted, 2000; Dahlsrud, 2008, Waddock and Graves, 1997). According to Husted (2000), a firm’s social environment increasingly plays a critical role in business survival, while Waddock and Graves (1997) find a positive association between corporate social responsibility and corporate financial performance. The modern debate on the need for firms to be socially responsible was sparked off by Bowen (1953) when he argued that businesses have an obligation to design policies, make decisions and engage in actions which are desirable to stakeholders and wider society. Most businesses engage in corporate social responsibility programmes to show stakeholders their interests are taken care of, but it is equally important for monitoring how well a firm is fairing in this sphere. Corporate social performance management practices are thus the business’s framework comprising principles of social responsibility, processes, policies and programmes guiding its social responsiveness, and the observable outcomes of these actions.

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Within the microfinance sector, this practice is known by the term Social Performance Management (SPM). The aim of SPM is to aid microfinance institutions (MFIs) in monitoring their social performance because apart from pursuing financial goals, MFIs are expected to pursue social goals too and be efficient at both (Gutiérrez-Nieto, Serrano-Cinca and Mar Molinero, 2009).

Besides the increasing calls for firms to be socially reasonable, there is an emerging notion that firm characteristics (age, size, ownership structure, technology adoption) can promote a business’s efforts to build loyal customers because customers care about how well a company offers its products and services. According to Hoang, Igel, and Laosirihongthong (2010), the use of supporting activities like technology systems, experience in offering the product or service, employing a reasonable number of educated and skilled staff and extensive distribution coverage of business operations are vital to meeting customers’ needs and consequently to customer retention. For their part, Ryals and Payne (2001) posit that information technology is an important element in customer data management. They argue that a company’s ability to understand and respond to customers’ needs will depend on the type and amount of information held about customers. Appropriate relationship marketing strategies should thus include technology adoption tactics, because information technology enables a firm to determine the economics of customer acquisition, customer retention and lifetime value (Ryals and Payne, 2001).

Literature on relationship marketing and customer retention suggests that when a firm builds relationships characterised by trust, commitment, communication, strong bonds and keeping promises, the likelihood of customer defection is much lower (Morgan and Hunt, 1994; Ryals and Payne, 2001; Oly Ndubisi, 2007). Recently, however, this outcome seems to be less apparent. Despite the deployment of relationship marketing programmes, customer retention continues to be the greatest challenge facing marketers (Alrubaiee and Al-Nazer, 2010), suggesting there could other factors affecting the outcome of relationship building efforts.

This paper reports results from a study conducted to establish empirical linkages between relationship marketing, SPM practices, firm characteristics and customer retention.

LITERATURE REVIEW

The organisational function of marketing has undergone progressive changes from the traditional orientation of the production philosophy predominant in the 1920s, to the selling orientation (1930s), to the marketing orientation (1960s), and finally to the relationship marketing (RM) orientation that emerged in the 1980s (Grönroos, 1989; Gruen, 1997). The shift in marketing attitude and practice from transactional marketing (TM) to relationship marketing (RM) arose due to increased competition, more informed customers, technological advancements and the saturation and maturing of markets (Alrubaiee and Al-Nazer, 2010; Varki and Wong, 2003).

RM

Numerous definitions of RM exist, signifying the variety of opinions on what constitutes this concept (Harker, 1999). Although this term was first mentioned in a conference paper on service marketing by Berry (1983), it has since gone through a variety of conceptualisations by different authors, demonstrating the high level of scholarly interest in this practice (Harker, 1999). Berry (1995) defines RM as the process of attracting, maintaining and growing customer relations. Grönroos (2004) suggests it is “to identify and establish, maintain and enhance and when necessary also terminate relationships with customers and other stakeholders, at a profit, so that the objectives of all parties are met, and that this is done by a mutual exchange and fulfilment of promises.” On their part, Jagdish and Parvatiyar
(1995) describe RM as a long-term interactive relationship between the provider and the customer with the aim of long-term profitability. Harker (1999) undertook to analyse these diverse definitions in an attempt to construct a general definition of RM. This resulted in seven “conceptual categories” the term seemed to espouse – birth; development; maintenance; temporal nature; interaction; outputs; and emotional content. The author concluded that Grönroos’ (1994) definition was the best because all seven conceptual categories were captured. It is a general consensus, however, that relationships between businesses and their customers evolve through a series of stages.

Firm Characteristics

Existing literature on organisational characteristics (such as age, size and structure) and their influence on performance seems to suggest that these factors have a role they play (Cadogan and Diamantopoulos 1995; Majumdar, 1997). Cadogan and Diamantopoulos (1995) suggest that, as firms grow larger in size and become older and more experienced, the tendency to become bureaucratic and inflexible increases. Majumdar (1997) on the other hand sought to investigate whether larger firms are superior in performance to smaller firms (or vice versa), and whether older firms are superior in performance to younger firms (or vice versa). The author found that older firms are more productive but less profitable, while larger firms are more profitable but less productive. Zahra, Ireland and Hitt (2000) find that the age of a firm (number of years in operation) influences a firm’s profitability, while Hendricks and Singhal (2001) find that firm size is an important predictor for financial performance. However, other scholars have found that firm characteristics such as age and size do not influence firm performance. For instance, Thuo (2010) establishes that the age and size of a firm neither directly influences firm competitiveness, nor even moderates the relationship between customer relationship management and marketing productivity; while Njeru (2013) finds that the age and size of the firm are statistically insignificant. Such contradictory findings suggest that the role of firm characteristics in determining firm performance, especially with respect to customer retention, is not yet conclusive. Ryals and Payne (2001) posit that the success of RM depends on deployment of appropriate organisational infrastructure. The authors argue that the use of information technology enables a firm determine economics of customer acquisition, customer retention and lifetime value. On their part, Pearce (1997, cited in Ryals and Payne, 2001) reasons that customer retention strategies cannot be effective without the support of a suitable data infrastructure. Further, Grönroos (2004) explains that a shift towards the adoption of a RM approach tends to demand a number of changes to be effected by organisations, especially in transforming from old structures to modern structures, from manual operating systems to technology driven system, and from employees’ transactional attitudes to relationship-driven attitudes. A firm’s characteristics, therefore, seem important in influencing the ability of a firm to realise its relationship building objectives; but empirical evidence on their role in influencing the RM-customer retention association is sparse.

SPM

The stakeholder approach to managing business operations suggests that organisations have a variety of stakeholders whose interests must be met (Donaldson and Preston, 1995; Freeman and McVea, 1984). This explains why some organisations engage in social responsibility practices and strive to measure their social performance. Scholars of stakeholder management argue that managers must understand the concerns of shareholders, employees, customers, suppliers, lenders and society to develop objectives and strategies supported by their stakeholders (Donaldson and Preston, 1995a). This kind of management philosophy translates into the need for social performance management practices. According to Sinha (2006), SPM is a set of management practices consisting of processes, structures and strategies that get an to act in a socially responsible manner for improvement in clients’ welfare. For his part,
Simanowitz (2003) defines it as a set of institutional operations that enable institutions to realise their social mission. With respect to the microfinance sector, SPM is guided by a set of standards, known as Universal Standards for SPM (USSP), introduced by the Social Performance Task Force (SPTF) in 2008. There are six standards: the existence of a social mission; board member and employee commitment to social goals; the existence of client-friendly products; responsible treatment of clients, responsible treatment of employees; and balanced allocation of resources. Such standards were introduced in response to industry concerns that many MFIs were experiencing mission drift, a concept in microfinance which means an MFI’s migration away from their original mission of serving the poor and low-income clients to alleviate poverty in favour of serving higher income clients (Wardle, 2012). Despite the existence of SPM practices, which aim are to transform MFIs into socially responsible and customer oriented institutions (Wardle, 2012), many Kenyan MFIs do not seem to embrace social performance practices, thereby raising the question as to whether SPM plays any significant role in influencing an institution’s customer retention efforts.

**Customer Retention**

RM aims to attract and retain customers, but, while it is easy for firms to attract new customers, it is often harder to retain them (Ryals and Payne, 2001). Customer retention refers to the repeated buying of a product from the same company over a period of time (Ibok, George and Acha, 2012). It is demonstrated through a customer’s continuous maintenance of a business relationship with a firm, which results from a set of antecedents: customer satisfaction, customer delight, customer switching costs and customer relationship management. Reichheld and Sasser (1990) pioneered work on the link between customer retention and profitability, revealing that retaining customers has a powerful impact on a firm’s bottom line. The authors argued that the longer a firm maintains a relationship with customers, the more its profits rise – by almost 90% through retaining just 5% more of their customers. Ang and Buttle (2006) also assert that loyal customers tend to engage in higher volumes of purchase, coupled with providing the firm with higher customer referrals. In addition, retaining customers leads to lower operational costs, less price-sensitive customers and hence lower relationship maintenance costs and better financial performance (Churchill and Halpern, 2001; Ang and Buttle, 2006). However, according to Ryals and Payne (2001), although RM has the dual objectives of attracting and retaining customers, limited attention has been paid to monitoring customer retention. In the current era of hyper-competition coupled with ever-changing customer expectations, marketers have no choice but to be concerned with customer retention and eventually loyalty because developing loyal customers is considered the single most important driver of a firm’s long-term financial performance.

