

# The Legitimacy of Profit of Microlending Institutions and Women's Empowerment: A Case Study from Jordan

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## SUMMARY

*The aim of this paper is to investigate the impact of the profitability policy of microlending institutions on women's social empowerment in specific aspects (education, health, and social status). Data were collected from 385 women-led microenterprises in Jordan. The dependent variable will be social empowerment measured by education, health, and social status. Descriptive analysis and regression analysis findings revealed there is no impact of profitability policy on women's level of education, social status and the whole dimension of social empowerment. However, there is a positive effect of profitability on women's health. This paper gives recommendations to policy makers to reformulate the current profitability policy to further support the global goal of women empowerment, and reflect the microcredit ideology.*

*Keywords: social enterprises, women's empowerment, microlending, Jordan*

*Journal of Economic Literature (JEL) codes: A13, C35, D12, O53*

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## INTRODUCTION

The popularity of microfinance stems from neo-liberal ideology, mainly the aim to dampen resistance to financial sector liberalization and economic austerity policies at the community level (Keating et al. 2010). In Jordan, the microfinance sector is conceived as an integral part of the national financial system (Policy Framework for Microfinance 2011). The industry includes organizations structured as quasi-governmental organizations, non-profit companies, for-profit companies and financial institutions. The largest microfinance providers are registered as non-profit companies (Sanabel Microfinance Industry Profile 2009). Since mid-2013 the Central Bank of Jordan has taken the lead in regulation and supervision of the microfinance sector in line with international best practices towards comprehensive financial inclusion (Betz & Frewer 2016).

A study by Chowdhury (2009) showed that the formal sector financial institutions leave out poor people through requirements for collateral, credit rationing, and preference for high-income clients. Apart from the government's provision of directed, subsidized credit, the operating environment of Jordan is relatively conducive to commercial microfinance operations. For example, no

interest rate restrictions are imposed on microfinance institutions, and government disbursement of subsidized credit has substantially declined in recent years. MFI's can access wholesale funds at market-based interest rates. Also, there are several reliable local providers of microfinance technical assistance and training. MFI's in Jordan are diversifying their funding base, financing their portfolio with a mix of debt and equity. Credit is obtained from local banks and international microfinance investment vehicles from the Development and Employment Fund (DEF). However, the capital-to-asset ratio is close to 50%, compared to a global median of 23%, shows a continued reliance on donated equity to finance operations. MFIs have been able to cover the cost of their debt funding through their pricing policies (Policy Framework for Microfinance 2011).

Recently some women in Jordan have been arrested because of their inability to repay the loan; this leads to increase the vulnerability of families and consequently diverges away from the mission of microfinance. Many questions were raised regarding whether the profits of lending institutions are a means to an end or an end in themselves. High interest rates forced more than half of female borrowers to use savings for payments and spend the initial loan on immediate needs, such as utilities and healthcare, rather than on what it was intended for. Many

women experienced shame for their apparent failure and deferred loan management to their husbands (Ward 2014). In this study, I choose to focus on not-for-profit micro-lending institutions because the commercial industry is different in its target group and objectives.

In an earlier paper (Al-Maaitah 2019) I investigated the impact of microfinance policies practiced at lending institutions on women's empowerment focusing on their policies on lending, profitability, monitoring and following up as their non-credit policy. I found that all policies have a positive impact on women's empowerment except for the profitability policy, which shows no impact on women's empowerment. From this point of departure, the current study aims to thoroughly figure out the reasons and rationalizations behind the result that profitability has no effect on the social dimension of women's empowerment; in addition the paper will provide recommendations to decision makers to avoid mission drift in the credit market. This study will answer the following questions:

#### **Research questions:**

1. To what extent do profitability practices of micro-lending institutions help to empower women socially?
2. To what extent do profitability practices of micro-lending institutions enhance the social status of women entrepreneurs?
3. To what extent do profitability practices of micro-lending institutions improve the level of education of women entrepreneurs?
4. To what extent profitability practices of micro-lending institutions enhance the health status of women entrepreneurs?
5. To what extent do micro-lending institutions profitability practices contradict women's social empowerment?

## **LITERATURE REVIEW**

### *Microfinance and Social Mission*

The term 'micro-finance' refers to small-scale financial services, primarily credit and savings to economically active low-income clients to produce goods and provide services. Some microfinance institutions (MFIs) provide other financial services such as micro-money transfer and micro-insurance, social mediation such as the development of social capital through group formation, training in financial and enterprise management and development of management capabilities (Aheeyar 2007). Thus, the idea behind microfinance is that the poor are able to work their way out of the poverty cycle through entrepreneurship and by obtaining the initial capital necessary to start a business (de Oliveira Crevelari 2017).

Recently the impact of microfinance has been questioned, and many studies argue that the impact of microfinance is divergent, reported to have positive impact, no impact and even negative impact (Angelucci et al. 2012; Rooyen et al. 2012; Ganlea et al. 2015). The impact of microfinance works differently from one context to another depending on the population density, attitudes to debt, group cohesion, enterprise development, financial literacy and financial service providers (Armendáriz 2005 as cited in Al-Shami et al. 2015). A large number of studies suggest that micro-finance has significant impact on poverty reduction and household well-being at different levels such as asset acquisition, household nutrition, health, food security, children's education, women's empowerment, and social cohesion (Hashemiet al. 1996; Armendáriz & Morduch 2000; Littlefield et al. 2003; Roodman & Morduch 2009). In the meantime, the recent negative media coverage of microfinance has concerned allegations of MFIs using coercive lending techniques and aggressive loan recovery practices (Priyadarshree & Ghalib, 2012). According to Littlefield et al. (2003) when MFI's focus on making profits by serving better-off clients at the expense of poorer customers in order to fulfil capital adequacy requirements, then a trade-off exists between financial sustainability<sup>1</sup> and the social mission of MFI's, and we refer to this trade-off as "mission drift". Moreover, Armendáriz & Morduch (2000) refer to the conflict between outreach to the unbanked versus sustainability as "microfinance schism", claiming that institutions move away from their primary objective of serving the poor because of rushing to become financially self-sustainable too quickly.

Further, the little bargaining power of the poor and the growing commercialization movement could mean higher microcredit interest rates (Strøm et al. 2014). A study by Roberts (2013) indicates that the higher effective interest rates charged for profit organization do not lead to higher profitability and therefore sustainability because these variables are also associated with increases in the major elements of an MFI's costs. The most crucial component of the interest rate is the cost structure (Rosenberg et al., 2009). Other major components include the gender of borrowers (D'espallier et al. 2013), the profit status of the MFI (Roberts 2013), the competition (McIntosh & Wydick 2005; Cull et al., 2015), and the country-specific macroeconomic and macro-institutional elements (Hartarska 2005). However, Augsburg & Fouillet (2010) showed that the practices of microfinance institutions intended to reach financial sustainability include low-interest rates (cost-covering) and high repayment rates so that the organization's portfolio remains secure. Augsburg & Fouillet point out that the repayment rate or the rate of investment returns do not tell us anything about the quality of services delivered to microfinance clients.

<sup>1</sup> Financially sustainable MFIs are those that are covering more than 100% of their operational and financial costs and generating a net income without support subsidies (<https://mop.gov.jo/echobusv3.0/SystemAssets/24092014/The%20Jordanian%20National%20Policy.pdf>)

Most MFIs are looking for high numbers of loans and payments, with equal attention being paid to the possibilities for profit and the minimization of potential loss (Adeel et al. 2013). Due to high transaction costs, with rates of 24-36%, it is common practice in microfinance to use a flat interest rate rather than the Annual Percentage Rate (APR), or effective interest rate, as is the banking standard in the developed world. Flat interest refers to charging interest on the full original loan amount, rather than on the declining balance (Augsburg & Fouillet 2010). According to Kling & Rudner (1996), in a market of extremely high transaction costs interest rate should cover costs but not be so high that institutions can be compared with money lenders, who are often portrayed as coldly preying upon their cultivator clients, luring them further and further into debt, and finally sucking them dry of surplus, savings, property, and liberty.

Microlenders have two kinds of operating costs: personnel and administrative. Often personnel costs are high because micro lending is still a labour-intensive operation. Administrative costs consist mainly of rent, utility charges, transport, office supplies and depreciation of fixed assets. Making and recovering small loans is also costly on a per unit basis (Fernando 2006). However, a minimalist approach that provides financial services only is adopted to reduce operating costs and improve the potential for sustainability (O'Brien 2008).

In the literature on micro-finance there are three lending approaches based on the following philosophies:

1. Institutional approach: This approach is based on the assumption that lending institutions must recover their operating and financing costs with program revenue through raising the interest rate and lowering costs to be financially sustainable (Armendáriz & Morduch 2010).
2. Welfare approach: This approach focuses on targeted outreach and social impact rather than financial returns or sustainability, based on the assumption that the poor cannot afford the high interest rate imposed by lending institutions (Hulme & Mosley 1996; Kodongo & Kendi 2013)
3. Win-win approach: This approach is based on the assumption that there is a balance between outreach to the poor, poverty reduction and financial self-sustainability (Rankin 2011).

Available evidence indicates that only those microfinance programmes started under institutional approaches are viable (Dhakal, 2010). However, proponents of the institutional approach argue that microfinance exploits the poor (Al-Azzam & Mimouni 2017). According to a recent survey, 18% of borrowers cut their food intake to repay debts, and 5% decided to take their children out of school in order to repay loans (Quang 2019, January 7). Clients make sacrifice to repay loans; besides eating less and taking children out of school, they may sell their furniture and utensils, borrow from loan sharks and take second jobs to pay off their loans in order to make the microfinance institutions successful and

sustainable (Brett 2006). Clients consider "unacceptable" in order to stay current on their loans. These sacrifices happen on the way to default. And as they struggle to remain current on their debts, by taking another loan, the chains may only get tighter (Solli 2015). However, it is up to the consumer to be cautious when it comes to money (Flynn 2007). For non-profits, interest rates are a way to offset the risk of default as well as to provide cash flow for expenses incurred by the organization. In for-profit microfinance organizations, interest rates are a profit-generator and a risk-adjustment tool (Crevelari 2017). Microfinance institutions should be "social businesses" driven by social missions (Malkin 2008). In the meantime, microfinance activities are not necessarily charitable; the Inter-American Development Bank estimates that on average the return on capital of microloans exceeds 20%, making this a profitable venture for many lenders (Sapp 2006). For example, Wall Street is now a microfinance creditor because microfinance is profitable (Flynn 2007).

Cull et al. 2009 indicate that a common mistake is to assume that non-profits are only dependent on donations to survive. Instead, earning profits does not imply being a for-profit organization. Non-profit MFIs can and do earn positive profits that are not distributed to shareholders but are re-invested in activities that further service their clients. From the economics standpoint, the main difference between for-profit and non-profit status is the ability to distribute profits (Glaeser & Shleifer 2001). If non-profits earn revenues greater than costs, they have to return them back to the business to further social missions. For-profit institutions, in contrast, can do what they wish with after-tax profits. The crucial differences emerge in the outreach and scale of the institutions (Cull et al. 2009).

The global average of interest rate is about 35 percent, but for example the average in Uzbekistan is above 80 percent, and in Sri Lanka it is around 17 percent (Kneiding & Rosenberg 2008). The interest rate provided by microfinance institutions is still high for the poor. The range is wide, but 30% to 50% is typical (Weinberg 2008). Contradictory Armendáriz & Morduch (2005) suggest that the poor can pay higher interest rates than others. If we assume that microfinance is a profitable in the commercial markets, then supply and demand of competition will drive interest rates down further (Rosenberg 2007)

Interest rates are significantly higher among the MFI's that have medium or large outreach levels, those that target women clients, and those that emphasize poverty-reduction in their mission statements (Roberts 2013). For example, in Mexico Banco Compartamos, which is a for-profit organization providing microfinance services to the poor, charges interest rates nearly double that of AISol, which is a non-profit organization servicing the poorest people in rural areas, while both gained profits from borrowers of around 41%; many have criticized these high rates and profits (Rosenberg 2007). The main difference between these two entities is the use of the interest income: AISol uses interest income to cover operating costs and leftover profits are then reinvested back into the

organization to provide additional loans. With Banco Compartamos, after covering operating costs, they choose between reinvesting profits and paying dividends to stockholders (Weinberg 2008).

### *Ethics of Microfinance*

Some scholars claim that there is an ethical crisis in the sector (Hudon 2011). Profit motives do not define whether an action is ethical or not, the outcome does. The high interest rates lead to debt traps which are usually linked to loan sharks and payday loans, which happens when a beneficiary falls into a debt cycle, having to borrow more in order to pay older loans; debt traps usually come from irresponsible borrowing (Crevelari 2017). Moreover, coercive techniques have been used to force the defaulting party to repay the loan, such as public humiliation by others in the loan circle, eviction from their dwelling, and appropriation of all of their worldly possessions (Karim 2008). In the literature of responsible finance and according to the Smart Campaign there are seven principles for client protection (Smart Campaign 2019) as follows:

#### **1. Appropriate product design and delivery:**

Products and delivery channels will be designed with client characteristics taken into account.

#### **2. Prevention of over-indebtedness**

Providers will take adequate care in all phases of their credit process to determine that clients have the capacity to repay without becoming over-indebted. In addition, to implement and monitor internal systems that supports prevention of over indebtedness

#### **3. Transparency**

Providers will communicate clear, sufficient and timely information in a manner and language clients can understand so that clients can make informed decisions. The need for transparent information on pricing, terms and conditions of products is highlighted.

#### **4. Responsible pricing**

Pricing, terms and conditions will be set in a way that is affordable to clients while allowing for financial institutions to be sustainable. Providers will strive to provide positive real returns on deposits.

#### **5. Fair and respectful treatment of client's**

Financial service providers and their agents will treat their clients fairly and respectfully. They will not discriminate. Providers will ensure adequate safeguards to detect and correct corruption as well as aggressive or abusive treatment by their staff and agents, particularly during the loan sales and debt collection processes.

#### **6. Privacy of client data**

The privacy of individual client data will be respected in accordance with the laws and regulations of individual jurisdictions. Such data will only be used for the purposes specified at the time the information is collected or as permitted by law, unless otherwise agreed with the client.

#### **7. Mechanisms for complaint resolution**

Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients and will use these mechanisms both to resolve individual problems and to improve their products and services.

### *Women's Empowerment:*

The notion of empowerment forms part of the vision to acquire power, to control one's life and make choices. This notion of "making choices" has been broadly debated by Sen (2000) who defines individuals' ability to "choose their life paths" as a determining factor for wellbeing, and also Kabeer (2001), who expanded the notion to people's ability to have access to things and to make choices. Furthermore, the capacity for empowerment is tied to institutions and laws. Kabeer (2001) added, according to feminist theory, empowerment involves change, both individual and social. Common indicators of women's empowerment such as nutrition and education were identified and can also include percentage of children enrolled in school (Pitt & Khandker 1998), consumption per week/month of specific nutritious foods (Hussain 1998), ability to treat children's illnesses (McNelly & Dunford, 1998) and medical expenditures (Coleman 1999). Many studies show how women's earnings may increase household expenditures on food and on the education of children (Pitt & Khandker 1996), and especially on the school enrolment of girls (Kabeer 2001) and improved health status (Pitt et al. 1999).

Moreover, it has been found that marital conflicts over finance decreased when women made substantial contributions to household expenditure and became financially independent (Haile, et al. 2012). A study by Naved (1994) indicated that women were more active in household decision making after participating in microcredit programs. However, Banerjee et al. (2009) found no impact of microfinance on women's empowerment. Moreover, research by (Roodman & Morduch (2009) criticizes microcredit programmes, concluding that the net effect of microcredit is negative. It has been claimed that feminization of debt destroys clients' self-respect and sometimes even their lives (Dash 2012).

## HYPOTHESIS:

Based on the previous discussion I formulated the following hypotheses: H1 -There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes on women's social empowerment

H<sub>1.1</sub> There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes on education

H<sub>1.2</sub> There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes on health

H<sub>1.3</sub> There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes on social status

## RESEARCH METHODOLOGY

### Data

The dataset used in the recent paper is same as the dataset that was used in the former paper (Al-Maaitah 2019) but the aim and the purpose of this paper is different. I requested data from the leading lending institutions in the government and non-government sector in Jordan. These institutions are the Micro Fund for Women, the Development and Employment Fund, and the Agricultural Credit Organization. The data requested contain (the number and characteristics of women client served, the type of loan product they received (development, start up, retired), loan size granted, project type (home-based, independent and registered, independent and unregistered), branch location, sector of activity, the disbursed amount of the loan, starting date of establishing the business, number of employees working in the business, number of job opportunities created by establishing the business, area/location of the enterprise, address of the borrower and mobile number).

I compiled and sorted the data in terms of number of women beneficiaries according to region (north, south, central) to cover urban and rural regions of Jordan; when the data were analysed it became clear that there are discrepancies in the number of female borrowers in different regions. Therefore, I consider the demographic and cultural differences among borrowers.

### Sample and Sampling Techniques

The population size is 46,962 female borrowers. A sample of 385 female borrowers engaged in entrepreneurial activity with loans up to 20,000 JOD<sup>2</sup> were chosen as the target of the study regardless of the sector of the enterprise<sup>3</sup>. The sample was drawn from either married or unmarried women, with age groups from 18-65 years and taken from all educational level (illiterate, preparatory, primary, secondary, diploma, higher education, cover the three main regions in Jordan (north, south, central) over 12 cities during the period 2015–2016. This time frame was chosen because the length of time relates directly to the outcome measures. According to Karlan & Goldberg (2011) an intermediate outcome is observed within six months to one year, whereas the working capital or fixed assets in the business may be observable in a shorter time. In Jordan the figures are the same as the global target; According to (Jorden 2014, 16 September) nearly 66 percent of small businesses will survive their first two years. Jorden indicate that only about one-third of total businesses will fail in these first two crucial years.

The sample size was chosen based on Sekeran & Bougie (2010), who suggest the survey system ignore the population size when it is "large" or unknown. Population size is only likely to be a factor when the researcher works with a relatively small and known group of people (e.g., members of an association). Homogeneity was explored in the sample by choosing the sample distributed according to region. To control for non-random program placement we randomized the order in which the program expands over the different regions of Jordan

The survey was conducted on 1 July, 2018. A total of 257 valid questionnaires were obtained, divided by region as follows: 98 from the central region, 79, from the north 80 from the south region. The researcher discarded incomplete questionnaires with missing values from the analysis. However the response rate was 66% which is considered high, hence the researcher distributed the questionnaire by hand which enable the respondents to give better responses (Sekeran 2000; Zikmund 2003)

### Instrumentations:

In this study I used questionnaire for quantitative data, and In-depth interview for qualitative data. An audio recording device with high-quality was implemented to record the interview with the participants

<sup>2</sup> The currency of Jordan, on 15 November, 2019 1JOD =1.28 EUR

<sup>3</sup> According to the Central Bank of Jordan, a loan up to 20,000 JD is considered a microloan (Central Bank of Jordan 2019)

## Data Collection Methods

In this study, I used both quantitative and qualitative data collection methods through a questionnaire survey and in-depth interviews with selected managers and executives in the concerned institutions, in addition to reviewing and analysing local and international reports. The researcher formulated the questionnaire by reviewing the literature. The instruments are used to collect data that are not directly measurable or observable; instead they are measurable through feelings, personal opinions, behaviours and expressions, since I used subjective variables with latent traits. I designed items for every variable; these items were adopted from analysing the literature.

All of the questions were closed-ended with a five-point Likert scale (1=Disagree strongly, 2= Disagree, 3= Neutral, 4= Agree, and 5= Agree strongly) which will measure the high and low dimension of the dependent and independent variables. The interpretation of the mean score is shown in Table 1:

*Table 1*  
*Range of mean score*

Range of mean score	Level
1.00-2.33	Low
2.34-3.67	Medium
3.68-5.00	High

Source: Lindell (1997)

The questionnaire directed to women borrowers consists of the following sections:

1. Women's social and demographic characteristics, such as age, educational level, and marital status
2. Microlending institution's policy (profitability policy): respondents were asked if interest rate incurred on delivered loans is high, if collateral is required, and if delinquent loans can be rescheduled, they were also asked their perceptions on whether the institution uses aggressive collection methods; focuses on instalment payment more than tracking project success; is making profit through accessing different regions; invests revenues in profitable aspects; and if the client's property can be confiscated in case of default.
3. Social empowerment variables covered education, health, and social status. Questions were designed to assess the extent to which women borrowers and their children have access to formal schooling, which is measured by the enrolment rate of children in school; developing the female borrower's financial literacy; or helping borrowers or their children to enrol in university or college. The health variable is measured by the probability of borrowers and their household members—adults and children—receiving medication for illnesses or improving the quality of the medication, whether the borrowers can join insurance programs, if

they can pay treatment and medication expenses, and if they can buy healthy food and medical devices to track their health status. A social status variable is measured by the probability of female borrowers having more power in decision making in the family in terms of a son's marriage; participation in community life, and self-confidence (Mason & Smith 2003; Alsopet al. 2006).

Semi-structured interviews of 30–45 minutes were conducted with ten microcredit managers. The aim of the interview was to report their views and perceptions on whether the institutions focus on financial sustainability rather than their social mission and if the profitability policy of micro-lending institutions contradicts with the sector's ideology. The validity of the questions was achieved by consulting 10 experts and academics to validate the questions and ensure clarity. During the in-depth interviews managers gave their views on the impact of social enterprises on women's empowerment and whether the focus on making profit conflicts with the social mission. I analysed the interview transcript and grouped comparable concepts into subcategories and then I grouped those subcategories into major categories.

## RELIABILITY AND VALIDITY

Before the pilot study the questionnaire was submitted to several reviewers, academics, and experts in microfinance to verify the sincerity of its paragraphs and to gather their opinions on the appropriateness, meaningfulness, and usefulness of each question. Based on the feedback I re-worded some paragraphs and made the required modifications. Results from the pilot study revealed that the data collected from the initial version of the questionnaire is reliable. Table 2 presents a summary of the results of the reliability coefficient: for the pilot study: for the borrowers (N=40) it is 0.72 and for a sample of the study (N=257) it is 0.755, which is considered acceptable according to Mertler & Vanatta (2005) and Hair et al. (1995).

*Table 2*  
*Cronbach's alpha for the study fields*

Variables	Statements	Cronbach Alpha n=40	Cronbach Alpha n=257
Profitability policy	1-10	0.72	0.755
Education	1-5	0.77	0.760
Health	1-6	0.83	0.852
Social status	1-9	0.83	0.827

Source: prepared by the researcher

### *Construct Validity for the Borrowers Scale:*

The researcher used the Pearson correlation test to show the construct validity for each statement and the relationship with its dimension; Table 3 shows the results.

*Table 3*

*Pearson correlation test for the statements and their relationship with the dimension of the profitability policy of the lending institution*

Profitability policy statement	
#	P.C.
1	.376**
2	.564**
3	.610**
4	.601**
5	.645**
6	.586**
7	.588**
8	.636**
9	.586**
10	.425**

\*\* : significant at level of 0.01

(P.C. = Pearson Correlation)

Source: Own calculations

Table 3 shows that all statements have a relationship with the dimension with P.C. values of more than 0.30 and this is significant at the level of 0.01 or less, which is acceptable.

*Table 4*

*Pearson correlation test for the statements and their relationship with the dimension of social empowerment of women*

Education		Health		Social Status	
#	P.C.	#	P.C.	#	P.C.
1	.836**	1	.745**	1	.709**
2	.827**	2	.733**	2	.798**
3	.769**	3	.837**	3	.735**
4	.512**	4	.796**	4	.743**
5	.636**	5	.719**	5	.710**
		6	.730**	6	.448**
				7	.726**
				8	.537**
				9	.600**

\*\* : significant at level of 0.01

(P.C. = Pearson Correlation)

Source: Own calculations

Table 4 shows the Pearson correlation test results. All statements have a relationship with the dimension's P.C. values of more than (0.30) and are significant at the level of (0.01) or less, which is acceptable. Thus, all 20 statements measure the social empowerment of women.

## RESULTS

According to the purpose of the research and the research framework presented in the previous section, I describe the results of the statistical analysis for the data collected. The data analysis includes a regression analysis and a descriptive of the means and standard deviations for the questions of the study.

### *Descriptive Statistics*

The researcher used the arithmetic mean, standard deviation, item importance and importance level to analyse the data as described below. Every item is rated by the respondent, and then I sum up the values given to every item to calculate the mean. Item importance measures the degree of compatibility of responses for each item; the higher the mean the higher the importance of the item.

### *Level of profitability policy*

As Table 5 shows, the mean of this dimension (profitability policy) ranges between 3.67–2.93, where the whole dimension has a total mean of 3.39, which is medium level. Paragraph 9 (the client is accountable legally in case of default) has the highest mean with 3.67, with a standard deviation of 1.02, which is considered medium level.

Paragraph 1 (high interest rate) comes in the last place. It has a mean of 2.93, and a standard deviation of 1.18, which is medium level. That means the profitability policy was medium level in the microfinance institutions from the beneficiaries' perspective.

*Table 5*  
*Arithmetic mean, standard deviation, item importance and importance level of Profitability policy statements*

No	Statements	Mean	Standard Deviation	Item Importance	Importance Level
9	The client is accountable legally in case of default	3.67	1.02	1	Medium
8	Capital is recycled to the next wave of poor (to lend to new clients)	3.53	1.01	2	Medium
4	Efficient collection methods	3.50	1.10	3	Medium
5	Collateral is required	3.50	1.15	3	Medium
6	Expanding outreach for profitability purposes	3.49	1.05	5	Medium
10	Focus on payment of installments rather than enterprise sustainability	3.48	1.11	6	Medium
7	Institution invests revenue in profitable projects	3.33	1.01	7	Medium
3	Priority on projects with high yield to ensure loan repayment	3.30	1.07	8	Medium
2	Rescheduling loans in case of loan default	3.12	1.10	9	Medium
1	High interest rate	2.93	1.18	10	Medium
<i>Total</i>		3.39	0.60		Medium

Source: Own calculations

*Table 6*  
*Arithmetic mean, standard deviation, item importance and importance level of Education*

No	Statements	Mean	Standard Deviation	Item Importance	Importance Level
5	the enterprise exposed me to other cultures	3.68	1.25	1	High
3	It improved my financial literacy	3.60	1.22	2	Medium
1	The project contributed to the enrollment of my children in school	3.28	1.21	3	Medium
2	It improved the educational level of my family members	3.13	1.21	4	Medium
4	It helped me to enrol in college or university	2.35	1.25	5	Medium
<i>Total</i>		3.21	0.88		Medium

Source: Own calculations

#### **Level of education**

As Table 6 shows, the mean of this dimension (level of education) ranges between 3.68–2.35, where the whole dimension earns a total mean of 3.21, which is medium level. Paragraph 5 (the enterprise exposed me to other cultures) earns the highest mean with 3.68, with a standard deviation of 1.25, which is high.

Paragraph (4) (the enterprise helped me to enrol in college or university) comes in the last place. It earns a mean of (2.35), and a standard deviation (1.25), which is medium level.

#### **Level of health**

As Table 7 shows, the mean of the dimension level of health ranges between 3.67–2.86, where the whole dimension has a total mean of 3.33, which is a medium level. Paragraph 2 (achieving food security for my family members) has the highest mean with 3.67, standard deviation 1.07, which is medium level.

Paragraph 6 (purchasing medical devices to follow my health, such as blood pressure gauge, glucose meter for diabetes) comes in the last place. It has a mean of 2.86, standard deviation 1.23, which is medium level.

*Table 7*  
*Arithmetic Mean, SD, Item Importance and Importance level of Health*

No	Statements	Mean	Std. Deviation	Item Importance	Importance Level
2	Achieving food security for my family members	3.67	1.07	1	Medium
1	buying healthy food	3.49	1.09	2	Medium
3	Covering treatment and medication expenses.	3.42	1.09	3	Medium
4	Treating my family members with a private doctor if necessary.	3.39	1.08	4	Medium
5	Joining a health insurance program.	3.13	1.12	5	Medium
6	purchasing medical devices to follow my health, such as blood pressure gauge, diabetes	2.86	1.23	6	Medium
<b>Total</b>		3.33	0.85		Medium

Source: Own calculations

*Table 8*  
*Arithmetic Mean, SD, Item Importance and Importance level of Social Status*

No	Statements	Mean	Std. Deviation	Item Importance	Importance Level
3	My self-reliance and self-confidence increased	4.16	0.88	1	High
4	The project contributed to changing the traditional image of women	4.02	0.92	2	High
5	My social interaction with others was strengthened	4.01	1.01	3	High
2	I occupied higher social status among the community members as a result of establishing my business	3.98	0.99	4	High
1	I held higher social status among my family members as a result of creating my business	3.79	1.11	5	High
7	It helped me to settle in the village and not migrate to the city	3.63	1.22	6	Medium
8	I can spend to marry my sons	3.29	1.22	7	Medium
9	I became a member of community associations and charities	3.21	1.22	8	Medium
6	My participation in social activities increased	2.86	1.39	9	Medium
<b>Total</b>		3.66	0.73		Medium

Source: Own calculations

#### **Level of social status**

As Table 8 shows, the mean of the dimension Level of social status ranges between 4.16–2.86, where the whole dimension has a total mean of 3.66, which is medium level. Paragraph 3 (my self-reliance and self-confidence

increased) earns the highest mean with 4.16, standard deviation (0.88), which is high. Paragraph 6 (my participation in social activities increased) comes in the last place with a mean of 2.86), and a standard deviation of 1.39, which is medium level.

*Table 9*  
*Arithmetic Mean, SD, Item Importance and Importance level of Social Empowerment*

No	Dimension	Mean	Std. Deviation	Item Importance	Importance Level
3	Social Status	3.66	0.73	1	Medium
2	Health	3.33	0.85	2	Medium
1	Education	3.21	0.88	3	Medium
<i>Total</i>		3.40	0.71		Medium

Source: Own calculations

#### ***Level of social empowerment of women as a whole:***

Table 9 shows the level of statements in the social empowerment dimension in descending order from the beneficiaries' perspective according to their access to microenterprise loans. The mean of the dimension of level of social empowerment), ranged between 3.66–3.21, where the whole dimension has a total mean of 3.40, which is medium level. The social status dimension comes in the first place with the highest mean, 3.66, with a 0.73 standard deviation, which is medium level; the second dimension was health with a mean of 3.33 and with standard deviation of 0.85, medium level; the third was education and has a mean of 3.21 and a standard deviation of 0.88 with a medium level.

#### ***Univariate Regression***

In this part regression analysis is used to analyze the impact of profitability policy of institutions providing microenterprise schemes on women's education, health, and social status.

H<sub>1</sub>: There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes in women's social empowerment

Results show the impact of profitability policy on social empowerment is statistically not significant (p-value = 0.74) and is over 0.05, which means that the hypothesis is rejected.

H<sub>1.1</sub> There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes in education.

Results shows the impact of profitability policy on education is statistically not significant (p-value = 0.342) and is over 0.05, which means that the hypothesis is rejected.

H<sub>1.2</sub>: There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes in health.

Result shows the impact of profitability policy on health is statistically significant (p-value = 0.002) and is less than 0.05, which means that this hypothesis is confirmed. The slope for the profitability is 0.270, meaning that for each unit of change in profitability the health change on average by 0.270 units.

Results of the scatter plot show the value of R-squared=0.037 indicate that 3.7% of all variability in health is explained by profitability.

H<sub>1.3</sub>: There is a statistically significant impact of the profitability policy of institutions providing microenterprise schemes in social status

Result shows the impact of profitability policy on social empowerment is statistically not significant (p-value =0.616) and is over 0.05, which means that the hypothesis is rejected.

## **DISCUSSION**

During the personal interviews with women borrowers, they pointed out that micro lending institutions aim to make a profit from non-interest sources including investment income and fees; they believe that lenders focus on loan repayment rather than tracking project success or expanding outreach, in addition to requiring collateral for the loan and confiscation of the client's property in case of default. The researcher observed that women borrowers ranked the questions related to the high interest rate in the last place, as shown in Table 5, which indicate that women entrepreneurs may not know the exact amount of interest rate charged on loans they received because they did not read the terms and condition of the loan contract. Another reason can be that borrowers believe that access to a loan is more important than its price. Women respondents also pointed out that lenders will not disburse a new loan until ensuring that the client has repaid the past due loan.

The results show that profitability policy did not contribute to improving the level of education of women and their family members; as Table 6 shows, 60.8% of women in the study sample hold a Bachelor degree, 10.4% hold a Master degree and 28.4% hold a Diploma (two years of post-secondary education) or less. Moreover, figures from the department of statistics shows that the literacy rate of female in Jordan was 92.5% in 2017 (Department of Statistics 2017). Thus, I conclude that women, after repaying loan instalments, disbursed the remaining part of their disposable income on emergencies and medication. These results agree with Asian Development Bank (2007) that changes in income or expenditures do not necessarily translate into increased investments in human capital. Profitability policy improved the health status of women

borrowers, probably because credit providers offer loan products specifically aimed to create income to enhance the level of health and improve the nutrition of women clients. For example, the Micro Fund for Women offers hospitalization coverage of 15 JOD per night to women entrepreneurs or their dependents under 21 years old. The Agricultural Credit Organization also tailored financial products that enable borrowers to create income with the purpose of improving the health status of women borrowers.

Profitability policies of the concerned institutions do not contribute to enhancing the women's social status. Women borrowers stay under the financial burden of the debt (loan instalments, late arrears, and fees), while the extra income generated from the enterprise – which is mostly established on a small scale – is so petty that it barely helps them to enhance their self-sufficiency but does not enable them to expand and grow their business. This situation reflects negatively on their social status and limits their social mobility and integration with the society members. This result agrees with the findings of Mayoux (1999). On the other hand, clients are also responsible for choosing the proper financial product that matches their needs to avoid indebtedness. During the field work I observed that the lending decision is influenced by identification bias. This result agrees with that of Schervish & Herman (1988), who define identification bias as an affective influence on a microloan funding decision due to an emotional connection that a lender feels with a borrower.

The opinions reported during the in-depth interviews with all participants support our findings. Three respondents mention that “financial sustainability is essential for the institution's survival”. Further, Respondent 2 reported that “we don't target risky clients who are unable to repay the loan.” All respondents reported that “the profit margin is used to cover the operating expenses, to maintain the capital adequacy ratio”. However, this result is not in line with the views of four participants (1, 7, 9, and 10) who indicate that “profit margin is used for relending to additional numbers of clients”. Respondent 4 indicated that the “profit margin is used to maintain financial sustainability.” However, findings agree with the view reported by Participant 8, who confirmed that “we don't use the profit for relending to more clients; we use the funds that we borrow from banks for this purpose”. He added, “We focus on a social mission, and profit is used to cover the operating and administrative costs in order to maintain financial sustainability.”

## CONCLUSION

This study analysed the impact of profitability policy of lending institutions in Jordan on the social dimension of women empowerment. In addition; the study observed the potential for mission drift in micro-lending institutions.

Profitability policy is hypothesized to impact women's social empowerment. The primary hypothesis, that there is a statistically significant impact of profitability on women's social empowerment, is rejected. The first sub-hypothesis (there is a statistically significant impact of the profitability on education) and the third sub-hypothesis (there is a statistically significant impact of the profitability on social status) were rejected, a significant correlation was found for the second sub-hypothesis, that profitability improved the health status of women entrepreneurs

The findings of this study suggest several potential recommendations for future policy regarding microcredit in Jordan. Firstly, there is a need to adjust the current profitability policy of credit institutions included (the level of interest rates, improper products, unfair bargaining tactics, and stringent collection practices. Secondly, women entrepreneurs should be protected and treated responsibly, by being provided with cost-efficient products and services. Thirdly, the central bank of Jordan should reduce the lending rate to MFI's, which is reflected in the interest rates charged to borrowers. Fourth, financial service providers need to look at innovative ways to reduce the costs of funding, either through savings mobilization or equity investment. Fourth, credit institutions must provide an opportunity to motivate poor women in their fight against poverty rather than focusing on loan repayment or unfair collection practices. Fifth, microlending institutions are recommended to take concrete steps to empower women entrepreneurs, incorporating the principles of the smart campaign in their business activities to achieve the best combination of financial and social returns. Finally, rigorous supervision is needed to achieve equal double-bottom-line returns and to empower the women of Jordan.

Even though credit institutions do not have an inherent motive toward making a profit and they are registered as not-for-profit organizations, their existing profitability policy need to be refined in order to achieve the promise of microfinance as a factor is women's empowerment. However, there is a fine line between financial sustainability and the social mission. When the institution is self-sustainable, it can meet its social goals. Profitability is not a crime, but it should not contradict with the sector's ideology; it should function to achieve the ultimate goal of microfinance to reach a Pareto-optimal outcome in women's empowerment. However, profitability can be increased by reducing the costs of financing. Thus, transaction costs and the interest rate on loan products should be reduced, especially, administrative costs, as this are considered the main driver of sustainability. In the meantime, profitability cannot be reduced to its financial dimension. Profits should be shared with clients or used to build up equity and expand outreach. Finally, clients should become more knowledgeable about the terms and conditions of credit providers to manage their finance properly and avoid over indebtedness.