Although earlier studies recognise the effect of RM practices on customer retention, other dynamic forces with the potential to affect this relationship are not yet conclusive. In view of this literature review, this study hypothesises that: \( H_1 \): RM, combined with firm characteristics and SPM practices, has a statistically significant greater effect on customer retention.

**CONCEPTUAL MODEL**

Based on a review of existing theoretical and empirical literature, this led to operationalisation of the study variables as shown in the conceptual model (Figure 1).
RESEARCH METHOD

This section presents the research design adopted for this study, the population and sampling methods used, the validity and reliability tests and the data analysis techniques employed.

Research Design

This study adopted the positivism research paradigm because it sought to objectively establish facts by empirically establishing the nature of relationships between the study variables. Using descriptive cross-sectional survey design, the target population was 55 MFIs in Kenya. The microfinance sector was deliberately chosen because it comprises institutions with varying characteristics; in addition, the nature of competition in the industry compels firms to adopt RM to survive. The study targeted employees and customers selected using non-probability sampling, specifically purposive sampling for the employees and convenience sampling for the customers. Total sample size of for employees was 55 while 554 customers were targeted. Primary data was collected using two structured questionnaires (employees and customers). Questionnaire items were developed based on existing literature (Morgan and Hunt, 1994; Wetzels et al., 1998; Oly Ndubisi, 2007; Sin et al., 2002; and Leverin and Lijander, 2006). Prior to data collection, respondents were assured of confidentiality and anonymity.

Validity and Reliability

The internal consistency Cronbach’s Alpha (α), which ranges from 0 to 1, is a coefficient that reflects how well the measurement items correlate to one another. Different authors recommend different cut-off points for reliability (Gliem and Gliem, 2003; Cooper and Schindler, 2006; Asikhia, 2009). This study thus adopted a cut-off Cronbach value of 0.7. Using SPSS version 17, validity and reliability tests were performed and alpha coefficients for all the variables were above the 0.7 threshold. Face-to-face and content validity were tested for to determine the extent to which the instruments were accurate and meaningful.

Figure 5: The Conceptual Model

Source: Researcher
RESULTS
Responses were received from 48 managers and 492 customers, representing a response rate of 87.3% and 88.8% respectively. Of the questionnaires, 22 were discarded for lack of consistency and completeness. Descriptive statistics were obtained from the data collected and a summary of the variables according to the two groups of respondents’ perception are presented in this section. The questions were framed on a five-point Likert scale type, ranging from not at all (1) to a very large extent (5); or strongly disagree (1) to strongly agree (5).
Table 1 presents a summary of descriptive statistics of RM, firm characteristics, social performance and customer retention.

<table>
<thead>
<tr>
<th>Table 1: Descriptive Summary of Study Variables</th>
</tr>
</thead>
<tbody>
<tr>
<td>RM (employees)</td>
</tr>
<tr>
<td>Trust</td>
</tr>
<tr>
<td>Commitment</td>
</tr>
<tr>
<td>Communication</td>
</tr>
<tr>
<td>Keeping promises</td>
</tr>
<tr>
<td>Relationship bonds</td>
</tr>
<tr>
<td>Shared values</td>
</tr>
<tr>
<td><strong>MEAN SCORE</strong></td>
</tr>
</tbody>
</table>

| RM (customers) | N | Mean | Std. Deviation | CV (%) |
| Trust | 492 | 3.965 | 1.086 | 27 |
| Commitment | 492 | 3.359 | 1.390 | 42 |
| Communication | 492 | 3.421 | 1.013 | 31 |
| Keeping promises | 492 | 3.802 | 1.223 | 32 |
| Relationship bonds | 492 | 3.373 | 1.278 | 38 |
| **MEAN SCORE** | 492 | 3.581 | 1.223 | 34 |

| FC (employees) | N | Mean | Std. Deviation | CV (%) |
| IT platforms | 48 | 3.262 | 1.180 | 38 |
| CRM actions | 48 | 4.036 | 1.169 | 27 |
| **MEAN SCORE** | 48 | 3.649 | 1.175 | 33 |

| SPM (employees) | N | Mean | Std. Deviation | CV (%) |
| Social mission statement | 48 | 4.655 | 0.506 | 11 |
| Board members commitment | 48 | 3.965 | 0.714 | 18 |
| **MEAN SCORE** | 48 | 4.210 | 0.873 | 17 |

| SPM (customers) | N | Mean | Std. Deviation | CV (%) |
| Client-friendly products/services | 490 | 3.606 | 1.412 | 40 |
| Responsible treatment of clients | 488 | 3.829 | 1.266 | 33 |
| **MEAN SCORE** | 489 | 3.718 | 1.339 | 37 |

| CR attributes | N | Mean | Std. Deviation | CV (%) |
| CR according to employees | 48 | 3.888 | 0.7889 | 21 |
| CR according to customers | 488 | 3.243 | 1.1834 | 37 |
| **MEAN SCORE** | 268 | 3.566 | 0.986 | 29 |

| Likelihood of customers to terminate relationship with the firm | N | Mean | Std. Deviation | CV (%) |
| Termination (according to employees) | 48 | 2.438 | 0.749 | 31 |
| Termination (according to customers) | 488 | 2.147 | 1.367 | 64 |
| **MEAN SCORE** | 268 | 2.293 | 1.058 | 48 |

Source: Primary Data, 2017

Overall mean score for RM according to employees was 4.289, SD=1.033 and CV=18%, whereas that score according to customers was mean=3.581, SD=1.223 and CV=34%. Findings suggest that, although employees profess strong relationships with their
customers, the customers’ perception on this aspect is moderate. Regarding firm characteristics, results show most firms (41.67%) have been in operation for between 1 and 10 years, with 1-20 branches countrywide, and are owned by investors; however, adoption of technology platforms and CRM actions have only been carried out to a moderate extent, as shown by the mean score=3.649, SD=1.175 and CV=33%. SPM practice attributes (according to employees) had a mean of 4.21, SD=0.873 and CV=17% while according to the customers they had a mean=3.718, SD=1.339 and CV=37%, suggesting that, while employees believed their institutions were socially responsive to customers and other stakeholders, the customers did not agree. Customer retention (according to employees and customers) registered a mean of 3.566, SD=0.986 and CV=29%. Further, the mean score of the likelihood of customers to terminate their relationship with the firm (according to employees and customers) was 2.293, SD=1.058 and CV=48%. These results imply there is a moderate likelihood of MFIs retaining their customers in the short term. This should be worrisome for MFIs because their long-term survival depends on the existence of a solid base of loyal customers who are willing to remain with the firm over a long-term period.

Regression and Hypothesis Testing

Using multiple regression analysis, this research sought to test the hypothesis that RM, combined with firm characteristics and SPM practices, have a statistically significant effect on customer retention. The results are presented in Table 2.

### Table 2: Regression Results of the Individual and Joint Effect of the Variables

<table>
<thead>
<tr>
<th>Model</th>
<th>RM, SPM</th>
<th>R</th>
<th>R square</th>
<th>Adjusted R square</th>
<th>Std. error of the estimate</th>
</tr>
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<tr>
<td>1</td>
<td>RM</td>
<td>.585*</td>
<td>.342</td>
<td>.340</td>
<td>.38402</td>
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<tr>
<td>2</td>
<td>Joint:</td>
<td>.830</td>
<td>.688</td>
<td>.668</td>
<td>.39410</td>
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(a) ANOVA

<table>
<thead>
<tr>
<th>Model</th>
<th>RM, SPM</th>
<th>Sum of squares</th>
<th>df</th>
<th>Mean square</th>
<th>F</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
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<td>RM</td>
<td>Regression</td>
<td>37.526</td>
<td>1</td>
<td>37.526</td>
<td>254.469</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Residual</td>
<td>72.260</td>
<td>490</td>
<td>.147</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Total</td>
<td>109.786</td>
<td>491</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Joint:</td>
<td>Regression</td>
<td>116.116</td>
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<td>5.372</td>
<td>34.586</td>
</tr>
<tr>
<td></td>
<td>RM, SPM</td>
<td>Residual</td>
<td>107.300</td>
<td>487</td>
<td>.155</td>
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<tr>
<td></td>
<td></td>
<td>Total</td>
<td>223.416</td>
<td>490</td>
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</table>