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# Multi-Agent-Based Macroeconomic Modelling

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## SUMMARY

*Macroeconomic modelling emerged at the end of the 20<sup>th</sup> century and by the first decade of the 21<sup>st</sup> century it had been widely accepted. However, the financial crisis of 2007 followed by the real economy crisis exposed the weaknesses of dynamic stochastic general equilibrium models (DSGE) and agent-based models became favoured. Agent-based models – better reflecting reality– assume that individuals are capable of learning from past experiences. In economics, aggregation is considered to be fundamental in the analysis of macroeconomic processes, leading to question such as: How can processes describing macroeconomics and related indicators be obtained from results generated from decisions made at a microeconomic level? Is the applied method appropriate? Are synergy possibilities considered? This study attempts to provide answers to these questions.*

*Keywords: multi-agent-based models, dynamic stochastic general equilibrium models, factors of aggregate demand, factors of aggregate supply*

*Journal of Economic Literature (JEL) codes: E10, E20, C53*

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## BRIEF DESCRIPTION OF THE MULTI-AGENT MODELLING

In reality, societal actors with independent entities have social, economic and other interactions with one other in social processes. The interactions developed in relationships shape actors and, ultimately, societies. In agent-based modelling the investigated system consists of numerous small units, so-called agents, who act as decision makers. The system behaviour depends on actors' behaviour, which means that the behaviour is not predefined at a system level. In systems of this type, operations and learning processes are decentralised and 'dispersed' across agent networks. Major characteristics of multi-agent models are as follows (Vág, 2007):

- Agents are controlled from a decentralised place rather than from a centralised one.
- Agents have limited information; consequently, they are boundedly rational when they make decisions.
- Factors influencing decisions are also decentralised.
- Agents constantly interact with each other and their interactions determine the system structure.

Agent-based models can be grouped in a number of ways. The grouping depends on the methods of identification of the problems to be solved, the agents and

the networks. The process characteristics to be modelled determine the model properties to be applied, that is the model architecture. Agents' behaviours – considering the specificities of the modelled system – are expressed by determined functions. Due to the supposed bounded rationality, both agents' properties and the functions expressing their behaviour change, because agents are units that are capable of learning. Consequently, the mechanism of their decision-making and the outcomes also changes. Also, during simulations the actors' behaviour develops and changes depending on their interactions and the characteristics of the environment.

In this modelling form, it is also important to define how higher, meso- and macro-level processes and events evolve from interactions between agents. In agent-based analyses emergent phenomena and synergy effects can be accepted and interpreted. Emergent means that at a system level effects that cannot be derived directly from individual decision algorithms are observed; that is, a new feature emerges in the old structure that does not have this new feature. In cases with synergy effects, a whole is greater than the sum of its parts; in other words, a team working together will produce better results than if each member of the team performs a particular activity individually.

The role of multi-agent models among even forecasting methods is consistently increasing. This process makes it easier for heterogeneous individuals to form a modelled community. If individuals' behaviour is simulated, not only the inner mental characteristics but also the environmental influences need to be considered (Vág, 2007).

## CHARACTERISTICS OF THE MULTI-AGENT-BASED MACROECONOMIC MODEL

The fundamental aim of an economic analysis is to determine the confrontation of market demand and market supply considering consumer behaviour and corporate behaviour and to determine the demand and supply function in formal situations. This happens when macroeconomic processes are described (Hardwick et al., 1994).

In my previous studies I dealt with current trends in macroeconomic modelling (Karajz, 2016) and specific features of agent-based macroeconomic modelling (Karajz, 2015). In order to investigate the macroeconomic balance and its changes and fluctuations, it is critical to determine the factors affecting aggregate demand and aggregate supply. In conventional macroeconomic models, different economic sectors consist of homogenous (typical) actors (households, companies). In this context aggregation is a simple technical task.

The application of analytical models assuming dynamic and rational expectations was a major milestone in the development of macroeconomic models. The explanatory and predictive powers of analytical models – because of the assumption of rational expectations – were limited. In contrast, multi-agent models are characterised by bounded rationality (possibility for 'unpredictable behaviour') and it is easier to make more accurate predictions for future events that are difficult to forecast.

In multi-agent macroeconomic models, actors are heterogeneous and have different characteristics, abilities and competencies. Each actor is boundedly rational, which means that their decisions are not always rational. An economic agent is capable of learning (for example, imitating others) and adopting the acquired knowledge to make decisions. Since there is a lack of perfection, unexpected and imperfect events may occur (for example, strikes, panics, etc.) (Hosszú & Mérő, 2017).

As noted above, by applying multi-agent models, it is possible – contrary to models used in conventional economics that assume rational decision-makers and institutions – to provide a more realistic representation. It goes without saying that demand-side and supply-side factors in multi-agent models type need to be extensively investigated. They are as follows:

1. Factors affecting the aggregate demand:
  - household consumption demand

- corporate investments
- government demand
- export demand

2. Actors determining aggregate supply are divided into two groups, which are as follows:

- manufacturing units meeting domestic demands
- exporting manufacturers

It is essential to divide the supply side into two groups because the domestic inflation is affected only by the behaviour of domestic manufacturers and not by the behaviour of export manufacturers. This methodological division makes it possible to use the model for forecasting inflation.

The next part of this study deals with the characteristics of economic actors responsible for the demand-side and supply-side factors that are required for effective modelling in a multi-agent macroeconomic model.

### *Factors Determining Aggregate Demand*

#### *Household consumption demand*

For measuring the aggregate consumption demand, a representative household is considered in the dynamic stochastic general equilibrium (DSGE) models discussed in the introduction. Because of the representative household assumption, households in the models are homogenous and do not represent the household sectors with heterogeneous composition existing in practice.

First, let us examine the three most popular consumption theories from this aspect. In his book *A foglalkoztatás, a kamat és a pénz általános elmélete (The General Theory of Employment, Interest and Money)* Keynes (1965) resolves the problem in a simple way at first sight. He expresses the present consumption as a function of present income ( $C=C(Y)$ ). In the short term if there is a change in income, the willingness to consume (consumption rate) also changes and the consumption limit willingness remains stable. Also, the amount of consumption depends on the amount of income, objective circumstances, subjective needs of individuals and psychological willingness and habits (Keynes, 1965). He lists six objective and eight subjective causes altogether. If this idea is elaborated further and external and internal factors are considered, Keynes in his theory assumes a household sector comprised of heterogeneous consumers.

Modigliani's life-cycle hypothesis (Modigliani, 1988) assumes individuals who maximize profit and allocate resources in time. Resources are made up of the organisation income and the possible inherited wealth. He states that the present consumption depends on the wealth accumulated during a life cycle rather than on the present earnings. Modigliani's basic model has a number of stringent requirements that are unrealistic (his failure to consider inherited wealth or his assumption of a zero interest rate).

Friedman formulated his Permanent Income hypothesis in 1957. He expresses the consumption model with an equation system consisting of three equations. He

assumes that the expected future income affects the development of the current consumption (Friedman, 1986).

$$c_p = k(i, w, u)y_p \quad (1)$$

$$y = y_p + y_t \quad (2)$$

$$c = c_p + c_t \quad (3)$$

Permanent consumption ( $c_p$ ) depends on the permanent income ( $y_p$ ) (Equation 1). Also, this consumption may be affected by the interest rate ( $i$ ), the ratio of wealth to income ( $w$ ) and the variable determining willingness to consume ( $u$ ). He breaks up the current income ( $y$ ) into two components: a permanent component ( $y_p$ ) and a transitory component ( $y_t$ ) (Equation 2). Permanent income is considered as the annual average of the expected long-term income. The transitory component of income is unexpected and may be either positive or negative or may mean an income decrease or an income increase. Similarly to income, the actual consumption is also comprised of a permanent component and a transitory component (Equation 3).

What conclusions can be drawn from the above three hypotheses for a multi-agent model in terms of consumption? In the Keynesian theory – even if in a hidden form – an idea of a heterogeneous consumption sector is formulated, because objective and subjective factors affect the consumption rate and the limit willingness value even at an individual level. In Modigliani's life-cycle hypothesis the relationship between wealth and consumption is worth focusing on. The role of wealth of particular consumers also plays an import role in multi-agent modelling. Most DSGE models – wrongly – derive aggregate consumption demand from representative consumer behaviour. However, in real life situations households with different financial backgrounds react to processes of real economy or economic policy that affect their income positions quite differently. Agent-based modelling allows us to model these types of situations.

In this world full of uncertainties it seems natural that consumers react to temporary and unexpected income changes. Friedman's Permanent Income hypothesis divides the income into two large groups and distinguishes between expected income and unexpected income. This grouping enables us to make a distinction between the effects of two different types of income on consumption. In multi-agent modelling this distinction can be applied in order to investigate the efficacy of different measures of the economic policy.

As for the behaviour of households, it can be stated that the key components of heterogeneity in the multi-agent macroeconomic model are as follows:

- subjective factors related to consumer preferences (reserve accumulation, intertemporal decision making, inheritance, etc.)
- objective factors affecting the amount of income (becoming unemployed, impacts of economic policies on income, etc.), and
- financial position.

The degree of consumer sensitivity to the above factors and the degree these factors affect consumption willingness are summarised in the indicator of carefulness.

### *Further Demand Factors*

#### *Corporate investment demands*

The demand for capital goods depends on companies in an economy. An investment function can be derived from profit maximisation conditions of the corporate sector. The size of the investment depends on the marginal efficiency of capital, which is finally the interest rate. Investment decisions are characterised by uncertainties. Uncertainties are closely related to future investment returns. Objective and subjective components affect the expected value of the return as in the case of consumption. Objective components encompass measures of economic policies and technical and engineering developments, among others. Subjective components include investors' attitude to risks and their subjective appraisals of the economic environment for the investment. These factors enable us to determine the investment level individually or in categorised groups in multi-agent models.

#### *Government demands*

Since government demands depend on the actual economic policy in macroeconomic models, they are not very affected by uncertainty effect factors. In agent-based models they are considered as exogenous variables.

#### *Export demand*

In conventional models in cases of an aggregate foreign sector, the demand depends on the economic climate and the relative prices of goods compared to prices of export products and to international prices. When a multi-agent analysis is conducted, these two factors are defined at a level of a specific country and not at world economic level in order to achieve more efficient modelling. The foreign sector heterogeneity is comprised of different economic environments prevailing in different countries and different price rates, more precisely, different price levels. In other words, the real GDP and the real exchange rate of a specific country determine a specific foreign actor's demand for export.

### *Factors Affecting Aggregate Supply*

The predictive power of multi-agent models, perhaps due to its methodology, is stronger than of DSGE models. It seems obvious that model properties and model architecture need to be appropriately determined since this is a crucial prerequisite for an accurate prediction. From the national economic perspective, forecasting inflation accurately is critical. This is the reason why the manufacturing sector needs to be divided into at least two groups. The first group comprises manufacturing companies producing goods for the domestic market, while the second group encompasses companies producing

goods for foreign markets. Since the companies belonging to the first group considerably influence inflation and the companies belonging to the second group do not affect inflation, the latter is not investigated.

### ***Domestic manufacturing sector***

A 'better' model can be built if companies producing goods for the domestic market are further divided into subsectors depending on their effect on inflation (energy sector, food sector, etc.). Another important aspect in establishing a heterogeneous manufacturing sector is the classification of companies based on pricing methods. The degree of price rigidity is determined by parameterising or by calculating the weighted average.

The most widely used parameterising method is Calvo pricing, where Calvo parameters are provided in advance. The parameters show the probability that a company will change its prices in a given period of time (Váry, 2015).

There is another method where members of a specific corporate sector are grouped by their price flexibility or price stickiness. The company share as a weighting factor can be used to calculate price levels.

### ***Additional Model Features***

The major criticism of DSGE models is that they failed to predict the 2008 economic crisis, the imminent danger, and to explain the reasons why this crisis really broke out and how deep the structural tensions were that moved and still move the processes. These models just describe the surface phenomena.

The basic methodological reason for this is that they laid emphasis on analysing business cycles and neglected financial cycles. Financial cycles are longer and more volatile than traditional business cycles. Excessive credit outflows can be observed in the boom period, which finally leads to bubbles in the real estate and/or security markets. The bubble burst is followed by a financial crisis and a prolonged real economic recession.

The current task of macroeconomic modelling is to build models based on new methodologies and modify the existing models so that they can manage the boom and bust cycles simultaneously. This is a difficult and complex task. There have been partial successes in this respect after the crisis, but a specific model integrating all aspects has not yet been developed.

In multi-agent based models, financial cycles must be taken into account in order to increase their forecasting capacity. Bubble formation is based on the accelerator principle. Because of the accelerator effect, investment-driven income growth encourages further investing and borrowing, whose burdens keep falling and lead to a credit bubble.

The output of agent-based models describing economic phenomena is the result of the activities of cooperating models. Model actors are like real people who, using the right decision algorithms, would be able to produce an output similar to reality. Thus, computer simulations are

used to analyse the interaction of a large number of heterogeneous economic operators of these models. The bottom-up approach allows building aggregate macro-models from micro-level elements. Since the assumptions are very close to real behaviour and economic environment, they yield more plausible results (Schneider 2010).

The models do not assume absolute equilibrium conditions. This is not 'pre-programmed'. What needs to be investigated in the models is that whether equilibrium conditions for a given set of operating rules occur and whether markets have equilibrium properties. A key issue for macroeconomic models is whether they comply with Lucas' critique on the issue of the effectiveness of economic policy measures (Lucas, 1976). Since agent-based models are simulation models, the principle of rational expectations cannot be taken into account in their case. However, this deficiency can be overcome by proper interpretation and algorithmisation of the learning processes. Economic fluctuations can also be simulated through parameter settings as long as a significant negative shock is not considered.

## **EXAMPLES OF AGENT-BASED ECONOMIC MODELS**

Several domestic and international agent-based economic models have emerged in the past decade. Hau et al. (2013) interpreted a traditional Marshall-Walras model on an agent basis. Their most important conclusion was that an increase in the number of players makes the operation of the market unstable even if the actors are assumed to be homogeneous.

Váry (2015) described the market processes with an agent-based model where he assumed that prices were sticky. The purpose of his analysis was to prove that the effects of price stickiness in dynamic stochastic equilibrium models derive only from the specific assumptions of mainstream economics. The results confirmed this hypothesis because he observed completely different effects with a more realistic agent-based model.

Troitzsch (2012) also deals with agent-based modelling of markets. In his study he investigates whether market equilibrium is achieved if market participants are formed as separate heterogeneous entities and how this equilibrium is reached. Agents are buyers with different properties (willingness to pay) and sellers (expected revenue). Using the model he points out that prices and quantities increasingly oscillate around equilibrium values as the number of transactions increases.

## COMPARISON OF AGENT-BASED MODELS WITH CONVENTIONAL MODELS

It is worth comparing the assumptions and model assumptions of traditional economics with those of agent-based modelling. Mainstream economic theories considered ideally-acted actors in basically equilibrium state. In real economic conditions dynamically changing situations and players having different characteristics cannot be interpreted with static methods and homogeneous entities. Based on the available research studies it can be claimed that the microeconomic soundness of dynamic models for the current mainstream is not sufficient because their microeconomics components are non-plausible empirically and they also have poor fit to aggregate data.

If the known features of the presented agent-based modelling are investigated, agent-based modelling differs from traditional modelling in the following areas:

- agents representing economic operators able to gain experience (thinking) and to learn. Agents are provided with learning algorithms. The algorithms are identical for individuals in simple cases, but may vary from group to group in more complex models.
- From the above it follows that the behaviour of the actors evolves over the course of the simulation and change, since their interactions with each other and the environmental characteristics also change. Formerly egotistical characters may become altruists, cooperate and collaborate.
- The modelling of market processes is characterised by a bottom-up process. Self-organized markets emerge that are characterised by endogenous, internal development.
- Agents are organically related to each other. Hence, economic relations and transactions are established, which involve costs. The models take into account transaction costs.
- Existing institutions and organizations that are developing and constantly changing during interactions can be modelled.

Also, it is worth comparing key features of neo-Keynesian models of models generally adopted in macroeconomic modelling with features of alternative agent-based models. Table 1 illustrates the assumptions, advantages and disadvantages of models.

In neo-Keynesian models sticky prices are generally assumed. Actors are rational. An important methodological character is that aggregates are formed and interpreted. These two defining qualities – heterogeneous actors and their interdependence – are characteristic of agent-based models. Let us investigate the advantages and

disadvantages that result. The most significant difference is that neo-Keynesian models focus on balance, the effects of economic policy measures, whereas agent-based models tend to provide their “handlers” with new knowledge about modelled processes. As for the disadvantages, neo-kinetic models are characterized by excessive system dynamics and isolation from the environment, which are definitely flaws. The disadvantages of agent-based models are the partial impact assessment of changes and the high demand for computing. Of course, the latter may become less of a problem with technological changes – it may just be a matter of time.

*Table 1*  
*Comparison of neo-Keynesian models*  
*with agent-based models*

	<b>Neo-Keynesian models</b>	<b>Agent-based models</b>
<b>Conditions</b>	<ul style="list-style-type: none"> <li>➤ sticky prices</li> <li>➤ rational behaviour</li> <li>➤ aggregate formation</li> </ul>	<ul style="list-style-type: none"> <li>➤ agents' heterogeneous behaviour</li> <li>➤ participants' heterogeneous behaviour</li> </ul>
<b>Advantages</b>	<ul style="list-style-type: none"> <li>➤ equilibrium mechanism</li> <li>➤ economic policy orientation</li> <li>➤ recognizable relationships between variables</li> </ul>	<ul style="list-style-type: none"> <li>➤ the relationship between micro and macro levels is clearly modelled</li> <li>➤ cognitively designed</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>➤ excessive system dynamics</li> <li>➤ disregard of social conditions</li> </ul>	<ul style="list-style-type: none"> <li>➤ partial analysis</li> <li>➤ high computing demand for simulation</li> </ul>

Source: author's based on Schneider (2010)

## CONCLUSIONS

The results of the study reveal that agent-based models are effective in modelling heterogeneity. The effect of changes in the behaviour of players and characteristics of the market environment can be clearly traced in the analysis.

Over the past four decades in macroeconomics, dynamic analytical models that assume rational expectations and based on neoclassical synthesis – primarily on the work of Robert Lucas – came to the forefront. Since these models have limited explanatory power and/or predictive power, agent-based models provide a real methodological alternative to them.

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# Survey of Consumers' Responsiveness to Small-Scale Producers' Marketing in the Northern Hungary Region

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## SUMMARY

*The purpose of our study is to survey the marketing issues of small-scale food production and short supply chains (SSCs) from the consumers' aspects, and to give insight into the effectiveness and potential of SSC marketing. The paper presents the result of a wide online consumer survey with the participation of more than 1000 consumers, mostly from the Northern Hungary region. According to our experiences, the most effective „marketing instrument” was the personal contact with producers, communication with relatives, and acquaintances. One-third part of our sample could be motivated by (this kind of) marketing and had more willingness to pay for small-producers' goods.*

*Keywords: small producers, local products, food marketing, consumers' behavior, primary survey*

*Journal of Economic Literature (JEL) codes: D12, Q13*

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## INTRODUCTION

Nowadays, the various problems arising from global trade have become well known. The largest market shares are held by great retail chains selling mass products. In this way, the trade of global products is gradually eliminating the national – local – element from production (Bylok 2014), and this may affect the local trade of consumer goods and services negatively (Kacz et al. 2017). In some

special cases, this global-local opposition has been echoed by the media and triggered community engagement for local products (Hoffmann et al. 2016). On the other hand, in Hungary, for example, most vegetable and fruit growers still produce on their own, in an unorganized manner; therefore, their trade is exposed, the degree of integration is weak (Horváth 2010).

For this reason, small producers who cannot benefit from economies of scale may be forced out of the mass

market. Participation in short supply chains (SSCs) is an alternative trade channel for them (Kiss 2017). The SSCs are a supported EU priority in the current budgetary period between 2014 and 2020. According to the Regulation (EU) No 807/2014, from the viewpoint of subsidy policy, those trade channels can be considered a „short supply chains,” in which the trades between consumers and producers happen directly or at most by one intermediate actor.

In the past decade, numerous literature sources debated on the roles of short food chains in the agricultural sector and their impact on rural development or small agricultural businesses (Dunay et al. 2018). Although SSCs have increasing popularity amongst consumers, their role in the European food system is considered marginal (Augere-Granier 2016).

In the current (2014-2020) budgetary period, the European Union allocates subsidies to wards the short supply chains, by supporting the market entry of small producers and the use of marketing tools. Therefore, we felt it necessary to assess the utilization of marketing activities from the consumer's side.

## LITERATURE REVIEW

According to our experiences from Hungary, the numbers of small producers are decreasing, and as a result of our empirical research, many of them are complaining about the customer „snatching” effect of great chain-stores. In the current article, we explore the benefits and opportunities of smallholders’ marketing activities.

Regarding product quality, according to Lehota et al. (2018), „products diagnostics” for food consumers and food buyers are based on product characteristics, which can be approached in three groups:

- experiential products properties (taste, colour, shape, fragrance, etc.)
- product properties based on information search (composition, nutrients and their effects)
- confidential product characteristics (food safety and technological characteristics).

The positive presence of these aspects also has marketing value.

In most case studies on SSCs, it can be observed that customers prefer producers’ goods (for example in producer markets) because they perceive producers’ goods to be of high quality (Benedek & Balázs 2014). More studies on SSCs highlight aspects of freshness and „healthy eating” generally and especially in the trade of fruits and vegetables (e.g., Bakos 2017/a, Bimbo et al. 2015, Kahin et al. 2017, Kawecka & Gebarowski 2015, Tanasa 2014). In the study of Campbell et al. (2014), consumers perceive local products as having higher quality and higher value than similar non-local foods. Local products can also be connected to consumers from a cognitive or emotional point of view. These perceptual processes and emotional relations can influence consumers’ willingness to buy.

For this reason, quality can also have high marketing value. According to Mancini et al. (2018, 19. p.) who examined the trade of cheese specialties in short food supply chains „product quality is the biggest attraction factor bringing consumers into the outlet.” However, in the case of premium-quality or premium price goods, the number of customers who are able and willing to pay higher prices for producers’ goods is very limited. Naturally, there are different consumer prices within the certain SSC-channels, depending on the type and geographical location of the given SSCs. For example, one of the main critiques of producers’ markets is the high consumer price (Benedek & Balázs 2014). However, depending on the type of the SSC channel, premium prices are not regular. For example, Bakos (2017/b) examining shopping communities, bring forth that such purchases can be made at relatively low, producers’ prices.

The results of the case studies on the willingness to pay for local products we know are very different in time and space. It makes the examination of this issue also difficult that definition of „local products” is unclear (Campbell et al. 2014), and it is possible, that different case studies have different approaches. In the study of Dogi et al. (2014), two-third part of respondents was willing to pay a surplus for handicraft products in value of 10-25%, compared to conventional (non-local) foods. In contrast, previous research from the United States reported that majority of respondents would prefer local products with only the same prices. According to this study of Brown (2003) only 6% of consumers would pay a premium of more than 10% for local products. According to Carpio and Isengildina-Massa (2009) consumers in South Carolina were willing to pay an average premium of about 27% for local products and 23% for animal products, compared to out-of-state (South Carolina) products. According to Eastwood et al. (1987; in Carpio & Isengildina-Massa 2009 p. 423) – consumers (at the time of that research), had not given preference for local products sold in Tennessee. According to the survey of Carpio and Isengildina-Massa (2009), it was found that this percentage (mentioned above) was higher among respondents who attributed higher quality to local products (than those coming from outside the Member State). Therefore, campaigns that highlight the quality aspects of local (South Carolina) products can be profitable. The willingness to pay for local products was influenced by age, gender, income level, the perceived product quality, the desire to support the local economy and producers markets, and the commitment to agriculture. (Willingness to pay increased with age and income levels, and women were more receptive to animal products.) The authors called „primary motivation” the importance of supporting the local economy and local producers (which influenced more than price and quality in this case). However, many consumers could not identify local (South Carolina) products.

According to Benedek and Takács-György (2013) demographic factors, such as social status, marital status, gender and qualifications can, or their phase of life (their

role in life) can be determining. According to their research results, the female members (in relationship, with children and high qualifications) of the elder generation group are significantly more environment-conscious and prefer the local food than those with other demographic features.

In addition to customer decisions and price levels, consumer preferences also play important roles in customers' decisions. There are consumer groups that are unwilling to buy non-local products (Berg & Preston 2017), although their numbers are presumably low. However, there are consumers who are willing to buy local food instead non-local but only in the cases of reasonable prices.

In the exploring study of Kiss (2017), according to the respondent producers, proper marketing and product promotion would be the most necessary to improve producer sales; in other words, the values of producer goods should be communicated to consumers. This pronouncing is connected to the current aim of the EU subsidy policy (between 2014 and 2020), which would help the small producers to reach markets by short supply chains and marketing activities. (The related priority is reported in the „3A Focus Area Summary – ENRD, 2016.) In our experience in Hungary, just a very few SSC producers pay attention (and money) consciously to marketing and advertising activities. The reason of this may be that they spend the majority of their time on production and sales, and they do not trust the return on marketing expenses.

Consumers and local products can possibly be brought together by focusing marketing campaigns, or through, for example, holding events (e.g. all local food week), or site-based education. These programs can ultimately increase the interested consumers' willingness to pay. Emotion-oriented marketing strategies can also help consumers' involvement. (Campbell et al. 2014). There are good opportunities in the related branding and promotion campaigns; if producers can distinguish the products properly and in this way, consumers can distinguish the local products (Carpio & Isengildina-Massa 2009).

According to Fehér (2007), producers need to find the reason why consumers prefer them, for example, to a hypermarket or any other commercial channels. Besides, the shopping experience can be decisive in attracting customers. According to Szabó and Juhász (2012), one of the characteristic features of producers' markets in developed countries is that they also provide experiences for their customers, for example through programs introducing producers and products. During these programs, consumers meet with producers and learn about the uses of products. According to the cited authors, there is a demand from customers for this. Cooking shows or seasonal recipes with associated shopping lists can serve this purpose.

According to Szabó and Juhász (2012), who examined market sales in Hungary, the majority of market leaders did not use almost any marketing tool for advertising the

wares or informing customers. On the consumers' side, 61 percent of the respondents had no information about the offers of the markets. The most common marketing „channels” were the signposting and getting information from relatives and acquaintances, but only a smaller part of the respondents noted them.

Bakos (2017/a) draws attention to the importance of marketing activities on local food. Her survey from Hungary shows that young people did not prefer local food; therefore, the various „product-popularizing” and awareness-raising activities can be very important in their case.

In contrast, behaviour and consumption of older generations and females may be different. Females - because of their particular social roles (motherhood, taking care) may be more altruist and hence may be more environmentally conscious and prefer local food which is intensified in their realized behaviour as age advances (Benedek, 2012).

## RESEARCH METHODOLOGY

The purpose of our research is to gain insight into the effectiveness and potential of SSC marketing through our wide-ranged, online, consumers' survey made in the Northern Hungary region. While the subsidy policy intends to help smallholders' sales through short supply chains and marketing, we consider it essential to assess the utilisation and success of those marketing activities. At this point, we emphasize one of the limitations of our research, that it is very difficult to measure the success of marketing activities objectively; many factors can influence it (Chrysochou 2017).

The sampling period lasted from October 2018 to June 2019. The survey included 1034 respondents with valuable answers. (We considered incomplete fillings as missing valuation; for one or two, we did not exclude the respondents yet. Only two cases were excluded for obviously unreliable or defective filling.)

The target area of the research was the North Hungary region; accordingly, 86% of the respondents lived in Heves, Nógrád or Borsod-Abaúj-Zemplén counties. The remaining participants came primarily from settlements that are close to the borders of these counties, or from Pest county or Budapest. The questionnaire was spread online by direct email inquiries and with the use of social media.

The group of women (69%), younger people under 35 years (49%), and participants with college and university degrees (50%) were overrepresented compared to the national average. (This is not a surprising fact, as the last two segments may point to the regular internet user groups of the population.) Regarding marital status, the majority of respondents were married (41%) or lived with partner (in common-law marriage). The number of persons living in their households was evenly distributed: 2 persons: 26,7%; 3 persons: 26,6%; 4 persons: 25,1%; 5 persons:

9,6%. The age of the sample was averagely 37,8 years. (with 13,43 standard deviation).

The questionnaires were collected using Google form. The results were processed and evaluated by Microsoft Excel and IBM SPSS statistical software. Descriptive statistics, factor analysis, cluster analysis were used to present the results, and Chi-square tests and analysis of variance (ANOVA) were performed to examine possible correlations at a 5% level of significance.

## RESEARCH RESULTS

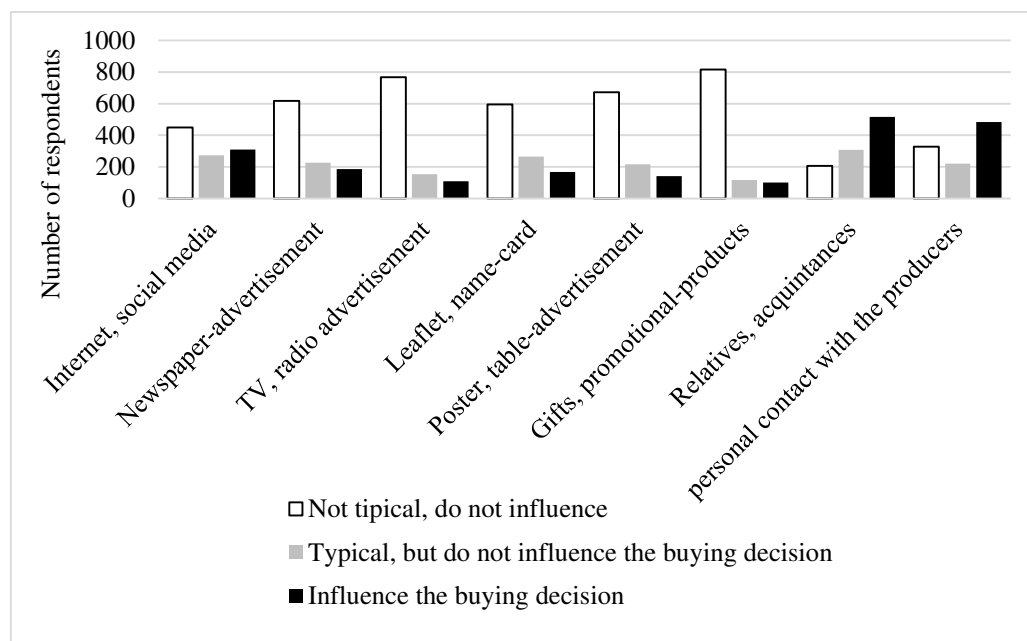
The results of our survey support the tendency presented by Augere-Granier (2016), that producers' sales played only a minor role in the purchases of consumers. One-third part of our respondents purchases from local producers up to maximum of EUR 16 (HUF 5000) in an average month. Another third bought between EUR 16 and 31 (HUF 5001-10000); more demand is generated only by the remaining part of the customers. The three most popular consumers' product-categories were honey, eggs, and fruits-and-vegetables.

In our survey, nearly half of the respondents felt it a problem, that they did not have sufficient information on the supply of local producers. This is related to the results of Szabó and Juhász (2012) that points to the lack of marketing activities. Lack of information can, of course, prevent or discourage consumers from buying. However, increasing marketing does not guarantee revenue growth

in itself. „Efficiency” of the certain small producers' marketing channels is very different.

Newspaper advertisements, television and radio advertisements, leaflets, posters, promotional gifts proved to be the least effective. We refer to these as „conventional” and „non-personal marketing channels” throughout the study. The most effective marketing channels were those that based on personal relationships, namely, getting information from relatives and acquaintances (in connection with the results of Szabó and Juhász 2012) and the personal contact with the producers themselves. These influenced the customers' decisions the most. In terms of efficiency and popularity, the role of the internet and social media is worthy of mention, and it is increasing nowadays.

The following and main purpose of our study was to identify the customer group that is most responsive to small-scale marketing and to determine their characteristics. Since the eight different marketing channels presented in Figure 1 are difficult to handle together, we reduced their numbers (as „variables,”) by factor analysis. We created two factors based on the existence, perception, and influence of the certain marketing channels. (The eight marketing channels could be perfectly separated into two factors, with the help of factor analysis. For a criteria test, we counted the Kaiser-Meyer-Olkin (KMO) index, which value was 0,794. This means that the variables in the sample are very suitable for grouping by factor analysis (Sajtos & Mitev 2007)).



Source: own editing

Figure 1. The efficiency of different marketing channels

The first factor was named „Non-Personal Marketing Channels,” and as the result of the analysis, it contains the following channels:

- television and radio advertisement
- poster-, and table (signboard) advertisements,
- newspaper-advertisements
- gifts, promotional products
- leaflets, name-cards
- internet, social media

To the second factor, we gave the name of „Marketing channels based on personal relationship,” and it includes the following two types:

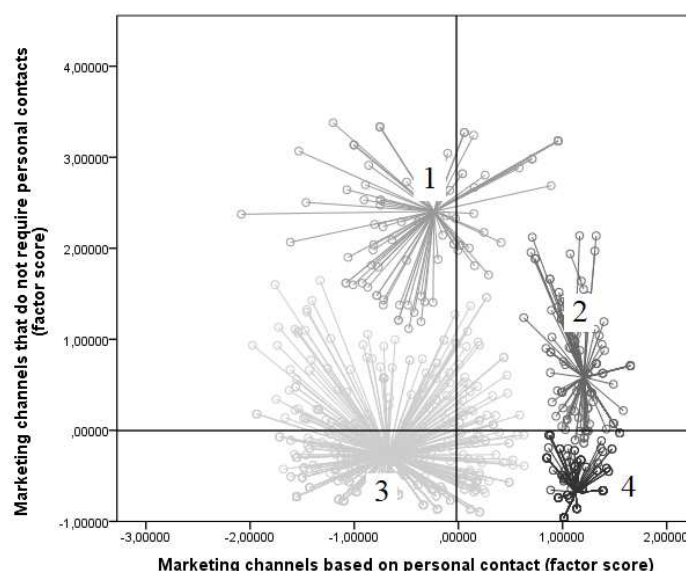
- information from relatives and acquaintances
- personal contacts with the producers.

It can be seen from Figure 1 that factor analysis separated the marketing channels based on the „effective” and „less effective” channels. After creating the two factors, we examined how customers relate to these factors. We performed a cluster analysis with the IBM SPSS statistical software (using Ward method) to identify consumer groups that behave similarly regarding marketing channels and to characterise them by their identifiable attributes. Based on the result, we decided to form four clusters or consumer groups, with the following names:

- Cluster 1: Consumers who are more open to wide (mass) marketing channels (number of members: n=95). This small group was significantly more influenced than other clusters by television, radio, flyer, and promotional advertising, but was only moderately motivated by personal contacts.

- Cluster 2: Consumers who are opened primarily for marketing channels based on personal relationships, but also open to others (n=132).
- Cluster 3: Consumers who are not or only marginally opened for small-scale marketing (n=581)
- Cluster 4: Consumers who are opened only to personal relationship marketing channels (n= 226) (Figure 2).

We wanted to find those criteria that distinguish these consumer clusters from each other. If relevant differences are discovered, targeted marketing activities may be made with the identified groups. By exploring their attitudes, marketing positioning becomes possible. Surprisingly, there were no statistically significant differences in their demographic features (such as gender, age, marital status, number of households, or self-reported financial status). Education-level is an expectation, where in the case the first cluster (people who are more open to wide (mass) marketing channels (n=95)) the proportion of „school-leaving certificate” and „technikum – i.e. vocational school” was higher than college or university qualification (as a highest educational level). In the other three groups, proportion of college or university qualification was the highest. It is a possible conclusion that consumers with higher education levels use newspapers, television, radio, posters, leaflets (as media) less. On the other hand, use of internet and social media was relatively high, except in cluster 3 (who were not responsive to marketing), and were less important in the case of cluster 4 (for those who prefer personal contacts).



Legend of consumer groups (clusters): Cluster 1: Consumers who are more open to wide (mass) marketing channels (number of members: n=95), Cluster 2: Consumers who are opened primarily for marketing channels based on personal relationships, but also open to others (n=132), Cluster 3: Consumers who are not or only marginally opened for small-scale marketing (n=581), Cluster 4: Consumers who are opened only to personal relationship marketing channels (n=226).

Source: own survey

Figure 2. Separation of customer groups regarding responsiveness to marketing channels.