<table>
<thead>
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<th>(Constant)</th>
<th>Unstandardised coefficients</th>
<th>Standardised coefficients</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
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<tr>
<td>1</td>
<td></td>
<td>B</td>
<td>Std. Error</td>
<td>Beta</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(Constant)</td>
<td>1.335</td>
<td>.108</td>
<td></td>
<td>12.333</td>
</tr>
<tr>
<td></td>
<td>Relationship marketing</td>
<td>.473</td>
<td>.030</td>
<td>.585</td>
<td>15.952</td>
</tr>
<tr>
<td>2</td>
<td>(Constant)</td>
<td>1.656</td>
<td>.596</td>
<td>-2.778</td>
<td>.008</td>
</tr>
<tr>
<td></td>
<td>RM</td>
<td>.741</td>
<td>.188</td>
<td>.383</td>
<td>3.933</td>
</tr>
<tr>
<td></td>
<td>Firm characteristics</td>
<td>.188</td>
<td>.125</td>
<td>.174</td>
<td>7.100</td>
</tr>
<tr>
<td></td>
<td>Social performance</td>
<td>.820</td>
<td>.145</td>
<td>.803</td>
<td>.830</td>
</tr>
</tbody>
</table>

Predictors: (Constant), RM, Firm characteristics, SPM practices; Dependent Variable: Customer Retention

Source: Primary Data, 2017
The simple regression results show that, individually, the influence of RM on customer retention is significant ($R^2=0.342$, $F=254.46$, $P<0.05$), implying that RM explains 34.2% of variation in customer retention ($P < 0.05$, $F=254.46$). The coefficient $\beta$ is also significant ($\beta = 0.473$, $t=15.952$, $P < 0.05$), suggesting that when RM changes by 1%, it leads to a 47.3% change in customer retention. However, to test for the joint effects, multiple regression analysis was employed to establish the combined influence of RM, firm characteristics and SPM on customer retention. Results show that the joint influence of these three variables on customer retention is significant and greater ($R^2=0.688$, $F=34.586$, $P<0.05$) than the individual effects of RM on customer retention ($R^2=0.342$, $F=254.46$, $P<0.05$). This implies that (jointly) RM, firm characteristics and SPM explain 68.8% of variation in customer retention, while the remaining 31.2% is explained by other factors not considered in the study. The $F$ ratio shows that the regression of RM, firm characteristics and SPM on customer retention is statistically significant at $P < 0.05$. Therefore, RM, SPM practices and firm characteristics have a significant joint influence on customer retention and hence can jointly be used to predict customer retention. Based on the results, the hypothesis that RM (combined with firm characteristics and SPM practices) has a statistically significant effect on customer retention is accepted, and the regression model for the hypothesis was fitted as follows: the original model: $Y_0 = \beta_0 + \beta_1 \text{RM} + \beta_2 \text{FC} + \beta_3 \text{SPM} + \epsilon$; the new model: $Y = 1.656 + 0.741\text{RM} + 0.188\text{FC} + 0.820\text{SPM}$

Where: $Y =$ Customer retention; $\text{RM} =$ RM; $\text{FC} =$ Firm characteristics; $\text{SPM} =$ SPM practices; $\epsilon =$ error term

**DISCUSSION**

Several existing studies show that RM and customer retention are associated (Morgan and Hunt, 1994; Bowen and Chen, 2001, Ang and Buttle, 2006; Henning-Thurau et al., 2002, Wetzels et al., 1998). However, an interesting angle this study sought to take was to determine the joint effect of a set of variables (RM, firm characteristics and SPM) on customer retention. Oly Ndubisi (2007) and Sin et al. (2002) recommended research into such factors, which the authors opined may either strengthen or weaken the association between RM and customer retention. This study sought to address this gap by establishing the nature of joint effect between all four variables. The results show that the joint effect of RM, firm characteristics and SPM on customer retention is superior. SPM had the largest contribution to customer retention ($\beta = 0.820$, $t=8.30$, $P<0.05$), followed by RM ($\beta = 0.741$, $t=3.933$, $P<0.05$), while firm characteristics had the lowest contribution to customer retention ($\beta = 0.188$, $t=7.100$, $P<0.05$). Such results indicate that SPM and RM are both strong predictors of customer retention, implying that, as firms embrace RM activities, they need to combine these with social performance practices to retain customers better.

**CONCLUSION**

The study investigated the joint effect of RM, firm characteristics and SPM on the customer retention and found this effect strong, positive and statistically significant. This suggests that if MFIs embrace all three initiatives, their influence on customer retention will be stronger than the individual effect of each. Consequently, RM and SPM are vital strategies for customer retention, whereas firm characteristics (information technology and customer relationship management actions) need to be combined with other initiatives to boost customer retention. Therefore, the success of MFIs in an increasingly competitive financial services sector requires a combination of strategies that focus not only on relationship management, but also on social responsibility and innovative technological platforms to improve customer retention levels for long-term sustainability.

**REFERENCES**


THE DETERMINANTS OF EMERGING AND DEVELOPED MARKET MNE OUTWARD FDI: A COMPARATIVE ANALYSIS OF MALAYSIAN AND SINGAPOREAN MNES

NORLIA MOHD ZAIN

ABSTRACT
Since early 1960s, the basic long-term pattern of FDI from industrialised multinational enterprises (MNEs) has become a foundation for traditional theories of FDI and MNEs. However, the rise of outward FDI from emerging economies’ (EMNEs) particularly from East Asia, such as China and India, has raised many interesting questions, such as how do Asian MNEs differ from developed economies’ (DMNEs) in their internationalisation, decisions and behaviour? Given that comparative studies on EMNEs, particularly from different South-East Asian countries, is limited, it is the central objective of this paper to examine and analyse the differences and similarities in the geographical patterns of outward FDI from Malaysia (EMNEs) and Singapore (DMNEs). This study measures the direction and impact of institutional effects, economic development factors and MNEs’ special ownership advantages on the location choice and underlying motivations of their outward FDI at two digits industry classification of NACE code.

Keywords: Multinational enterprise (MNEs), Outward FDI (OFDI), industry-level analysis.

INTRODUCTION
Since the early 1980s, substantial progress toward the removal of cross-border restrictions on international capital flows and the trend towards an integrated world economy have increased the growth of foreign direct investment (FDI) activity (Doukas and Lang, 2003). Globalisation has been widely recognised for the past several decade as being driven by the multinational enterprises (MNEs) of developed nations (Buckley et al., 2014). In the voluminous literature on FDI and MNEs from developed countries, a strand of the literature focuses on the phenomenon of increasing outward FDI (OFDI) from emerging market MNEs (EMMNEs), and this has become one of the “big questions” of the 21st century International Business research agenda (Mathews, 2006). Bhaumik and Driffield (2011) highlight that total OFDI stock by EMMNEs recorded a 107% increase within a decade, from $72 billion in 1980 to $149 billion in 1990, then to over $1 trillion by the end of 2005. As illustrated in Figure 1, in 2013, the outward stock from developing countries was $5 trillion, or 19% of the worldwide flow of FDI (United Nations Conference on Trade and Development (UNCTAD)).
Two motivations drive the current research. The first is the phenomenal growth of MNEs from East Asian countries such as Korea, Taiwan, Singapore and Malaysia. While the extant literature on EMMNEs focuses on major global players from BRICS countries, this study will make a comparative analysis of Malaysia and Singapore. Second, the dominating theories of FDI postulate that MNEs must possess ownership advantages before they invest abroad, but in most cases EMMNEs that are successful on the global stage do not possess the competitive advantages that developed country MNEs might (Ramasamy et al., 2012). Thus, they tend to undertake OFDI to acquire the strategic assets they lack (Child and Rodrigues, 2005; Luo and Tung, 2007). This research aims to add to the existing literature by analysing home and host country institutional and economic development effects, as well as the special ownership advantage of the MNE itself. This will be accomplished by examining the activities of Malaysian and Singaporean MNEs in their first foreign destination, and also by looking at how they engage with the activities of their affiliates in further direct investment enterprises. A direct investment enterprise is an enterprise resident in one economy and in which an investor resident in another economy owns (either directly or indirectly) 10% or more of its voting power if it is incorporated, or the equivalent for an unincorporated enterprise (OECD, 2009).