The increase in factor values on the x and y axes indicates the receptivity to and awareness of them.

In this way, we were not able to identify the demographic characteristics of consumers who are responsive to small-scale marketing. The results from case studies examining SSC-user consumers (e.g. Carpio & Isengildina-Massa 2009) may offer a basis for marketing strategies aiming certain consumer groups. The authors mentioned above experienced that willingness to pay may increase with age and income level, and women were more susceptible for certain products.

## RELATIONSHIP BETWEEN WILLINGNESS TO PAY AND RESPONSIVENESS TO MARKETING

Statistically, significant differences could be measured between the four consumer clusters and monthly expenditures on producers' goods and the willingness to pay (Table 1, Table 2).

While clusters 1 and 3 mostly spent less than 5000 HUF (16 EUR), in the cases of cluster 2 and 4 spending

between 5000 and 10 000 HUF (16-31 EUR) were determinant, and the ratio of spending more than 10 000 HUF (31 EUR) was also higher. Distribution of willingness to pay was similar to that of monthly expenses (Table 2.)

It can be pronounced that clusters 2 and 4 mean the most solvent demand for producers' goods (together they make up about one-third part of the sample). From marketing point of view, their purchasing habits were significantly influenced by personal relationships, contacts with the producers and information by relatives and acquaintances. We conclude that, in this way, these personal relationships have a strong relation with consumers' willingness to pay. Thus, the phenomenon described in the literature (Carpio & Isengildina-Massa 2009) that consumers' may be intended to support local producers. It also related to sense of community. The willingness to pay of clusters 1 and 3 approaches the average value from below. In the case of Group 1, the influence of traditional (mass) media did not lead to a higher willingness to pay. The average, 20,7% surplus as willingness to pay fits in with the results of the case studies presented in the „Research background” section.

Table 1

*Breakdown of average monthly expenditures on producers goods according to the consumer clusters*

Monthly amount spent on producers' goods	Cluster 1. (n*=94)	Cluster 2. (n=131)	Cluster 3. (n=573)	Cluster 4. (n=222)
0-16 EUR (0-5000 HUF)	36,2%	23,7%	41,7%	18,9%
17-31 EUR (5001-10000 HUF)	25,5%	29,8%	31,6%	39,2%
32 -47 EUR (10001-15000 HUF)	21,3%	23,7%	15,4%	17,6%
48-63 EUR (15001-20000 HUF)	9,6%	16,0%	6,6%	13,1%
above 63 EUR (above 20000 HUF)	7,4%	6,9%	4,7%	11,3%
Total	100%	100%	100%	100%

Legend: n\*: number of elements could be included in the Chi-square test.

Source: own survey

Table 2

*The willingness to pay of consumer clusters – how much premium are they willing to pay for local products compared to similar quality factory-made products*

Consumer clusters	Willingness to pay for local products
Cluster 1 (n=95)	+ 19,8% (std. deviation:16,98)
Cluster 2 (n=132)	+ 23,84% (std. deviation:18,43)
Cluster 3 (n=581)	+ 18,34% (std. deviation: 17,85)
Cluster 4 (n=226)	+ 24,98% (std. deviation: 20,69)
Consumers in total:	+ 20,7% (std. deviation: 18,64)

Source: own editing

## RELATIONSHIP BETWEEN CONSUMERS' PRODUCT, OR SHOPPING PLACE CHOICES AND RESPONSIVENESS TO MARKETING

We asked our respondents to rate each store-types and sales channels to determine how important they to their food purchases. Markets and producers' markets (as producers' sales channels) were mostly preferred by members of cluster 2 and 4. (On the other hand, very few people attached importance to buying at the producers' places, or home delivery; regardless of the clusters).

In the next session of our survey, we examined how the members of certain clusters chose products. Product-preferences were assessed by 11 characteristics, and they were grouped to the following three factors:

- Factor 1.: – *Product quality and food safety aspects*: product quality; being organic product; Hungarian (domestic) origin, environmental awareness, uniqueness, brand, and manufacturer
- Factor 2.: – *Influence of personal relationships and advertisements*: family traditions; personal contacts and emotional attachment; influence of advertisements
- Factor 3.: – *Influence of prices*: price; special offers (Table 3.)

For clusters 2 and 4 (which indicates the highest demand for small producers wares), quality and food safety aspects were the most important. Compared to cluster 3 (less responsive to small-scale goods), personal relationships and emotional attachments were important.

Although price, as a factor, influenced the food buying habits of all clusters, it can be observed that clusters 2 and 4 were the least price-sensitive (with small differences). The consumers from cluster 3 were least interested in quality, and their price sensitivity was almost the highest in the sample. Emotional relationships were the least influencing in their case.

## PERCEIVED QUALITY PARAMETERS OF SMALL PRODUCERS' GOODS ACCORDING TO THE RESPONDENTS' CLUSTERS

In general, all groups agreed that producers' goods were characterised by freshness, naturalness, and good taste. Concerning purchasing decisions, also the clusters 2 and 4 were the most responsive to these aspects. Opinions about the constant quality, cleanness, and (inner) composition were more divided, but more than half part of members from clusters 2 and 4 was positively influenced by them. Right looks as perceived positive quality has shared these two clusters too, but nearly half of their members found that these wares have good looks, and it was influencing for nearly 40% of them. These listed, perceived quality parameters were well suited to fit into a single factor (value of KMO index: 0,833). The resulting factor values are in the range of -1,9 to 1,47. The higher the factor value, the better the respondents perceived the quality aspects, and the more they were influenced in their purchases by them. (Table 4.)

Table 3  
Average values of factors influencing food purchasing, related to the consumer clusters

Consumer clusters	Aspects influencing food choices (average values on five-rank Likert scales)*		
	Factor 1: Product quality and food safety aspects	Factor 2: Influence of personal relationships and advertisements	Factor 3: Influence of prices
Cluster 1 (n=95)	3,67	2,91	4,04
Cluster 2 (n=132)	3,83	3,02	3,91
Cluster 3 (n=581)	3,46	2,61	3,95
Cluster 4 (n=226)	3,72	2,85	3,72

\*Legend: our five-scale Likers scale is ascending; the value of „1” indicates that it is not important and the value of „5” indicates maximum importance

Source: own editing

Table 4  
Perceived positive quality parameters of small producer goods according to the consumer clusters and the factor created from the quality parameters.

Clusters	Factor values by clusters	
	Average	Standard deviation
Cluster 1 (n=95)	0,13	0,900
Cluster 2 (n=132)	0,65	0,760
Cluster 3 (n=581)	-0,39	0,980
Cluster 4 (n=226)	0,36	0,365

Source: own survey

Form the perceived quality parameters approach; it appears that the second and then the fourth cluster mostly considered the small producers' wares to be of high quality. The result is consisted with the findings of Carpio and Isengildina Massa (2009) that perceptions of higher quality [respectively the demand and responsiveness on them] are associated with higher willingness to pay.

## CONCLUSIONS

In our survey, we sought to assess the need for small-producers' marketing and its effectiveness. The examination is based on a consumer survey of more than thousand respondents, mainly from the Northern Hungary region. Not a surprising result, that local products and short supply chains play only a complementary role in the modern food trade.

On the one hand, the importance of the issue is based on that the European Union supports short supply chains in the budgetary period between 2014 and 2020. On the other hand, nearly half part of our respondents mentioned that there is a lack of information about small producers' wares, and this causes difficulties during purchasing.

Four consumer groups were identified based on their responsiveness to small-scale marketing channels. The greatest cluster (with 581 members) consisted of consumers who typically had the lowest demand for small producers' goods. A smaller cluster of 95 respondents was attracted by traditional marketing channels based on mass communications (television, radio, advertisements and so on), but this group only slightly exceeded the demand and willingness to pay of the previous cluster. The remaining two clusters meant the greatest demand for small-scale goods, with a total of 358 consumers. Most of these consumers (226 people) were hardly interested in traditional, wide, mass-media marketing (television, radio,

newspaper advertisement, flyers, posters, promotional products). Even internet had only lesser importance in their cases. For them, the most important marketing channel was personal contacts with producers and acquaintances. At product selection, they were the most interested in product quality attitudes, such as freshness, origin, or (inner) content. Many respondents ascribed good quality attributes to small producers' goods, but these groups were most influenced regarding purchasing habits.

In marketing, we highlight two important facts: personal relationships and product quality. According to our findings, these are what attract customers the most. Consumers are receptive to these, accounted for one-third part of the sample according to our methodology. Widespread „classic” advertising methods (TV, radio, flyers, posters) were not considered effective tools. Internet and social media reached and influenced a relatively lot of people.

We agree with the suggestions of the literature regarding marketing campaigns focusing on the quality aspects of products or holding public events (maybe in the farmsteads). These events could be, for example, cooking shows or product exhibitions, handicraft programs, or demonstrating production and production method itself (even by visiting the farmstead). (The role of shopping experience is not to be underestimated.) It should be noted that in many cases, shopping could happen on an emotional basis; therefore, we see opportunities in any programs or campaigns that promote producer-consumer relationships and trust.

We want to draw attention to an important limitation of our research: greater willingness to pay is not merely a consequence of marketing activity. It may be related to consumer preferences that are not covered in our study. A previous commitment to producer goods can trigger or result in responsiveness to small producers' marketing.

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# Study Compliance of Economic Security of Ukraine

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## SUMMARY

*The article examines the current state of security compliance of the Ukrainian economy. The essence of compliance and the possibility of its use to characterize the economic security of the object of study are considered. Various types of compliance violations in the Ukrainian economy over several years have been investigated. The main trends that are characteristic of the economies of Ukraine in the area of compliance are identified and substantiated: the level of the shadow economy, the number of officially registered compliance violations in industrial enterprises and their structure, the level of corruption and its perception in Ukraine, etc.*

*It is proposed to determine the compliance safety of an industrial enterprise as protection of the vital interests of an industrial enterprise from external and internal violations of laws, regulations, standards, constituent and internal documents of an enterprise by determining, assessing and minimizing (eliminating) compliance risks. Recommendations are given for the industrial enterprises of Ukraine with the aim of improving their economic security.*

*Keywords: compliance, economic security, compliance security, shadow economy, corruption*

*Journal of Economic Literature (JEL) codes: D73, F52, K13, K42*

*DOI: <http://dx.doi.org/10.18096/TMP.2019.01.04>*

## INTRODUCTION

The socio-economic development of Ukraine today takes place in conditions of market transformation and modernization of the economy. At the same time, the oligarchic model of economic relations inherent in the country gives rise to such undesirable phenomena as the illegal economy, its monopolization, a constant increase in economic inequality, the growth of unemployment, and the poverty of the majority of the population. Various sources of information put the level of the shadow economy in our country from 28 to 40 per cent of GDP. This strongly affects the level of impoverishment of the citizens of Ukraine, which increases by 10-15% annually. According to the UN statistical reports, about 80% of citizens are living in poverty in Ukraine. Existing studies of the current state of the Ukrainian economy indicate that an important factor in its decline is the presence of elements of corruption, fraud, money laundering, and total violation of many existing laws and regulations both at the macro and micro levels. All of this requires a detailed study, reflection and development of scientific and methodological recommendations for countering this kind of violation.

The purpose of the study is to introduce use the term "compliance security" into academic and study its theoretical and methodological nature as an economic category, as well as to consider the formation and use of the organizational mechanism of compliance as a component of ensuring the economic security of a country, industry, region or enterprise.

## ANALYSIS OF THE LITERATURE

Most of the existing studies in the field of economic security consider the problems related to providing economic security based on a detailed analysis of macro and micro-projects in the work of an enterprise and on this basis form scientific and methodological recommendations for preserving the existing economic achievements of an industrial enterprise or for their improvement. Without rejecting such an approach to the question, we note that there may be cases in which even fairly successful enterprises can operate in a very dangerous state. The reasons for such a conclusion can be corruption schemes in the work of the enterprise, the presence of fraudulent transactions, tax evasion, violations of antitrust laws and other equally important

manifestations of violations of the current legislation, regional regulations, industry regulations and standards of the enterprise itself. It should be noted that all these manifestations of violations of the existing regulatory and legal framework, unacceptable for any enterprise, are within the scope of compliance. However, the vast majority of industrial enterprises in the Ukrainian business sector prefer not to allocate funds for compliance activities, and many of them are not even familiar with the conceptual provisions of compliance. It should be noted that the provisions and principles of compliance in the Ukrainian economy are still practically not used in the activities of real business; to a certain extent, compliance control provisions have been introduced into the practice of only some Ukrainian financial and credit organizations, in particular, banking institutions.

Theoretical and practical issues of compliance have been discussed in Ukrainian and other economic scientists, in particular, Aleshin & Aleshina (2016), Pererva (2017) Kocziszky et al. (2017, 2018a), Romanchik & Pererva (2018), and others. In these studies the basic terminological concepts of the compliance system are reproduced, the main areas of its use are substantiated, the fact is determined Banks for the effectiveness of compliance programs in industrial enterprises and financial organizations. At the same time, the questions of the formation and use of the organizational mechanism of compliance as a component of ensuring the economic security of an industrial enterprise require further research. In my opinion, the compliance function includes all the necessary functions for qualitatively counteracting corruption schemes in the work of an enterprise, carrying out fraudulent transactions, evading taxes, violating antitrust laws, etc.

## THE RESULTS OF THE STUDY OF COMPLIANCE VIOLATIONS IN THE ECONOMY OF UKRAINE

Currently, industrial enterprises carry out production and commercial activities in difficult conditions of enterprise development risk. Therefore, the issue of economic security in their activities is very important. Most top managers seek to ensure the sustainable development of their enterprise with the lowest level of volatility risk (uncertainty, unpredictable fluctuations in business performance), since such volatility significantly affects the main strategic indicators, that is, sharp unpredictable fluctuations in the value of both the enterprise and its assets. The current realities of management are such that ensuring the security of an enterprise and above all economic security is impossible

without implementing the compliance system in its business practices.

Compliance (derived from the verb to comply) means acting on request or instructions; submission. Compliance as used here is the compliance of specific actions of a country, enterprise, individual team or employee of any rank with all existing internal or external requirements (laws, standards, norms, regulations, etc.).

In my opinion, the permanent control of the compliance regime should be dealt with by a part of the enterprise's management and control system that is associated with compliance risks, non-compliance with the requirements of legislation, rules and standards of supervisory authorities, industry associations, codes of conduct, etc. Such compliance risks may ultimately manifest themselves in the form of legal sanctions or regulations of regulatory bodies, financial, material and reputational losses as a result of violations of laws, standards, regulations and rules. Compliance with the compliance function usually covers issues such as adherence to appropriate standards of market behaviour, managing conflicts of interest, fair treatment of consumers and ensuring an objective approach in advising them. Compliance functions also include specific areas, such as countering the legalization of criminal proceeds and the financing of terrorism; development of documents and procedures to ensure compliance of the company's activities with current legislation; protection of information flows, counteraction to fraud and corruption, the establishment of ethical standards of employee behaviour in the organization and beyond, etc.

A modern compliance system is able to provide industrial enterprises with lower costs to protect their business interests, as well as the property rights of owners, to optimize the structure of business processes and to improve the quality level of top management of the enterprise as a whole. All of this creates important and relevant prerequisites for the development of theoretical and practical foundations of compliance and for their adaptation to the realities of large and medium Ukrainian businesses.

The author's studies suggest that there is a significant impact on economic processes from processes of reducing the volume of government funding in all sectors of the economy, a significant increase in the level of the shadow economy to 43% in 2014 (Official website of the State Statistics Service of Ukraine, 2019) and its effects on indicators of socio-economic development and components of the state's economic security. Ukraine, practically throughout its entire period of independence (Ukraine is an independent country since 1991 traditionally has had a high level of shadow economy, as evidenced by the data in Table 1.

*Table 1*  
*Level of the shadow economy as a percentage of the official GDP of Ukraine*

Year	The level of the shadow economy, % of the official GDP of Ukraine	Changes in the volume of real GDP of Ukraine, %, to the corresponding period of the previous year
2010	38	4.1
2011	34	5.5
2012	34	0.2
2013	35	0.0
2014	43	-6.6
2015	40	-9.8
2016	35	2.4
2017	31	2.5
2018	32	3.5

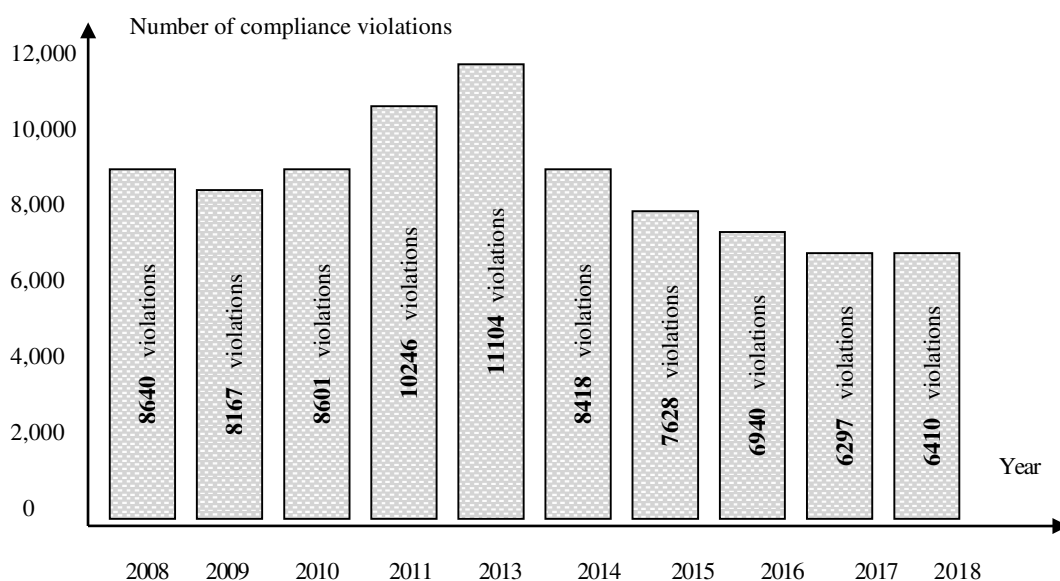
Source: Calculations of the Ministry of Economic Development and Trade of Ukraine: <http://www.me.gov.ua/Documents/List?lang=uk-UA&id=e384c5a7-6533-4ab6-b56f50e5243eb15a&tag=TendentsiiTinovoiEkonomiki>

Most of our closest neighbours are no better off regarding the extent of the shadow economy. For example, in Russia, the indicators of the shadow economy were 38.4% on average and 33.7% of GDP in 2018, in Azerbaijan 52.19% and 43.66%, in Armenia 42.59% and 35.96%, in Georgia 64.87% and 53.07%, in Kazakhstan, on average, 38.88% and 32.82% in 2015, in Moldova 43.43% and 39.68%, in Tajikistan 42.99 and 37.73%, in Kyrgyzstan 37.92% and 30.78%, in Estonia 23.8% and 18.49%, in Latvia 22.23% and 16.62%, in Lithuania 25.15% and 18.65%, and in Poland – 25.1% and 16.67% of GDP (Kolesnichenko 2018).

The high level of the shadow economy affects the level of criminality in Ukraine and the increase in crime in general and in the economic sphere in particular. Economic crime has become significantly higher in terms of both the number and the results. For example, according to the data of Nipialidi (2018), economic crimes constitute 75.3% of all crimes in our country, including: crimes against property – 68.4%, crimes in the sphere of official activity – 4.4%, and crimes in business activity – 2.5%. In 2017, 335,910 criminal offenses against property were

registered, which is slightly less than the previous year (in 2016 - 405,549), which was almost 15% more than in previous years (in 2013 - 334,821, in 2010 – 318,216, and in 2009 - 242,766). This is taking into account the fact that statistical data on crimes committed in the occupied territories of our country are not included in these figures. The most vulnerable regions in terms of crimes of this category in 2017 were Kyiv (45,767), Dnipropetrovsk (29,362), Kharkiv (24,239), Zaporizhia (23,981), Odessa (21,104) and Lviv (18,494) , (Nipialidi 2018).

Of particular importance in the context of our study are crimes in the sphere of economic activity, which are most relevant to the area of compliance violations. According to official statistics, the number of crimes in the sphere of economic activity continues to be insignificant compared with all offenses taken into account: in 2014-15 the share was 1.6%, in 2016-18 the share decreased to 1.2% (Nipialidi 2018). Thus, law enforcement agencies in 2017 (Figure 1) recorded 6,297 offenses in the sphere of economic activity, in 2016 there were 6,940 such offenses, while in 2015 there were 7,628, in 2014 8,418, and in 2013 11,104 (Melnychuk 2016).



Source: PwC (2018)

Figure 1. Officially registered compliance violations at Ukrainian enterprises

Table 2  
Structure and number of compliance violations in the enterprises of Ukraine

Type of compliance violations in enterprises	Year					
	2013	2014	2015	2016	2017	2018
Production, storage, purchase, transportation, shipment, import to Ukraine with the purpose of using counterfeit money when selling goods, selling or selling	1233	709	1860	1316	1022	1078
Officially registered businesses not in operation	891	858	885	681	784	723
Legalization (laundering) of proceeds from crime	291	296	221	159	243	208
Inappropriate use of budget funds	48	34	24	15	21	19
Tax and tax evasion	3069	1899	1748	1203	1099	1154
Financial resources fraud	327	345	129	62	58	73
Illegal privatization of state communal property	26	45	28	8	17	22
Gambling business	1248	1084	735	964	469	533
<b>Total criminal compliance violations</b>	<b>11104</b>	<b>8418</b>	<b>7628</b>	<b>6940</b>	<b>6297</b>	<b>5789</b>

Source: PwC (2018)

Analysing this category of crimes, Nipialidi (2018) notes that the total number of detected offenses in the economic sphere has rapidly decreased between 2015-18, which clearly indicates a weakening of the fight against economic crime (Nipialidi 2018).

The sharp decrease of investigations by all law enforcement agencies in the field of economics is evidenced by the following figures: while in 2016 the detected crimes of this category caused losses of UAH 8.65 million, in 2015 it was UAH 289 million, UAH 624.9 million in 2014. In the process of compensating for these losses in the course of the pre-trial investigation in 2016, it

amounted to UAH 27.8 million, in 2015 UAH 63 million and UAH 4.9 million UAH in 2014 (Baganets 2017)

The shadow economy is both the source and the result of compliance violations. Table 2 shows statistical information of the General Prosecutor's Office of Ukraine on compliance offenses committed by industrial enterprises, institutions and organizations since 2013 by economic activity under Article 199-235 of the Criminal Code of Ukraine and are subject to criminal prosecution.

Despite the fact that since 2015, the scale of the shadow economy is gradually decreasing (Table 1), its level remains high with all the ensuing political and economic

consequences and corruption implications. It should also be noted that the high level of the shadow economy is also explained by the fact that the shadow economy itself is one of the business strategies that allows the shadow economy to mitigate the impact of the economic crisis (and therefore, of course, that its level increases during the crisis).

All this led to the greatest economic crisis during the years of independence of Ukraine, as well as to the loss of a significant part of the industrial and export potential. In 2018, the country's GDP amounted to only 77.9% of the 2008 level, while GDP per capita fell to USD 2,100 (on the same level as the Congo) (Official website of the State Statistics Service of Ukraine, 2019). The ultrahigh level of inflation and the decrease in real incomes of the population, combined with the devaluation of the national currency, led to an increase in the volume of the shadow economy, an increase in the level of corruption in all spheres of society, and higher vulnerability of the majority of the population. According to the results of a global study developed by the American non-governmental organization Social Progress Imperative with the support of Deloitte, Ukraine was in 64<sup>th</sup> place of the Social Development Index rating among 146 countries of the world. Under these conditions, the main efforts of state anti-crisis measures have touched upon fiscal consolidation, fiscal discipline and tariff policy. The combination of such factors requires the search for new approaches and the adoption of urgent measures to strengthen the social component of the economic security of Ukraine. This situation makes this topic – studying the relationship between the level of the shadow economy and the indicators of the social component of the economic security of both Ukraine and individual industrial enterprises – extremely relevant.

In the conditions of a substantial growth in the Ukrainian shadow economy, the development of economic relations, the restructuring of the economy, and the transformation processes also entail the presence of manifestations of crime in the economic sphere. Building

a system for effective counteraction to such crimes is an urgent task, since illegal actions in the economic sphere can significantly affect the development of the economy, undermine the economic foundations of the state and contribute to the formation and development of the shadow market, the emergence of corrupt ties and other unacceptable phenomena, the presence of which can lead to undermining the economic sustainability and economic security of the country and its citizens.

The process of legalization of the economy will acquire proper intensity only if the state creates favorable conditions for the growth of economic and investment activity in the legal economy by its citizens, against the background of improving the business climate in the country, improving the quality of government, the stability of the financial system and the macro-environment.

A strong shadow economy creates ample opportunities for the development of corruption and bribery in Ukraine. The world community perceives our country as a country with a very high level of corruption. In international practice, the Corruption Perception Index (CPI) (Transparency International EU 2019, <https://gtmarket.ru/ratings/corruption-perceptions-index/info>) is calculated to assess the level of corruption in the country, which reflects the perception of the level of corruption by entrepreneurs and analysts from different countries of the world, including experts residing in a country whose corruption level is being studied. This indicator focuses on corruption in the public sector and defines it as the abuse of official position for personal gain. The level of the CPI for each country is evaluated by the international non-profit public organization Transparency International. For its evaluation, a number of indicators for the past three years are processed: on bribery of officials, payment for supply contracts for state needs, embezzlement of public funds, as well as the frequency of corruption, and the total cost of paid bribes. The corruption perception index in Ukraine in recent years is presented in Figure 2.

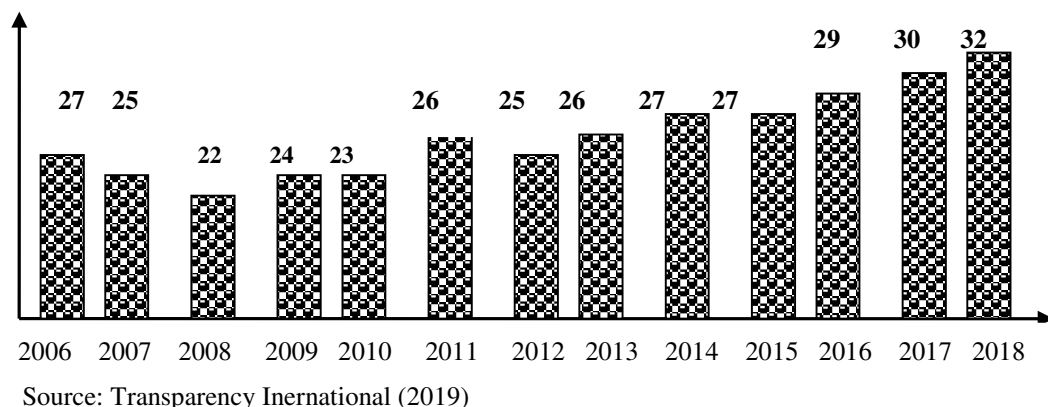


Figure 2. The corruption perception index in Ukraine

The lower the corruption perception index, the higher the level of corruption. The rating is based on the results of a survey of experts and business representatives about how they perceive the level of corruption in a particular country. Each country's CPI is rated on a 100-point scale, where 100 points is the total absence of corruption, 0 is highly corrupt (Transparency International EU 2019). In recent years, Transparency International does not carry out independent surveys, but leads "to a common denominator" those that are carried out in Ukraine and in the world by specialized international organizations. The reports of the international organization Transparency International devoted to research on and the fight against corruption, show the stability of the problem of corruption in Ukraine. The CPI of Ukraine is on average 25.9 (over the period of 2007-18), reaching a maximum of 32 points in 2018 and a record low of 22 points in 2008. The government's extraordinary efforts to counter corruption in 2018 improved the level of this indicator by two points. All EU countries are less corrupt than Ukraine, including Bulgaria, which has the worst performance in the EU - 42 points. Of the post-Soviet states, Ukraine is rated as more corrupt than any of the Baltic countries, as well as Georgia, Armenia, Moldova and Belarus. A positive point is the fact that the level of corruption in Ukraine was lower than in Kazakhstan and Kyrgyzstan (scored 31 and 29 points in 2018, respectively), and also Ukraine for the second year in a row comes out ahead of Russia, which was previously considered less corrupt than Ukraine. Russia scored 28 points in 2018.

The current 32 points give hope. After all, those who score from 31 to 60 points are called countries that "try to fight corruption." Ukraine joined this group only in 2018.

Every two years PwC conducts a worldwide survey of enterprises and organizations on compliance violations in

various sectors of the economy and an assessment of the attitude of organizations to economic crimes. Since 2009 the survey has included Ukraine. This allowed PwC experts to identify trends in the most common types of economic crime and fraud. In the survey of 2018, more than 100 representatives of various Ukrainian enterprises, in both private and public sectors of the economy, took part. The results of this survey allow specialists in the relevant segments to identify and analyse the trends of the most common types of economic crimes and fraud in Ukraine, assess their impact on the production and commercial activities of industrial enterprises, analyse changes in the activities that Ukrainian enterprises use to prevent compliance violations. The number of compliance violations in our country is increasing every year. According to the 2018 Worldwide Study of Economic Crimes and Fraud conducted by PwC, 48% of Ukrainian organizations have suffered from economic crimes and fraud over the past two years, although in 2016 this figure was 43% (see Table 3).

The data in Table 3 also show that throughout the world the number of enterprises affected by compliance violations is also increasing. In 2018, according to this indicator, Ukraine is almost in line with global trends in the field of economic crime. At the same time, the Ukrainian economy looks much better than the Russian economy. According to the survey, the number of economic crimes in Russia in 2018 also increased significantly compared with two years earlier: 66% of business representatives said that their company faced them, whereas earlier this number was 48%.

Practically all industrial enterprises support the claim that corruption practices are widespread in our country. Over the past five years, this statement has been supported by 96–99% of respondents (Table 4).

*Table 3*  
*Share of enterprises affected by compliance violations*

Scope of observation	Year of observation				
	2009	2011	2014	2016	2018
The whole world	30%	34%	37%	36%	49%
Russian Federation	71%	37%	60%	48%	66%
Ukraine	43%	36%	63%	43%	48%

Source: PwC (2018)

*Table 4*  
*Share of enterprises in Ukraine giving a positive answer to the question*

Contents of the question	Survey year				
	2014	2015	2016	2017	2018
Do you think that corrupt practices are common in Ukraine?	99%	98%	97%	96%	97%
Have you ever faced corruption when doing business in Ukraine?	91%	88%	81%	91%	92%
Do you think that the level of corruption in Ukraine has decreased over the past year?	27%	27%	47%	36%	31%

Source: PwC (2018)

At the same time, in our opinion, it is difficult to draw an unequivocal conclusion on the increase in the level of economic crime in a particular country or not. The results of the survey can be explained, for example, by an increase in the level of manifestation of compliance violations in enterprises and organizations. This conclusion is to be confirmed by statistical data. For example, despite the fact that the share of Ukrainian enterprises that have actually suffered from compliance violations varies between 30–50% (Table 3), in reality the number of enterprises that are faced with corruption when doing business is much higher and fluctuates in the range 81–92% (Table 4). Such a discrepancy in statistics is explained, in our opinion, by the fact that almost 50% of compliance violations are ignored or not detected; therefore, no one calculates the losses from them.

Today in our country certain types of compliance violations are gaining popularity, such as misappropriation of property, the purchase of non-existent goods and services, the provision of charitable assistance (used as bribery), various payments to companies not formally linked to common business, interaction with government agencies through intermediaries, the implementation of investment projects, an opaque structure of marketing costs, procurement and personnel management fraud and cybercrime. The latter include unauthorized monitoring of databases and transactions and hacking of personal

electronic mailboxes of subscribers. On this basis, the divisions of industrial enterprises such as marketing and purchases, sales and investment departments often become a source of compliance violations for enterprises, along with the actions of top management. The dynamics of the most significant compliance violations in all areas of the Ukrainian economy are presented in Table 5.

Bribery and corruption remain the main types of economic crimes that adversely affect the activities of Ukrainian organizations (Table 5). Only in the last two years, 48% of the surveyed companies were affected by these crimes, and every third Ukrainian respondent (33%) recalled that his organization received an offer to give a bribe. As the results of the study showed, the most common types of crime faced by companies are misappropriation of property (46%), fraud in procurement (33%) and personnel management (33%), and cybercrime (31%). The disappointing thing is the forecast of representatives of Ukrainian organizations for the next two years: they believe that corruption will remain the most significant economic crime for their companies. In Russia, as well as throughout the world, the most common type of economic crime is misappropriation of assets. Bribery and corruption came in second, and the third most common type of violation was fraud in the procurement of goods and services. Globally, after misappropriation of assets, we find cybercrime and fraud committed by the client.

*Table 5*  
*The main types of compliance violations in the Ukrainian and world economy*

Types of compliance violations	In the world	In Russia	In Ukraine	
	2018 year	2018 year	2016 year	2018 year
Bribery and corruption	25	41	56	73
Customer fraud	29	31	23	17
Misappropriation of property	45	53	62	46
Procurement fraud	22	35	25	33
HR Management Fraud	12	19	4	33
Cybercrime	31	24	24	31
Violation of business conduct principles	28	23	t/d	t/d
Legalization of proceeds from crime	9	15	t/d	t/d
Manipulating accounting data	20	19	t/d	t/d

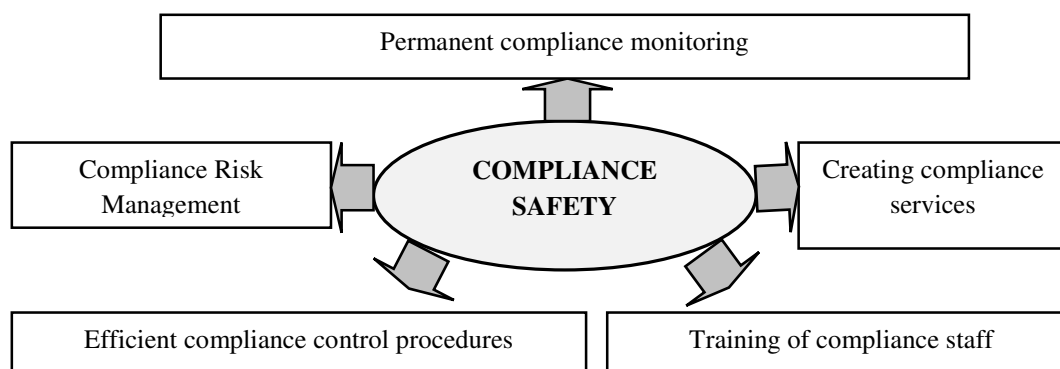
t/d – there is no data.

Source: PwC (2018)

*Table 6*  
*The most widespread forms of compliance violations in Ukrainian enterprises*

Compliance violation type	Year			Compliance violation type	Year		
	2016	2017	2018		2016	2017	2018
Bribe request	68%	67%	69%	Sponsorship Request	5%	7%	6%
Malpractice	70%	68%	64%	Return request to win a tender	35%	27%	32%
Request for partnership with a company branch	29%	25%	23%	Request for a bribe to stop illegal pressure	41%	45%	46%
Donation Request	18%	18%	19%	Other	5%	4%	4%

Source: PwC (2018)



Source: own compilation

*Figure 3. Components of the mechanism for ensuring the compliance security of an industrial enterprise*

Within each of the types of compliance violations, there are corresponding forms of their implementation, the ways in which this violation is carried out (Table 6).

From the data of Table 6 it can be seen that the most common forms of compliance violations are to demand a bribe (67–69%) or abuse of official position (64–70%). We note that the dynamics of the Bribe Requirement indicator has been almost stable over the past few years, and there are no trends towards its change. In recent years, the number of cases of abuse of official position has slightly decreased (from 70% in 2016 to 64% in 2018). This, in our opinion, can be explained by the creation and active work in Ukraine of anti-corruption bodies.

Studeis by the author show that the Ukrainian economy currently has negative manifestations associated with corruption, fraud, money laundering, violation of business rules, corporate ethics, etc. All this creates opportunities for causing real damage to the economic security of the country in general, as well as the level of economic security of each enterprise or organization.

The components of economic security, as a rule, are taken into account when determining the integral indicator of the economic security of an enterprise. However, it is comon for companies to neglect to include indicators of corruption, fraud, money laundering, violation of corporate ethics, antitrust issues, or tax laws. In the past 20–25 years in the global economy, this has been the subject of compliance research. Based on these provisions,

we propose to introduce into economic terminology the definition of “compliance safety of an enterprise”. The new definition requires its theoretical and methodological substantiation and definition as an economic category.