Malaysian companies have been investing abroad since the mid-1970s, but Malaysian OFDI became significant in the early 1990s with the completion of the GATT/WTO Uruguay Round in 1994 and the formation of the ASEAN Free Trade Area (AFTA) in 1992 (Ariff and Lopez, 2008). According to Yean (2007), after recovering from the 1985 economic crisis, Malaysia seeks to explore non-traditional markets. The former Prime Minister, Tun Mahathir Mohamad, encouraged Malaysian firms to invest in the south to reduce the country’s dependence on the United States, Japan and Europe. One of the initiatives was his business trip to Chile, Brazil and Argentina in 1991. Other than that, the Malaysian South-South Association (MASSA) was formed to promote trade and investment with South-South countries in 1991. As depicted in Figure 2, outflows grew to USD $0.35 billion in 1991 and tripled to USD$1.19 billion in 1993. These outflows reveal a general upward trend, with the exception of some moderation in 1997 and 2001. However, it dropped substantially to USD...
$3.4 billion in 2003 before escalating threefold to USD $9.74 billion in 2004. In 2007, the volume of Malaysia’s OFDI was reported at USD $11.3 billion, surpassing the value of inward FDI (USD $8.5 billion). The upward trend for OFDI continued until 2013 at USD $13.6, while inward FDI remained lower at USD $12.3 billion (UNCTAD).

**Figure 2: Malaysia’s FDI 1970–2013—-inward and outward (millions of dollars)**

The specific objectives of this study are to investigate key issues on the push and pull factors in the home and host countries, and the importance of their influence on the OFDI of EMMNEs. It will focus on, first, the institutional quality in the home and host country that influence Malaysian MNEs (MMNEs) and Singaporean MNEs (SMNEs) in their overseas expansion; and second, the economic development indicators in home and host country that attract MMNEs and SMNEs undertaking their outward investment. This research aims to explain the motivation for MMNEs and SMNEs investing abroad, and to design and construct a model incorporating home and host institutional and economic development determinants. It will also propose policy recommendations (and define their implications to policymakers) for home country institutions and the decision makers of EMMNEs to make feasible location choices for their OFDI. Despite the fact that literature on the success of EMMNEs has grown considerably, a consensus has not yet been reached to fully understand the behaviour and dynamics of MNEs from Asia and other developing countries (Sim, 2012). Sim (2012) examined the internationalisation characteristics and strategies of MNEs from Malaysia, Singapore and Taiwan using empirical data from six matched case studies at two different level of economic development based on the Investment Development Path (IDP). The IDP relates the net outward investment of a country to its stage of economic development (Dunning and Narula, 1996). While there have been comparative analyses of several emerging countries, there have been no comparative studies conducted using large firm level data at different level of economies engage by the foreign affiliates. Hence, this comparative research between Malaysian and Singaporean MNEs will fill an empirical gap and provide a better and more comprehensive understanding of Asian MNEs, as well as of EMMNEs in general.

Given that comparative study on EMNEs is limited, particularly from different South-East Asian countries, it is the central objective of this chapter to examine and analyse the differences and similarities in the geographical patterns of outward FDI from Malaysia (an
emerging economy representing EMNEs) and Singapore (a newly industrialised economy representing DMNEs). Malaysia and Singapore are both South East Asian countries that have a similar cultural and historical past, and are both geographically proximate. The Federation of Malaya, formerly a British Colony, became independent on 31 August 1957. Eight years later, on 16 September 1963, Malaysia was formed, which included the territories of the Federation of Malaya, Singapore, Sabah (formerly British North Borneo) and Sarawak. However, when Singapore separated from Malaysia in 1965, it sought foreign investment in the early stages of its development to overcome the disadvantages of having a small domestic market and limited natural resources (Liang, 2005). In terms of economic development, Singapore is now a more advanced economy, categorised as a Newly Industrialised Country (NICs) along with Korea and Taiwan. In contrast, Malaysia is a fast developing country. In terms of income level, regardless of having a population five times smaller than that of Malaysia (Malaysia has a population of 29.7 million; Singapore’s is 5.4 million), Singapore’s GDP per capita is five times higher than that of Malaysia (Malaysia’s is $10,538, Singapore’s $55,182). In general, Singaporean MNEs are more internationalised (consistent with stage three of IDP) than the Malaysian MNEs, which are at stage two (Sim, 2012). Figure 3 provides a comparison between the inward FDI (IFDI) and OFDI stock of Malaysia and Singapore.

Figure 3: Malaysia and Singapore inward and outward FDI stock, 1980–2013 (millions of dollars)

This study contributes to the literature by exploring the phenomenon of OFDI from Malaysia and Singapore in terms of their unique behaviours in international expansion, motivations, strategies and location choice. A further point is that, in most cases, EMMNEs do not conform to the traditional view of MNEs (Bhaumik and Driffield, 2011). Thus, from observations and gaps in the OFDI literature, this study adopts a more comprehensive approach by incorporating general theories of FDI with institutional factors and economic developments indicators in the extension of the model.

In terms of methodology, this study explores the OFDI from Malaysian and Singaporean MNEs using a large firm level dataset to investigate the activities of MNEs at the foreign affiliate’s level and their next destination of OFDI in other countries using an OECD guideline (OECD, 2009). However, the OECD’s definition of FDI is not sufficient because it does not exclude the activities of holding companies in tax havens and offshore financial centres. Thus, this study excludes holding companies for each level of direct investment and those investments that return to home countries. Numerous recent literature uses official data to measure the FDI outflow (either stock or flow) that ignores tax havens
issues and activities of holding companies in tax heavens destination such as Hong Kong, the Cayman Islands, the British Virgin Islands and other places such as Luxembourg and the Netherlands. This official data suffers from the “round-tripping” FDI problem that involves investment holding companies undertaking investment abroad, which did not represent real economic activity (Buckley et al., 2013; Sutherland and Ning, 2011; Ning and Sutherland, 2012; Yao and Sutherland, 2009). The dataset is obtained from a novel firm-level database, the Bureau van Dijk’s (BvD) Orbis, to obtain a viable population of investing companies. The Bureau v. Dijk database (Amadeus for Europe and Orbis for the World) is a useful source of secondary data, as this data has the appeal that comparisons of Malaysian OFDI vis-a-vis other countries can be undertaken, as comparative analysis strengthens this type of work. Simultaneously, the research provides recommendations to policy makers and MNEs to identify new outward FDI opportunities in other feasible destinations and sectors.

The findings of this paper suggest that there is a need to extend the extant theories of FDI, particularly when the OFDI of firms from developing countries like Malaysia and Singapore are brought into the equation. The findings of this paper are that Malaysian and Singaporean OFDI behaviour can be explained by three major attributes: institutional factors, economic development indicators and the special ownership advantages of the firms. More specifically, the results indicate that Malaysian MNEs are most likely to establish their operation in neighbouring countries if the quality of government system and administrative procedure is void at home, rather than choosing OECD and Rest of the World region far from home with a dissimilar culture and complex administrative rules and regulations. This finding supports the Stages Model that that MNEs are more likely to invest in those countries with similar cultures and psychic distance (Johanson and Vahlne, 1977; Johanson and Vahlne, 2009). In contrast, separately from the independent variables, Singaporean MNEs are more likely to invest in the OECD region compared to Malaysian MNEs.

THE GENERAL THEORY OF FDI

Several dominant theories exist on the development and motivation of FDI that are relevant in explaining OFDI activities, but most are related to firms from advanced countries. Buckley and Casson (1976) were the first to formalise various streams of thought into a coherent theory of MNEs. This theory postulates that firms will invest abroad if the benefits of exploiting firm competitive advantages outweigh the relative costs of the operations. Dunning (1979) brings together internalisation theory and traditional trade economics to create the eclectic paradigm of FDI. In the MNE theory, FDI was explained by identifying three types of special advantages MNEs have: the ownership, location and internalisation (OLI) advantages. Firms will internationalise when they have ownership advantages (patents, technical knowledge, management skills and reputation) to be exploited abroad in a location that offers lower transaction cost (I advantage). According to Buckley et al. (2007), the OLI paradigm also suggests a location choice aspect, in that MNEs undertake OFDI based on three main motivations: market-seeking, efficiency-seeking for cost reduction, and resource seeking (including strategic-asset-seeking FDI).

Rugman (1981) developed the matrix of firm specific advantages–country specific advantages (FSA–CSA) at the MNE level, which underlines the company’s motivations for investing abroad first to exploit its FSA, such as a company’s property, technologies, knowledge, and managerial or marketing abilities; and, further, to benefit from host country advantages such as natural resources, labour force, cultural factors, tariff and non-tariff barriers and public policies. Another general theory of FDI is the Stages model, which identifies geographic distance for firm internationalisation. Johanson and Vahlne (1977) postulate that firms start to internationalise in markets close to the home market in psychic distance terms, gradually entering markets further away and choosing low risk entry modes,
later increasing their commitment to better exploit the market potential. This process involves a concept of liability of foreignness (LOF) that explains why foreign firms need to possess FSAs to offset the liability.