The essence of the term "compliance security" is defined both by the term "compliance" and the concept of "economic security". Therefore, the proposed definition for the concept of compliance security of an industrial enterprise is the protection of the vital interests of an industrial enterprise from external and internal violations of laws, regulations, standards, constituent and internal documents of an enterprise by determining, assessing and minimizing (eliminating) compliance risks. Such a definition allows us firstly, to show the dynamic compliance of safety in space and time; secondly, to determine the importance of both internal and external factors influencing the degree of safety compliance; thirdly, to show close interaction on the legal basis of the state and corporate systems for ensuring economic security; fourthly, to determine the presence and level of compliance risks as the main instrument for the compliance safety of an industrial enterprise.

In order to avoid compliance violations or at least minimize compliance risks at an industrial enterprise, it is proposed to form, implement and use the following measures, determined to be effective to a certain extent, (Figure 3), which should be implemented as part of ensuring the compliance safety of an industrial enterprise.

## CONCLUSIONS AND PROSPECTS FOR FURTHER RESEARCH

Conducting effective compliance control indicates that the company must establish procedures, the use of which will ensure reliable testing as candidates for employment as well as contractors. Constant compliance control will be carried out using tools that ensure compliance safety and by conducting internal investigations.

At present, most enterprises carry out internal control and internal audit, the powers of which include compliance control procedures. Some enterprises have created such units (services). But the current state of compliance violations in the economic sphere means that we are in dire need of creating an independent target unit (compliance service) with extended powers and specific professional skills. In our opinion, the compliance service should include specialists from different professional fields: accountants, IT specialists and lawyers. The efficiency of the compliance service is ensured by the close interaction of its employees with legal and HR services (divisions working with staff).

The main task of the compliance service is to find the operational functions of the production and commercial activities of an enterprise where compliance violations may occur in order to carry out the identification, elimination or minimization of compliance risks. To this end, the enterprise should effectively operate its compliance risk management system, within which the identification, assessment and elimination of the prerequisites for the occurrence of compliance risks are carried out. If the mechanism for managing compliance risks is introduced correctly and professionally, then it will become a reliable advocate of an industrial enterprise opposed to such risks.

Detection of compliance violations at an industrial enterprise or the prerequisites of their occurrence are

impossible to carry out without an effective compliance monitoring system. Such a system assumes continuous (almost daily) tracking of changes in a number of the most significant performance indicators, the value of which signals the company's top management about the presence or absence of certain problems in the compliance sphere.

A very important component of compliance security of the enterprise, in our opinion, is continuous staff training, raising its intolerance and the inadmissibility of compliance violations not only in the enterprise itself, but also in other areas of each employee's life. In face-to-face communication at meetings and corporate meetings, it is necessary to constantly emphasize the importance of ethical business conduct to employees and to broadcast the position of top management on corruption and fraud. Internal training for employees on ethical practices and the corporate code of ethics can be effective in this regard. There should be a transparent system of inevitable punishments for those who initiate compliance violations and the widespread announcement of violators in the collective of each enterprise. If these events are held regularly, on the basis of fair information without any selectivity, the ethical behavior of an industrial enterprise will become part of the corporate culture, an important factor in the mechanism for ensuring the compliance security of the enterprise.

The use in practice of the considered proposals, of course, will not be able to provide full compliance protection against corruption, corporate fraud and other compliance violations. But if the relevant work is constantly carried out ahead of the schedule, taking into account the specifics of the production and commercial activities of a particular enterprise, then this will no doubt help the country and its enterprises to ensure a high level of compliance security, reach a qualitatively new level of business and minimize the compliance risks associated with the loss of profit through compliance violations.

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# Acceleration Methods of Managers' Transversal Competences – Results of Testing Process

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## SUMMARY

*The underlying goal of the paper is to present the results of testing the reference model in the process of transversal competences development. The tested model is an element of the method that accelerated development of competences, which was developed within an international research project. In particular, the article outlines main stages of implementing the method referring to individual partial reports of the project – publicly available on the Internet. Three methods of practical training have been applied in the tested model: brainstorming, group work and problem lecture. The increase rate of the following four transversal competences has been evaluated: entrepreneurship, creativity, communicativeness and cooperation within a group.*

*Keywords: transversal competencies, entrepreneurship, creativity, communicativeness, group work*

*Journal of Economic Literature (JEL) code: I23*

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## INTRODUCTION AND STUDY BACKGROUND

Generally, at higher education institutions there are three levels of training students that are complementary to one another: formal, non-formal and informal ones. All these levels are relevant as they complement one another. This concerns in particular practical training aimed at knowledge acceleration as well as development and improvement of students' practical competencies – expected on heterogeneous labour markets, which are no longer constrained by territories (Poczmańska et al. 2015, Rostkowski 2004, Sidor-Rządkowska 2006, Stankiewicz 2005). For entrepreneurs apart from practical competencies it is also important to develop the social capital, in particular such its elements as social networks, organisational culture and trust (Byłok, Cichobłaziński

2016). Various methods are applied in formal training processes that facilitate acquisition of knowledge and particular skills and their future utilization in professional practice. Non-formal training in turn, at Polish universities is a formalized institutional form, similarly to formal training. However, it is carried out outside programmes that allow for gaining qualifications recognized in the legal system. The third level of training at Polish universities – informal training, is a form of training that functions outside the formal training system. Its nature is usually non-institutional, sometimes non-system. Informal training is dominated by non-formalized, horizontal relationships among the learners. Informal learning is chosen voluntarily, unlike the traditional educational system where it is compulsory. In the present paper the cognitive focus comprises most important transversal competences (Jędrzejczyk 2013, Oleksyn 2006), such as entrepreneurship, creativity, communicativeness, group

work and testing their growth in practical training processes (Komisja Europejska 2002, Parlament i Rada UE 2006). The portfolio of practical training methods in formal training includes: problem-solving methods, activating methods, demonstrating methods, programme methods and practical methods. The method that is also frequently applied in formal training is group work – in formalized groups of students.

In the analytic and empirical part of the present paper, its Authors attempt to present and justify the course of testing and verifying the reference model of transversal competences development (Kiełtyka, Jędrzejczyk, Kucęba 2011) in the selected group of students. The measurable value of the paper is the empirical verification of the adopted reference model, in the growth context of the adopted and summarized above transversal competences. The summarized results reflect the research conducted by the Authors within the “ERASMUS+” project “The acceleration method of development of transversal competences in the students’ practical training process”, comprising seven universities from four EU countries: Poland, Slovenia, Finland and Slovakia.

## DATA AND METHODS: THE BASIC ACTIVITIES WITHIN THE PROJECT

Within the research procedure in the period from 01.10.2015 to 31.08.2018 employees of the Institute of Information Management System (the Faculty of Management of Czestochowa University of Technology) carried out an international research project “*The acceleration method of development of transversal competences in the students’ practical training process*”. The underlying goal of the project was to develop and implement an innovative method that accelerates development of students’ transversal competences through improved application of formal teaching.

One of the detailed goals of the project was developing a method that will effectively combine various elements of training (practical training and transversal competences development (Whiddett, Hollyforde 2003) in order to accelerate preparation of social sciences students to start employment, considering the needs of employers, in particular in the scope of transversal competences. Therefore, it was relevant in the intention of project participants to develop a method to trigger creativity and innovativeness in the process of training. The project was carried out within the Erasmus+ programme – the key action: Cooperation for innovation and good practice. The financing entity was the Foundation for the Development of the Education System (FDES) – the National Agency of the Erasmus+ programme. The project leader was Poznan University of Technology and the partners include: Czestochowa University of Technology (henceforth CUT, the affiliation of authors), Wroclaw University of Economy, Western Chamber of Industry and Commerce, in Gorzow Wielkopolski, Centria -

Ammattikorkeakoulu (Finland), JEDU Jokilaaksojen koulutuskuntayhtymä (Finland), Univerza v Mariboru (Slovenia) and Univerzita Mateja Bela v Banskej Bystrici (Slovakia).

Research works according to the accepted schedule and determined beforehand project goals comprised the following actions – in chronological grasp (The Project 2016):

1. Preparing a report on applied methods of transversal competences development and practical training methods at higher education level (primarily analysing secondary sources, benchmarking).
2. Recognizing the demand for transversal competences among entrepreneurs – agreeing on coherent terminology and research so as to consider the economic specificity of partner countries, preparing and evaluating research results (“Research methodology for recognizing the demand of employers for transversal competences in the project”, “Questionnaire to test the demand for transversal competences among entrepreneurs”).
3. Developing a matrix of practical training methods and transversal competences training dependencies – preparing proposals of practical training methods analysed as a tool for transversal competences training and their importance for employers, analysing data from partners in order to select data for the matrix, developing the final version of the matrix and its characteristics (Matrix of the dependencies between practical teaching methods and an increase in students’ transversal competences).
4. Preparing papers and developing a monograph summarizing research results in partner countries (The monograph summarizing the research results and analysis from partner countries).
5. Developing models of transversal competences development processes within practical training – selecting the training processes to be tested, preparing the specification and map of the process reference model, developing the documentation of the reference model process (“Developing the selection principles of practical training methods for the reference models of processes (taking into account the developed matrix in IO3) and summarizing the consultation of principles introduced together with the partners”, “Instruction for developing and testing models of transversal competences processes within practical training”, “Selection of groups for testing process models”).
6. Analysing and aggregating results of process models testing – designing the testing process, preparing guidelines concerning various test groups and selecting the groups, process testing, studying the pace of competences level change, aggregating the test results in the form of database, evaluations, publications („Instruction for analyzing the results of testing process X”, „Development of the results of testing process 5 (CUT), „Partial report concerning the results of testing processes in the ATC ERASMUS + project, Czestochowa University of Technology”).

7. Selecting the most effective training processes – the review of obtained results and developing the characteristics of training processes, which being applied most effectively develop transversal competences among students, identifying and analysing the influence of cultural factors and considering their impact on training, preparing the final version of the method, ready to be implemented both in partner countries and in other countries, developing the documentation of tested process reference models („Table to be filled in to evaluate factors that could have influenced the results of an increase in competences in the tested processes”, “Consolidated report with the results of process testing in the project ATC ERASMUS+”, „The most effective training processes”).
8. Developing the final documentation of the method for transversal competences training within practical training – developing additional instructions and guidelines for implementing entities, which will allow for implementing the method in any country, without the necessity of introducing significant modifications to the basic training process.

The tasks according to the adopted schedule were carried out simultaneously by all the partners participating in the project.

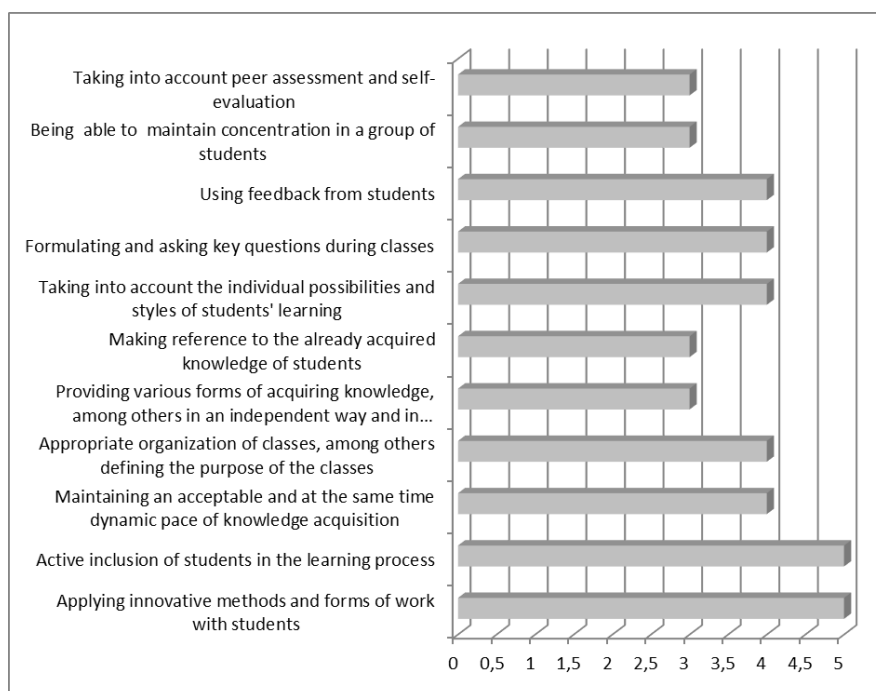
The following has been accomplished in the project *The acceleration method of development of transversal competences in the students' practical training process*: an overview of the existence and use of practical teaching methods in the students' training process in selected EU

countries was performed and the issue of the degree of potential importance of transversal competences in enterprises was examined. The outcome of the work was summed up in two reports: *A report concerning methods used to teach transversal skills and practical teaching methods* (IO1) and *A report on the research into the demand for transversal skills among entrepreneurs* (IO2).

## INFLUENCE OF FACTORS ASSOCIATED WITH TRAINING METHODOLOGY APPLIED AT HIGHER EDUCATION INSTITUTIONS FOR THE RESULTS OF EDUCATIONAL PROCESSES

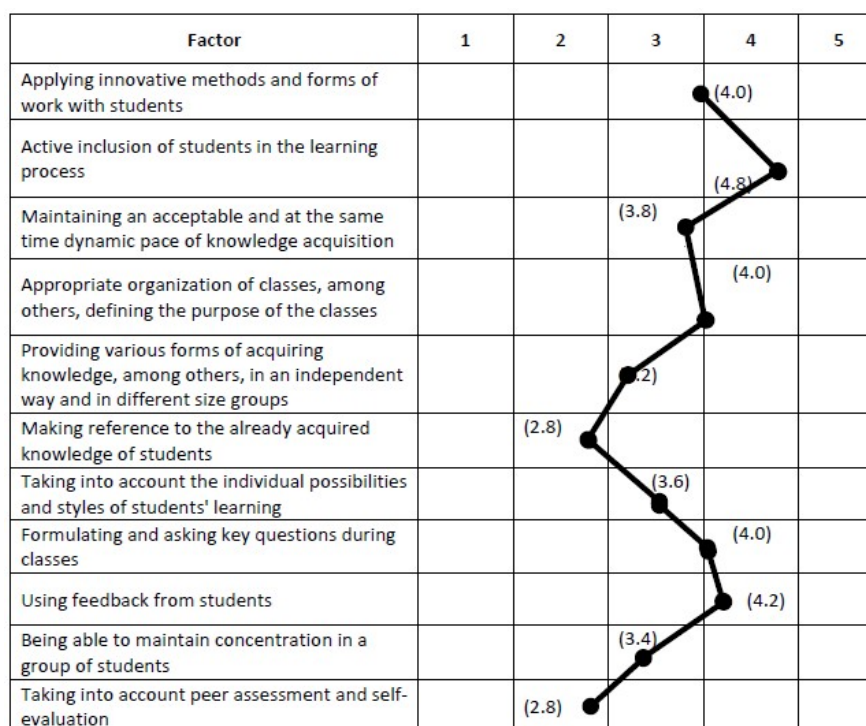
Training processes results are highly influenced by applied training methodology. Project partners frequently pointed out the potential influence of the teaching methodology of subjects directly or indirectly associated with transversal competences on the results of testing the growth pace of transversal competences.

The group of experts of Czestochowa University of Technology evaluated the influence strength of this factor on the scale from 0 to 5, where 0 means no influence and 5 very strong influence. The evaluation has been presented in Figure 1 (Kiełtyka, Kucęba, Jędrzejczyk, Kulej-Dudek 2018, Whiddett, Hollyforde 2003).



Source: own elaboration

Figure 1. Evaluation of factors associated with the training methodology applied at universities on the results of transversal competences growth pace testing



Source: Report IO7 Documentation of Intellectual Output 7 under the name „The most effective training processes”

Figure 2. Factors associated with teaching methodology and assessments of their impact on test results

The highest ranks were given to the following factors: Applying innovative methods and forms of work with students and Active inclusion of students in the learning process) (both factors were given the rank 5). Effective training depends on the ways of managing training, that is methods and forms of work with students. On the basis of the programme of studies and appropriately selected curriculum the teacher should plan training methods, ways of learning, didactic tools and programme content, that is establish a strategy of actions. It should be remembered that each of the applied methods may be effective if it suits specific needs of the recipient. Methods based on student's active operation have impact on larger and better acquisition of knowledge than methods that do not inspire to activity or do it only to a small extent. Application of active methods in the training process may increase the effectiveness of training and learning, develop creativity and creative thinking and also the ability to cooperate and communicate within the group. Other important factors are also: Appropriate organization of classes, among others defining the purpose of the classes, Formulating and asking key questions during classes and Using feedback from students – 4 points each. Key questions should include the main issues of classes, be closely related to the goal of the classes, indicate a wider perspective of the discussed issue and result in student's interest in the carried-out task. These questions lead to discussions and receiving feedback in the scope of search for answers, justifying views and way of thinking, as a result making the students involved. Less important is Reference to

already acquired knowledge and Being able to maintain concentration in a group of students – 3 points. The Authors of the present paper believe that in case of university studies it is not a difficult thing. Concentration is the key to better memory, effective learning and work, and also achieving success in life. It is also an ability and as any other ability it can be developed through proper exercises.

It needs to be mentioned that each of the partners also evaluated these factors and aggregated evaluations as to the strength of this influence presented by teams from particular universities have been summarized in Figure 2.

While summarizing the results presented in Figure 2 it can be concluded that (The Project 2016, The Project 2018):

- all the analysed factors have an above-average (on average 2,5) influence on the testing results,
- close to “very strong influence” (4,8) impact has: active inclusion of students in the learning process
- equal or close to „strong influence” impact on the testing results have: using feedback from students (4,2), formulating and asking key questions during classes(4,0), applying innovative methods and forms of work with students (4,0), appropriate organization of classes, among others defining the purpose of the classes (4,0).

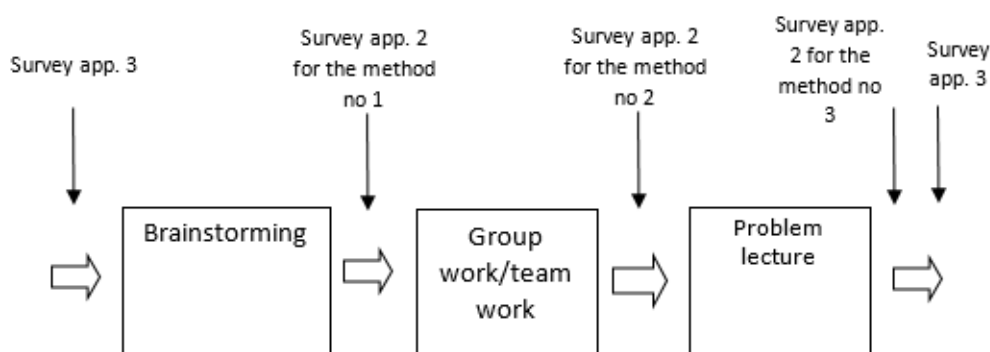
The next sub-chapters of the present paper present the aggregated results of the measurement of competences pace growth results in the groups of tested students with the use of the tested model.