As the general theory of FDI has been built largely on the experience of industrialised country investors, there are inevitably questions over whether these theories can be readily applied to emerging market investors (Buckley et al., 2007). According to Hennart (2012), the argument surrounding the theory that can explain EMMNEs is divided into three camps. The first IB scholars invoked the OLI model, believing that EMMNEs will not be successful in investment abroad owing to the absence of a strong FSA; their current foreign investment are ill advised and will not survive for long term. A second group of researchers agree that EMMNEs invest abroad regardless of whether or not they possess FSAs, which indicates that the OLI model is unable to explain EMMNEs and should be replaced by a specific theory applicable to EMMNEs (Mathews, 2006). Another group argues that the OLI model must be extended because EMMNEs possess unconventional types of FSAs that are not included in the model (Cuervo-Cazurra, 2012; Ramamurti, 2009; Ramamurti, 2012).

WHY ARE EMMNES DIFFERENT?
An emerging market is often characterised by poorly developed institutions in terms of social, political, geographic, economic factors, as well as regulation, which have been termed institutional voids (Khanna and Palepu, 1997). However, this disadvantage has become an advantage to the EMMNEs, as it gives them initial FSAs to operate in difficult environment in local, which they reinforce later in foreign investment (Ramamurti, 2009; Ramamurti, 2012). EMMNEs are often capable of turning these disadvantages into advantages when they embark on foreign investment (Cuervo-Cazurra and Genc, 2008). Moreover, Madhok and Keyhani (2012) argue that EMMNEs need theoretical advancement, contrary to the extant IB literature, to answer the question of how to make the most of what they have to create advantage. In their study, they introduce the concept of Liability of Emergingness (LOE), which is incurred due to national environments that suffers from underdeveloped markets, unsophisticated customers, weak suppliers, infrastructure bottlenecks and many other institutional voids. To overcome the LOE, EMMNEs undertake outward internationalisation through acquisition in advanced economies. Acquisition of firms from advanced countries makes it possible for EMMNEs to acquire the brand or world class image in one quick step, thus overcoming the “less than world class” image that comes from LOE.

Child and Rodrigues (2005) argue that the internationalisation of Chinese firms is significantly impacted by institutional factors because they receive large amount of support from the government. Many developing countries are characterised by a heavy institutional and political involvement in their business system. Thus, Child and Rodrigues (2005) have suggested that international business theory needs to take the role of government into account in developing and transitional countries. A few studies discuss government involvement in emerging market OFDI. For instance, Luo and Tung (2007) mention home government encouragement for “springboard”, particularly via state-owned enterprises (SOEs), while these MNEs are still being subject to home government influence due to fact that their governments are usually the largest shareholders. Hennart (2012) also discusses complementary local resources (CLRs) such as land and natural resources, which are monopolised by the government and only available to local firms.

Buckley et al. (2007) utilise the general theory of FDI in their study of Chinese OFDI, incorporating three special explanations of capital market imperfections, special ownership advantages and institutional factors. One of the common institutional voids related to emerging market is an underdeveloped capital market. However, Buckley et al. (2007) find
that the Chinese MNEs have transformed the disadvantage of operating in market imperfections into ownership advantages, whereby the state-owned firms provide capital at below market rates to the Chinese MNEs, soft loans granted to potential outward investors due to inefficient banking systems, role of business group to raise capital for their foreign affiliates due to inefficient internal capital market and cheap capital from family members. In their study, Buckley et al. (2007) also recognise that the dark side of government involvement includes high levels of bureaucratic engagement and burdensome administrative FDI approval procedures, because the government will often control the amount, direction and scope of outward capital flows. Similarly, Luo and Tung (2007) mention that SOEs receiving greater institutional support and government underwriting also face higher bureaucratic and political intervention.

Building on extant theories and previous research, six hypotheses are proposed:

H1: Government effectiveness of the home and host country is associated positively with the location choice of Malaysian and Singaporean MNEs in undertaking OFDI.

H2: Economic development of the home and host country is associated positively with the location choice of Malaysian and Singaporean MNEs in undertaking OFDI.

H3: The size of the firm is associated positively with the location choice of Malaysian and Singaporean MNEs in undertaking OFDI.

H4: The age (experience) of the firm is associated positively with the location choice of Malaysian and Singaporean MNEs in undertaking OFDI.

H5: The type of ownership (stated-owned or private firm) is associated positively with the location choice of Malaysian and Singaporean MNEs in undertaking OFDI.

H6: The type of industry determines the motivation of Malaysian and Singaporean MNEs in undertaking OFDI.

METHODOLOGY

The base model estimates the probability of the firm $i$ investing in different regions according to determinant variables using multinomial logistic regression. The location of OFDI is classified into four main regions in this analysis based on political regions, namely ASEAN countries, other Asian countries, OECD countries and the rest of the world. The explanatory variables are classified into three groups as summarised in Table 1.

Table 1: Explanatory Variables

<table>
<thead>
<tr>
<th>Firm level data</th>
<th>Governance index</th>
<th>Economic development</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age of the company</td>
<td>Voice and accountability</td>
<td>GDP growth</td>
</tr>
<tr>
<td>Size</td>
<td>Political stability</td>
<td>GDP per capita</td>
</tr>
<tr>
<td>Industry</td>
<td>Government effectiveness</td>
<td>Population</td>
</tr>
<tr>
<td>State ownership</td>
<td>Regulatory quality</td>
<td>Host patent</td>
</tr>
<tr>
<td></td>
<td>Rule of law</td>
<td>Skilled labour</td>
</tr>
<tr>
<td></td>
<td>Control of corruption</td>
<td>Natural resources</td>
</tr>
</tbody>
</table>

Source: Bureau Van Dijk Orbis, The Worldwide Governance Indicators (WDI) and World Development Indicator (WDI) database.
The four destination groups where chosen after considering different regions according to distance, political relations and the results from estimations. All the independent variables were also considered, but for governance stability and economic indicators the best approach was to estimate factor analysis to identify relationships between the variables. The reason for this was to measure the institutional and economic indicators, which proxied by governance and technology and to avoid the problem of multicollinearity. Based on factor analysis regression, two factors where developed: a governance factor and a technology factor. A multinominal regression was estimated using the selected-developed independent variables, identifying differences between Malaysia and Singapore through composite dummies for Singapore.

RESULTS AND DISCUSSION

To check the level of influence of each determinant, this study calculates the marginal effect associated with the multinomial logistic regressions as illustrated in Table 2. Overall, the marginal effect results indicate that large Malaysian and Singaporean MNEs are both more likely to invest in ASEAN countries than small or medium-sized firms. There are significant and strong results by industry. Each of the industries deserves a particular analysis. A substitution effect appears to exist between other Asian and OECD countries. Government stability appears to favour the investments in OECD countries and to avoid investments in other Asian countries. It is interesting to note that the technology-seeking motivation is more attractive in other Asian countries and diminishes the probability of investing in OECD. Apart from the Information and Communication industry, Malaysian and Singaporean MNEs seem to be indifferent about investments in the rest of the world. In contrast, Singaporean MNEs show strong significant regional differences in the probabilities of investing abroad compared to Malaysia. Singaporean MNEs seem to be less affected by the size of the company than Malaysian MNEs. In contrast to Malaysian MNEs, Singaporean firms are less sensitive to investments in the Information and Communication industry. Overall results prove that state-owned Singaporean MNEs tend to favour investments in OECD countries. Separately from the independent variables, Singaporean MNEs are more alike to invest in the OECD than Malaysian MNEs. Parsimony of the model is tested using joint test regression for the Singaporean firm composite dummy for all the explanatory variables, as shown in Table 3.

Table 2: Marginal effects per variable
Table 3: Parsimony of the model: joint-test results for the Singapore composite dummy

<table>
<thead>
<tr>
<th>Joint-test variable</th>
<th>chi2</th>
<th>Prob &gt; chi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td>13.08</td>
<td>0.0003</td>
</tr>
<tr>
<td>Size</td>
<td>6.42</td>
<td>0.0113</td>
</tr>
<tr>
<td>Industry</td>
<td>1.62</td>
<td>0.2027</td>
</tr>
<tr>
<td>SOE</td>
<td>9.75</td>
<td>0.0018</td>
</tr>
<tr>
<td>Governance and Technology</td>
<td>3.5</td>
<td>0.0613</td>
</tr>
<tr>
<td>Overall Model</td>
<td>4.61</td>
<td>0.0317</td>
</tr>
</tbody>
</table>

*, ** and *** indicate significance level at 10%, 5% and 1% respectively

CONCLUSION

The Malaysian government could provide more incentives, facilities and promotional activities for small and medium MNEs to invest in the ASEAN region. The financial support for small and medium-sized firms would encourage more outward FDI to neighbouring countries and support the regional agreement for ASEAN. The budget for 2007 announced an increase in the paid-up capital of the EXIM Bank by USD $0.5 billion by the government to enhance the bank’s role in providing financing for domestic companies investing abroad, and the setting up of a USD $25 million Overseas Investment Fund to finance the start-up costs of domestic companies doing business overseas; these measures will be sufficient for this purpose. For the corporate sector, opportunities beyond national borders are abundant and overseas investment would be increasingly regarded as an important strategy to maximise company’s total growth in terms of revenue, profit and export market share. Manufacturing, wholesale, information and communication industries could provide a large network and diaspora/ethnic to local firms to invest abroad. This is supported by Goh (2011), who mentions that Malaysia’s economy is in the transition from stage three to stage four of the
investment development path (IDP) as the nation has embarked on a higher level of economic development, with domestic firms building up ownership advantages and expanding their operations abroad. With competitive pressure from globalisation and increasing trade openness within the country, Malaysian firms have to respond to these challenges, either by relocating their production activities in the host countries to gain competitive/cost advantage and to expand markets, or by moving upstream to achieve higher value added and total factor productivity in the home country. Furthermore, Kueh et al. (2008) mention that the time frame for achieving the next stage can be shorter if Malaysia particularly (and ASEAN members generally) make the transition from a paternalistic top-down governance structure to a pluralistic market economy structure. Malaysia should also grab the opportunity from the emergence of fast-growing economies like India and China in the world market. For example, by locating production in China’s low labour costs, Malaysia can gain a competitive advantage in terms of price and therefore be able to compete and survive in the challenging market.

BRIEF BIOGRAPHY
Norlia Mohd Zain is a PhD candidate in Economics at Durham University Business School (UK). A piece of her work was presented at the 42nd Academy of International Business, United Kingdom and Ireland Conference 2015, the largest chapter of the worldwide AIB hosted by Manchester University. Another chapter of her work was presented at the 2016 International Academic Conferences on Business and Economics, at Harvard Faculty Club, Harvard University, Boston, USA. Her research has looked at, among other things, how the institutions and technology of home and host countries could influence the location choice and motivation of MNEs towards FDI activities.

REFERENCES


THE ROLE OF GOVERNANCE, RISK AND COMPLIANCE IN SUCCESSFUL PORTFOLIO PROJECT MANAGEMENT

SAIF SAEED ALQUBAISI

ABSTRACT

Governance, Risk and Compliance (GRC) are methodologies that are used for the betterment of corporate decisions, both tactical and strategical. They will also directly affect the corporate capacity to acquire an exhaustive comprehension of their risk. Without a genuine comprehension of the considerable number of risks it confronts, the corporation cannot settle on solid vital and strategic choices that push supportable cost efficiencies, quicken execution and drive gainful development. Overseeing risks in a project is achieved through the portfolio methodology, which encourages conformity and the reallocation of assets among tasks and takes into account extra portfolio risks and interdependencies between risks. In the field of business today, the success of the project depends on early and aggressive risk identification activities. It primarily depends on collaboration and coordination of the related stakeholders. An integrated approach is used to effectively mitigate and anticipate the risk, which can have a critical impact on the project.

Governance is another element that has become popular in recent years, especially after the fall of big business giants globally. Efficient governance allows the timely identification of possible risks and the related remedies. Corporate governance focuses on developing and establishing a decision-making architecture from the upper level to the front line that aims to strengthen the business model and maximise the performance, eliminate risk and contribute to project value. The ultimate goal is to ensure accountability, timely disclosure of the information and authority. Research shows that corporate governance is equally important for the internal and external stakeholders. Achieving a certain level of sustainable compliance is considered a primary goal of the business, and leaders are required to unveil new and unprecedented methods for reducing costs, improving business performance, and strengthening the decision making process. In short, in a competitive and fast-paced business, success depends on attaining the balance between risk and opportunities, and this is becoming more complex with time with the number, budget and scope of programmes, and projects.

The concept and application of portfolio management has gained attention in this regard. It is a process of holistically looking across different process, analysing the strategic alignment and return on investment of portfolios. It is a systematic process of opting for the right programmes and projects for the corporate strategy. It translates and applies the strategic vision to the individual projects, leading to a greatest potential efficiency. GRC integrates isolated projects and programmes in an efficient and effective business-wide way with a control structure to ensure that strategic initiatives align with the risk management process. Therefore, it is a branch of management targeted to attain a balance between the competing demands of stakeholders, regulators, market forces and customers. Portfolio GRC enjoys a fundamental importance in the world of business and its success for government. This research aims to develop a relationship between GRC and portfolio management, which will facilitate the entity in strategically aligning the resources and processes in the government sector.

Keywords: Governance, Risk and Compliance, Portfolio GRC, Portfolio Management

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INTRODUCTION

Over the years, the adoption of portfolio project management (PPM) has experienced significant growth in a variety of disciplines with the aim of ensuring that tasks are aligned to diverse sectors and departments (Kaiser, 2015). Notably, the continuously elevating economic requirements to reduce time to market indicates that projects such as these are not conducted individually and are always meant to satisfy a larger scope of priorities. Given that interrelationships in various business environments have led to a rise in the number of projects undertaken together within government, there has been an increase in the need for GRC on the running portfolio, programme and projects. The combination of these aspects has led to model results from projects conducted by various organisation and government departments across the globe (Patanakul, 2012; Badewi, 2016). Irrespective of the increased adoption of suitable PPM and GRC in the management of various projects, the value arising from such projects is subject to scrutiny through case studies, which have concluded that most projects are not conducted to end within the specified time frame and budget, leading to the delivery of incomplete reports (Teller and Kock, 2013). As a consequence, there are disconnects between existing projects that are misaligned or managed as a single project. As a result of this, government and enterprise project governance and compliance officers have endeavoured to develop structured ways to manage multiple projects in a manner that maximises value addition in the project activities. Further on, the integration of GRC, in accompaniment with PPM, in the management of various projects has enhanced the alignment of enterprise and government projects with the critical strategies that form part of the approval and initiating processes.

Recently, the awareness of the need for GRC as part of the portfolio has increased in specifically governmental entities due to the strategic importance of the programmes and the requirement to align the projects with government aims and strategic objectives, as well as in corporate GRC. Government representatives and senior management have to ensure that they are able to capture the risks facing them and their project, and government should have the resources to handle any obstacles facing them and convert the obstacles to corporate value. However, project governance and risk can always be indicated on the project level, but still cannot be indicated at the programme level and portfolio (Neckowicz et al., 2015). For effective corporate operations, corporate strategy, portfolio, programme and project strategy need interaction (Mayer et al., 2015). Activities of business alignment along the integrations of project governance and the associations among process and structure are the main requirements of having portfolio GRC.

Many of the objectives under strategic planning are not achieved due to the differences between the implemented strategic planning in reality and the corporate objectives (Killen et al., 2015). To transform the planning into real action, corporations have to be more effective in their ability (El Kharbili, 2012). Batenburg et al. (2014) similarly found that articulating strategies by corporations is easier than executing strategy in practice. Hence, the defined strategic objectives and plans have to be transformed into action plans as well as into completed projects. Corporations on specific governmental entities are not capable to have visibility on their programmes and projects within their portfolio, which leads to lack of proper selection and prioritisation of projects. Nor are they able to execute the projects in a cohesive and consistent way to reach planed corporate objectives, which set obstacles in the way of executive management and stakeholders.

In this paper, the gap in the literature concerning project governance, risk and compliance is examined, as the alignment of Project GRC (PGRC) with corporate GRC is significant for success. The initial literature review conducted in the area of PGRC reveals the lack of significant literature in this area and the absence of clarity on the measurements and markers with a specific end goal and which are used to assess the quality, risk,
governance and compliance. This paper presents a detailed review of GRC and PPM and the impact creation through their combination as PGRC. PPM rotates around the current practice of management of projects, giving rise to guidelines for monitoring projects being carried out across the country to bring about effective management of the government risk exposure, which is critical to financial sustainability as well as forming an integral part of governance risk compliance.

PPM
The concept of project management and its development can be traced back to a report published by the UK institution of Civil Engineers. It discussed post-World War II national development and drew attention to the need for a systematic approach, with a planned breakdown of activities to achieve fixed objectives. In the literature, a project is described in many ways; for example, it can be described as “a temporary endeavour to create a unique product, service or result” (PMI, 2013). Before the emergence of portfolios, there existed programmes. The term “programme management” has been defined in the literature in various ways; however, most definitions refer to the coordinated management of a collection of interrelated projects (Sarbazhosseini et al., 2014). The importance of programme management in organising both potential and approved projects and activities and presenting an integrated approach to project management has often been discussed in the academic literature (Jonas et al., 2013). This approach analyses the needs of working with high-priority objectives to support the implementation of the corporate strategy, at the same time increasing the visibility of the important projects at higher management levels and prioritising those with the highest potential for stakeholder value maximisation.

In PPM, a distinction between three elements – collaboration, foresight and risk management - is observed, as per the project management theory (PMI, 2013). While they are noted as to be closely linked, they are nevertheless distinct. PPM is noted as a broad concept with a series of processes that lead to selection, prioritisation and allocation of resources for multiple projects (at independent level) and programmes (PMI, 2013; Voss and Kock, 2013). In PPM, there are few main components that define its importance and hence, the framework of operation (Kaiser et al., 2015; Yang et al., 2014). These components include strategy, governance, processes and methods. Strategic alignment is crucial for the successful management of a project portfolio. They emerge from the mission, vision and objectives of the organisation. Governance in PPM is targeted to distribute responsibility among various members (i.e. internal and external) that are involved in decision-making (Alneyadi and Ali, 2014).

Key factors affecting the success of PPM
PPM as a process is executed many times in a year by matching it to business type, organisational size and the culture followed by the management (Heagney, 2016). The aim is to translate strategy into initiative, to identify programmes and projects, to optimise the portfolio followed by its approval and to identify risks and suggest remedial strategies for them (Kerzner, 2013).
The success of PPM is associated with its stages of implementation. At the initiation stage, a poor link between the strategy and the objectives affects the overall implementation, as seen in Figure 1 (Heising, 2012). Strategic initiatives within PPM are collectible programmes and projects that lead to attaining specific performance objectives through a vision (Martinsuo, 2013) and act as competencies at a cross-functional level. Similarly, boosting the economic value of new initiatives improves the performance of projects and programmes required to be defined at a high level (Bakar and Yusof, 2016). Setting their scope increases the chances of success, but this needs to be undertaken as a phased approach with an emphasis on risk (Lerch and Spieth, 2013). Setting strategy, the role of the decision-making framework and its formulation leads to optimised portfolio and enhanced economic value creation (Aubry and Hobbs, 2011; Patanakul and Shenhar, 2012). A point to note is that the framework differs based on the geography as well as the business sector of the organisation.

PPM and its success, as attributed by literature in the past, has been linked to management approach in terms of optimisation of the portfolio (Kaiser, Arbi and Ahlemann, 2015; Aubry and Hobbs, 2011). It raises concerns about the need to continue projects found to be low in economic value and emphasised on its termination in order to align with the overall strategy (Klingebiel and Rammer, 2014). It is a part of the risk alignment achieved through effective decision-making formulation. On the other hand, the success of PPM can also be linked to its execution, as found by Aubry and Hobbs (2011), achieved through the review of projects and programmes in terms of risk. By bringing in corrective measures, risks can be controlled with due attention given by the management towards high risk factors (Teller, Kock, and Gemünden, 2014). This requires a holistic approach with a centralised view on risk management and portfolio management, with a collaboration between risk monitoring and decision-making. The implementation of PPM, as per the literature, is also linked to the differentiation of risk activities through a top-down versus bottom-up approach.

**Figure 6: Key Factors Governing the Success of PPM (Kerzner, 2013)**
With similarities in portfolio management, risk management in enterprises can be efficient in managing operational, legal, financial and compliance-related risks with the output derived in the form of an audit plan (Costantino et al., 2015; Eggers, 2012). This enables effective management of risks in PPM, while bringing together risk intelligence with decision-making, optimising the overall portfolio (Kaiser et al., 2015).

**INTEGRATION OF GRC IN PPM**

Increasing business complexity, regulations and accountability have led organisations to focus on initiatives related to risk, compliance and governance (Samra, 2016; Vicente and da Silva, 2011). With existing interdependent risks and shared controls, the initiatives taken to control and manage such risks enhance effectiveness, as seen in Figure 2 (Racz et al., 2011). However, there is also a risk of duplication triggered from risk initiatives that work in corporate compliance creating uncontrolled costs (Bhagat, 2012). In organisations, governance exists in various forms, ranging from policy development and enterprise risk management to compliance through regulations and business performance review. The process of governance is interlinked with risk management, which allows firms to identify, measure and prioritise risks for effective control through strategic orientation (Larcker and Tayan, 2015). On the other hand, compliance brings in overall management of risk and governance through the policy setup and process obligations, which are in turn an essential part of the overall corporate strategy (Butler and McGovern, 2012).

![Figure 7: Key areas of challenge in PPM (Costantino et al., 2015; Kim et al., 2011)](image)

Over the past few years, the emergence of an integrated approach to GRC has been observed with each feature overlapping with the other, creating a comprehensive system for corporate management (Lama and Anderson, 2015; Bhagat, 2012). Large-scale organisations that have overlapping systems and departments face the issue of duplication, leading to conflicts and delayed decision-making (Nissen and Marekffia, 2014; McClean et al., 2009). Through an integrated GRC, corporate systems have the power to handle a multiplicity of governances, risks and compliance initiatives together (Kim et al., 2011). This brings changes to the organisation in the form of a single solution without altering the overall corporate strategy of the company in dealing with compliance and risk management, and in line with multiple regulatory conditions (Larcker and Tayan, 2015). The challenges of PPM are elaborated in Table 1.

<table>
<thead>
<tr>
<th>Challenges of PPM</th>
<th>Risks associated with PPM</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strategy</strong></td>
<td></td>
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<tr>
<td>Misalignment of the portfolio with strategy</td>
<td>Failure to meet the strategic goals</td>
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<tr>
<td>Multiple overlapping projects with single driver at project level</td>
<td>Reduced (delayed) performance</td>
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<tr>
<td>Poor prioritisation of projects and project goals</td>
<td>Additional costs due to delays</td>
</tr>
<tr>
<td><strong>Governance</strong></td>
<td></td>
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<tr>
<td>Low priority towards low performing projects</td>
<td>Resource misallocation</td>
</tr>
<tr>
<td>Lack of scrutiny in developing unrealistic benefits</td>
<td>Delay in meeting deadlines</td>
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<tr>
<td>PPM extending beyond the portfolio</td>
<td>Poor strategy deployment</td>
</tr>
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</table>
Mismanagement of delivery of projects due to poor sequencing

<table>
<thead>
<tr>
<th>Management</th>
<th>Poor expertise of PPM management</th>
<th>Poor decision-making</th>
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<tbody>
<tr>
<td></td>
<td>Poor prioritisation of PPM skills/experience</td>
<td>Poor delivery and delays</td>
</tr>
<tr>
<td></td>
<td>Poor organisation capacity to achieve change absorption</td>
<td>Inconsistencies in execution</td>
</tr>
<tr>
<td></td>
<td>Tools for portfolio data management</td>
<td>Increased costs and low quality</td>
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<tr>
<td></td>
<td>Portfolio reporting</td>
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</tbody>
</table>

**Table 1: Challenges and risks associated with PPM**

With consideration towards the commercial, regulatory and philosophical elements that impact a firm’s performance, an integrated GRC approach brings in effective control on incident management and failure of risk management (Eggers, 2012). The merit of an integrated GRC system for an organisation is primarily clarity on the processes to be followed to achieve the desired result without complications (Hardy and Leonard, 2011). Today, the core GRC components and their platforms are provided by the vendors, and they are then configured to fit into the diverse GRC solutions of individual firms. In a multi-project business environment, firms understand that adopting proper portfolio management is a means by which there can be an overall performance improvement, cost cutting, risk reduction and increased return on investment (Costantino et al., 2015; Eggers, 2012). A successful strategy towards PPM should have the ability to direct the businesses from the very first step of project selection up to its execution (Neckowicz et al., 2015; Khameneh, Sobhiyah and Hosseini, 2016). It reflects the need for a GRC model that can play a crucial role in imposing accountability, aiding in cross-functional alignment as well as making sure that issues are worked upon by the decision-makers.

**Integrating Governance in PPM**

The need for robust governance always exists to achieve a successful and efficient portfolio management (Too and Weaver, 2014; Mosavi, 2014). The existence of proper governance will assist the corporate performance management office (PMO) to attain a better alignment with goals and business strategy, followed by an increasing project success rate and return on investment on a portfolio (Racz et al., 2011). In PPM, the integration of governance is found to link to a few important benefits, including issue escalation and developing a culture of accountability (Crowther and Aras, 2013). Issue escalation assists PPM managers in identifying the stakeholders (decision-makers) and communicating the issues with them for quick remediation. They are required to identify the dependencies in the form of HR, process or tools and to incorporate them into a resolution within a specific time period (Nissen and Marekfia, 2013; Racz et al., 2011). On the other hand, governance in PPM allows development of a culture of accountability, wherein the performance goals are aligned to the business values and hence form the success criteria for PPM success (Lama and Anderson, 2015; Bhagat, 2012).

The integration of governance in PPM enhances the role of communications and also the cross-functional coordination within the teams (Racz, Weippl and Bonazzi, 2011; Asnar and Massacci, 2011). The strategy for communication must be developed by portfolio leaders for ensuring accountability within the company culture, thereby improving its overall performance. The strategy should present clear goals, and a vision and mission related to PPM with centralised communication plans to meet stakeholder needs (Larcker and Tayan, 2015). Cross-functional coordination in PPM requires alignment of the portfolio with the PMO, attained through the establishment of strong regulations and a portfolio charter (Mosavi, 2014). It also forms the base for gap assessments performed by the PPM leaders, comprehending the future state and the essentials to meet the portfolio and corporate objectives. In PPM, the role of governance is linked with the process automation and alignment of the calendar with the process goals. Effective governance in PPM conveys the policies automatically by making use of standardised communication tools such as
SharePoint. Similarly, aligning the objectives through a calendar allows rhythm-building in PPM, thereby overcoming delays and reducing complications in project tasks and overall planning (Schäfer et al., 2012).

<table>
<thead>
<tr>
<th>Governance integration in PPM</th>
<th>Benefit</th>
<th>Sources</th>
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<tbody>
<tr>
<td>Issue escalation</td>
<td>Allows recognition of escalation dependencies like tools, processes and human resources, followed by incorporation of predictability and repeatability</td>
<td>(Too and Weaver, 2014; Mosavi, 2014)</td>
</tr>
<tr>
<td>Culture of accountability</td>
<td>Aligning of objectives with performance goals to bring business value in line with success criteria of the portfolio</td>
<td>(Larcker and Tayan, 2015; Schäfer et al., 2012)</td>
</tr>
<tr>
<td>The role of communications</td>
<td>Communication plan developed by portfolio leaders for ensuring accountability within the company culture</td>
<td>(Mosavi, 2014; Bhagat, 2012)</td>
</tr>
<tr>
<td>Cross-functional coordination</td>
<td>Achieving cross functional coordination with PMO through establishment of strong portfolio regulations and a charter for portfolio management</td>
<td>(Mosavi, 2014; Bhagat, 2012)</td>
</tr>
<tr>
<td>Calendar alignment</td>
<td>Alignment of management aspects in PPM and their recognition at all levels of the portfolio</td>
<td>(Larcker and Tayan, 2015; Too and Weaver, 2014)</td>
</tr>
<tr>
<td>Process automation</td>
<td>Conveying the policies automatically through standardised communication tools that are updated on a regular basis</td>
<td>(Mosavi, 2014; Schäfer et al., 2012)</td>
</tr>
</tbody>
</table>

**Table 2: Benefits of integrating governance in PPM**

**Integrating Risk in PPM**

Given the market demands and the competitive landscape of businesses, the need to stay competitive while meeting the corporate goals is highly necessary (Mayer et al., 2015; Nissen and Marekia, 2013). For a single risk project, compliance is vital with the factors of time, cost and the level of quality as the main objectives. However, in PPM, choosing the right projects within portfolios and managing them with effective alignment and balance is necessary for overall success (Gozman and Currie, 2015). While the interrelation qualities of projects between portfolios are favourable, they also pose certain risks, apart from single project risks (Hilson, 2016). The structure of the hierarchy at the corporate level must be aligned with the portfolio level, and any failure in this can lead to the risk of information loss, delay and excessive costs (Kendrick, 2015).

To reduce the risks of PPM, a portfolio-wide approach is suggested that encompasses resource allocation and its adjustment to meet project requirements (Kendrick, 2015; Mayer et al., 2015). Given the probability of new risks arising from the portfolio and the existence of interdependences, risk management in PPM should be undertaken at three levels – at the project, programme and portfolio level (Kerzner, 2013; Thamhain, 2013). Such an approach has the potential to lower risk and reduce duplication, leading to enhanced efficiency and accuracy. It also introduces transparency to the PPM process through the identification of the key transfersences that have failed between interconnected projects. A well-developed risk approach in PPM allows provision of recovery from risks, improves decision-making and focus on objectives, and enhances the overall performance of the decision-making process (Thamhain, 2013). It boosts the success rate of the process significantly while taking control of various contingent operations that negate the risk factor. This includes contingencies in the form of uncertainty, complexity and portfolio type (Teller, 2013).

The need for risk management in PPM also arises from the fact that there are differences in risk management in project and portfolio (Drennan et al., 2014). The performance of risk management in finding and eliminating risks at project level is higher than at portfolio level (Thamhain, 2013). Risk management in PPM requires a more holistic
view, given the low availability of research on the application of risk management to portfolios and the complexities that exist in identifying risks (Kim et al., 2011). Another point to note is the lack of literature on the integration of risk management process within PPM (Drennan et al., 2014; Vicente and da Silva, 2011). While the importance of risk management in portfolios is widely understood by organisations, there are complications in linking it with strategic objectives and its influence on the risk management cycle of individual projects and programmes (Nissen and Marekfia, 2013). Hence, there is a need for an effective risk management process for PPM that transcends project-level risk management, eliminating interdependencies in projects and thereby portfolios. Such a process will allow knowledge exchange across the portfolio and increase the chance of success (Sanchez et al., 2008).

**Integrating Compliance in PPM**

In PPM, managing compliance is a challenging task, given the need to comply with multiple laws (locally and internationally), the diverse lines of business and the existence of multinational business operations (El Kharbili, 2012). It is highly essential that businesses undertaking PPM understand the intensity of “what aspects the business needs to comply with.” More importantly, it is about “how to make people take accountability” (Mitchel and Switzer, 2009; Bhagat, 2012). The process of PPM compliance encompasses a four-step approach that initiates the identification of the legal, statutory, contractual and regulatory obligations faced by the business (Abdullah et al., 2016). This includes requirement analysis and deviation analysis, leading to deficiency management and reportingcum documentation (Tricker and Tricker, 2015). This four-step approach to compliance management is a standard framework that allows firms to build a control system internally (Parker and Nielson, 2011; Mayer et al., 2015). Compliance in PPM is undertaken through audit, security checks and self-assessments, with the examination frequency varying from one channel to the other. (Mayer et al., 2015; Racz et al., 2010).

In PPM, assurance of achieving the set of objectives on reporting and compliance reliability is achieved through an effective integrated GRC model (Ele and Ola, 2016; Gozman and Currie, 2015). Compliance is hence considered a vital aspect of the GRC model in PPM, which allows compliance with laws and regulations externally and integrates various categories of the system for compliance and reporting review (Abdullah et al., 2016; Batenburg et al., 2014). A weak point in a standard compliance management framework is its poor integration with risk management, as there are no risks identified for non-compliance (Nissen and Marekfia, 2013). An integrated GRC in PPM should consider the alignment of compliance with risk management to enable a compliance approach based on the risk of non-compliance (Parker and Nielson, 2011; El Kharbili, 2012).

To achieve a successful compliance model while in integration with the other elements of GRC, companies are required to focus on delineating policies and framework for compliance and to checking compliance health (Ramezani et al., 2011). Along with the above, companies should also focus on preparing checklists, enabling automatic tools and ensuring provision of regular updates on the compliance process (Bhagat, 2012; Ettredge et al., 2011). Enabling compliance processes in companies with elements of governance and risk is a complex process. As identified by Lama and Anderson (2015), there are two main procedures to adhere to. The first procedure is setting up the conditions for the procedures, work and infrastructure, along with the statutory records (Schäfer et al., 2012), later classified into policies and process (Asnar and Massacci, 2011). The second procedure covers licensing, returns, payments and registration, among other aspects (Vicente and da Silva, 2011b). Companies also need to focus on enforcing compliance at the employee level, with a team delegated to monitor, review and manage compliance status and reports (Racz et al., 2010; Vicente and da Silva, 2011a).
CONCLUSION

The PPM concept and the integration of governance, risk and compliance is both challenging and intriguing. While there is extensive literature on PPM and GRC, there is not much literature in the field of PGRC, reflecting a need for further probing into this unique concept and its application in the government and private sectors. Notwithstanding the effect of GRC on the concept of PPM, it can be said that each concept has the potential to offer unique benefits to the other, while achieving effective management of risks across various levels. Most importantly, PGRC has the potential to bring PPM into alignment with the strategic vision and objectives, thereby enhanced decision-making, effective control on redundancies and improving the overall performance.

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