## DEVELOPMENT OF THE RESULTS OF TESTING PROCESS AND EVALUATION OF COMPETENCES PACE GROWTH

The Czestochowa University of Technology tested process 1, which includes 3 methods of practical teaching

selected for this process: brainstorming, group work/team work, problem lecture. Presented below is the presentation of the tested process at the Czestochowa University of Technology (Figure 3).

These methods was applied within the subject "Methods of Organization and Management" in the group of 1st degree students of full-time studies at the Management Faculty in the 4th semester. The subject is carried out within 30 hours of lectures and 15 hours of laboratory classes (Table 1).



Source: own elaboration

Figure 3. Application of practical teaching methods in process 5 – Czestochowa University of technology (CUT)

Table 1  
Schedule of conducting process 1 testing (CUT)

Date	Process stage	Duration	Number of participants in classes / number of filled-in questionnaires
04.04.17	<b>STAGE I OF METHOD I</b> Introduction to the project and process. Filling in the questionnaire concerning the level of transversal competences at the beginning of testing. Introduction to the <b>method I - Brainstorming</b>	45 min	18/ NA
11.04.17	<b>STAGE II OF METHOD I</b> Characteristics of <b>method I - Brainstorming</b> ; dividing students into groups; presentation of problem tasks; running classes using <b>brainstorming</b> .	45 min	16/16
25.04.17	<b>STAGE III OF METHOD I</b> Summing up the results concerning solving problems; filling in the questionnaire concerning an increase in transversal competences after using <b>method I brainstorming</b> .	45 min	16/16
9.05.17	<b>STAGE I OF METHOD II</b> Introduction to method II, discussing the idea - <b>group work/team work</b> , presentation of stages of group work in the classes, presentation of problem task, conducting classes using <b>group work/team work</b> .	45 min	17/NA

23.05.17	<b>STAGE II OF METHOD II</b> Discussion and summing up the results concerning solving problem using <b>group work/team work</b> , filling in the questionnaire concerning an increase in transversal competences using <b>method II group work/team work</b>	90 min	17/17
5.06.17	<b>STAGE OF METHOD III – Characteristics of method III – Problem lecture</b> ; conducting classes using method III. Summing up the results; filling in the questionnaire concerning an increase in transversal competences after using <b>method III problem lecture</b> . Filling in the questionnaire concerning an increase in transversal competences after the entire testing process.	90 min	18/16

Source: The Report IO6 A set of results of processes' models testing 2018

The research comprised 18 students, out of whom 16 took part in the entire research process. All the questionnaires were filled in by 16 students. Data that was rejected was the one provided by students who did not participate in the entire research process, e.g. filled in questionnaire 2 and not 3, or they participated in one or two testing stages. Data analysis comprised results provided by 16 students, which is compliant with “Instruction for preparing and testing models of processes of developing transversal skills as part of practical training” where the minimum number of students is 15.

The evaluations that were analysed come from two questionnaires (The Project 2016, The Project 2018):

- Questionnaire appendix 2 - to measure the dynamics of changes in the evolution of acquired transversal competences (degree of change) - the questionnaire, which allows to assess the rate of an increase in competences (the questionnaire filled in by students after each method used in the tested process);
- Questionnaire appendix 3 - for assessment of the evolution of transversal skills level of the students in practical teaching process (the level of possessed skills) - the questionnaire, allowing for students' self-assessment in relation to 4 transversal competences before and after the testing process.

In the questionnaires, students had to answer one question for each skill. In view of the fact that each transversal competence consists of a different number of skills, a differentiated number of questions was asked in relation to transversal competences in accordance with the list of questions in the questionnaires. For subsequent competences the number of questions was:

- entrepreneurship - 6 skills (6 questions),

- creativity - 3 skills (3 questions),
- teamwork - 7 skills (7 questions),
- communicativeness - 8 skills (8 questions).

The total number of evaluations made by each student is:

- in the case of first questionnaire: 72 evaluations on a scale of 1-5 (24 evaluations after each of the three methods obtained from each tester),
- in the case of second questionnaire: 48 evaluations on a scale of 1-5 (24 evaluations before and after testing the process obtained from each tester).

The total number of evaluations obtained before and after testing by one student is therefore 120. The basic self-assessment results are presented below.

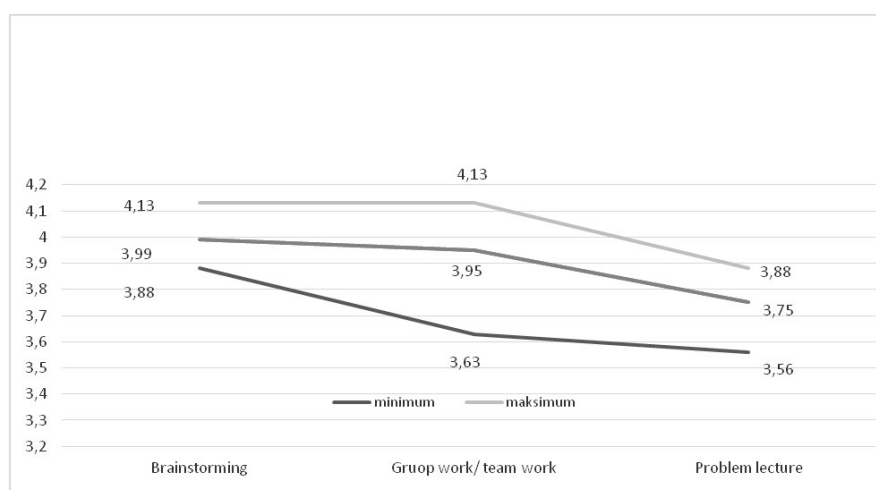
## EVALUATION OF THE RATE OF AN INCREASE IN A COMPETENCE - ANALYSIS OF DATA FROM THE QUESTIONNAIRE (THE QUESTIONNAIRE FILLED IN BY STUDENTS AFTER EACH METHOD USED IN THE TESTED PROCESS)

The following results were developed based on the data collected in the IO6 task during process 5 testing (CUT). The full scope of results is available in the report from the IO6 task entitled Development of the results of testing process 5 (CUT).

*Table 2*  
*The average values of an increase in students' transversal competences*  
*for subsequent methods tested in process 5 (CUT)*

Competences	Methods in process 5	$\Delta U_{\min}$	$\Delta U_{\max}$	$\Delta U_{\text{Wed}}$
entrepreneurship	Brainstorming	3,88	4,13	<b>3,99</b>
	Group work/ teamwork	3,63	4,13	<b>3,95</b>
	Problem lecture	3,56	3,88	<b>3,75</b>
creativity	Brainstorming	3,56	4,19	<b>3,90</b>
	Group work/ teamwork	3,63	3,94	<b>3,81</b>
	Problem lecture	3,69	3,88	<b>3,79</b>
teamwork	Brainstorming	3,81	4,13	<b>4,01</b>
	Group work/ team work	3,75	4,31	<b>4,10</b>
	Problem lecture	3,69	4,14	<b>3,93</b>
communicativeness	Brainstorming	3,56	4,25	<b>3,95</b>
	Group work/ teamwork	3,94	4,31	<b>4,08</b>
	Problem lecture	3,56	4,00	<b>3,88</b>

Source: „Partial report concerning the results of testing processes in the ATC ERASMUS + project, Czestochowa University of Technology (CUT)”



Source: Documentation of Intellectual Output 7 under the name „The most effective training processes”

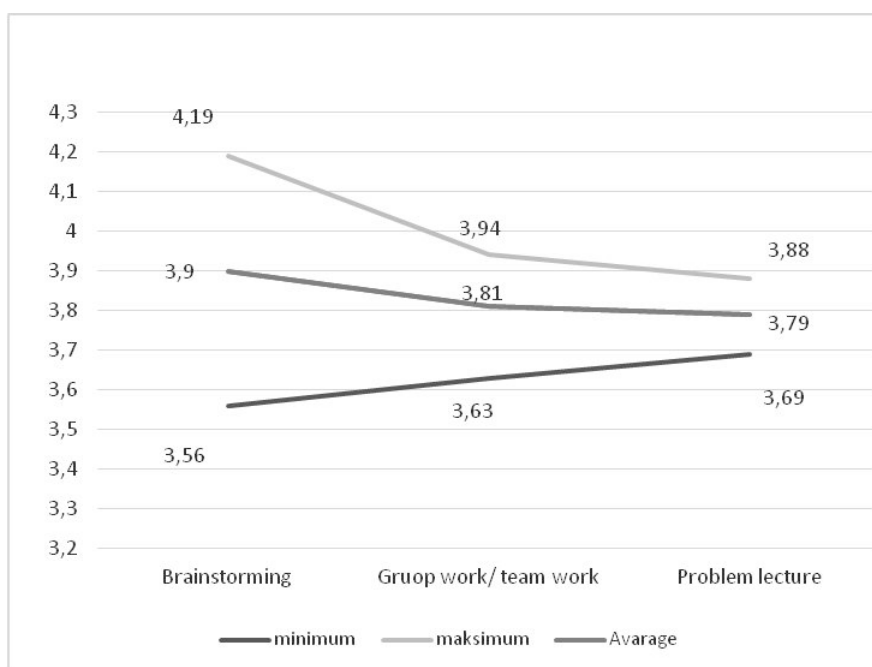
*Figure 4. The minimum and maximum values of the rate of an increase in individual component skills of the transversal competence "entrepreneurship" and the value of the rate of an increase in all component skills of the transversal competence "entrepreneurship" (averages of students' self-assessment - process 5 / CUT).*

Table 2 summarizes all the results of students' self-assessment. The analysis took into account the average evaluations of an increase in competences after each method for each of the students participating in the testing. The method of their calculation is presented in IO6 entitled Development of the results of testing process 5 (CUT).

Figures 4-7 show the minimum, maximum and average values of an increase in the four competences tested after successive practical teaching methods in the tested process 5 (CUT).

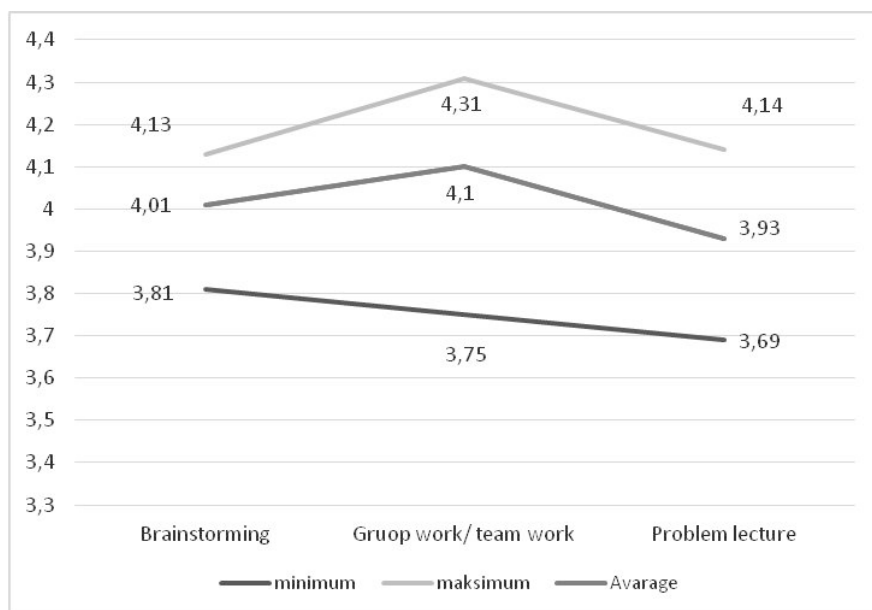
Conclusions related to Figure 4:

1. The value of the rate of an increase in all component skills of the transversal competence "entrepreneurship" (measured as the average students' self-assessment) - is relatively high.
2. There is a large variation in the rate of an increase in individual component skills of the transversal competence "entrepreneurship" (measured by the interval between the maximum and minimum rate of an increase in individual component skills).
3. All average rates of an increase decrease with the use of consecutive methods.



Source: Documentation of Intellectual Output 7 under the name „The most effective training processes”

Figure 5. The minimum and maximum values of the rate of an increase in individual component skills of the transversal competence "creativity" and the value of the rate of an increase in all component skills of the transversal competence "creativity" (averages of students' self-assessment - process 5 / CUT).



Source: Documentation of Intellectual Output 7 under the name „The most effective training processes”

Figure 6. The minimum and maximum values of the rate of an increase in individual component skills of the transversal competence "teamwork" and the value of the rate of an increase in all component skills of the transversal competence "teamwork" (averages of students' self-assessment - process 5 / CUT).

Conclusions related to Figure 5:

1. The value of the rate of an increase in all component skills of the transversal competence "creativity" (measured as the average students' self-assessment) - is high.
2. There is a large variation in the rate of an increase in individual component skills of the transversal competence "creativity" (measured by the interval between the maximum and minimum rate of an increase in individual component skills).
3. All average rates of an increase decrease with the use of consecutive methods.

Conclusions related to Figure 6:

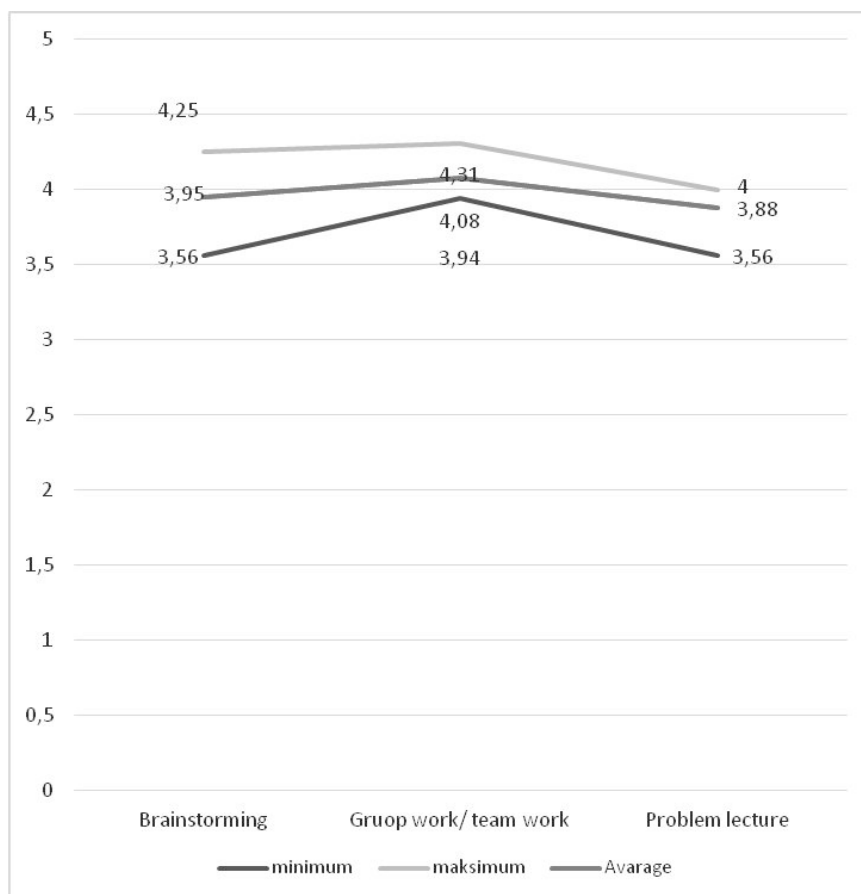
1. The value of the rate of an increase in all component skills of the transversal competence "team work" (measured as the average students' self-assessment) - is relatively high.
2. There is a large variation in the rate of an increase in individual component skills of the transversal competence "team work" (measured by the interval

between the maximum and minimum rate of an increase in individual component skills) after the first method. Greater variation in the rate of an increase occurs after the second method.

3. All average rates of an increase decrease after the second method.

Conclusions related to Figure 7:

1. The value of the rate of an increase in all component skills of the transversal competence "communicativeness" (measured as the average students' self-assessment) - is high.
2. There is a relatively low variation in the rate of an increase in individual component skills of the transversal competence "communicativeness" (measured by the interval between the maximum and minimum rate of an increase in individual component skills).
3. All average rates of an increase decrease after the second method.



Source: Documentation of Intellectual Output 7 under the name „The most effective training processes”

Figure 7. The minimum and maximum values of the rate of an increase in individual component skills of the transversal competence "communicativeness" and the value of the rate of an increase in all component skills of the transversal competence "communicativeness" (averages of students' self-assessment - process 5 / CUT).

*Table 3*  
*Average values of an increase in the level of students' transversal competences for subsequent transversal competences in process 5 (CUT)*

Average values of an increase for the group testing the process for the selected competence	Method number in process 5 (CUT)	Minimum value (min) of the average of students' evaluations of a given skill of the selected transversal competence before testing	Maximum value (max) of the average of students' evaluations of a given skill of the selected transversal competence before testing	Average values of students' evaluations for a given competence
entrepreneurship	before	1,83	4,17	3,00
	after	3,17	5,00	4,09
creativity	before	1,67	4,33	3,00
	after	3,00	5,00	4,00
teamwork	before	2,43	4,29	3,36
	after	3,29	4,86	4,08
communicativeness	before	3,25	4,25	3,75
	after	3,88	4,88	4,38

Source: „Partial report concerning the results of testing processes in the ATC ERASMUS + project, Czestochowa University of Technology”

The minimum (min)/maximum (max) value of the average of students' evaluations of a given skill of a selected transversal competence before testing means that on the basis of the data the average value for the level of a competence was calculated before and after the entire process for each student. This value indicates the minimum/maximum average per student out of the entire group of students participating in testing (Table 3).

- The students evaluated the level of possessed skills after the entire testing process highly – average level of skills 4.25.
- Students rated the level of their communicativeness and teamwork as the highest possessed competences.
- The highest increase of the competence was observed in the creativity and the lowest - in the communicativeness.

## RESULTS

With reference to the obtained results summarized in the above tables, it can be stated that:

- The tested students (in the self-evaluation process) evaluated the level of possessed skills too highly.
- Students rated the level of their creativity as the lowest possessed competence and communicativeness as the highest.
- The students (in the self-evaluation process) evaluated degree of change of possessed skills after using tested teaching methods too highly.
- The highest dynamics of change was observed in the competence of teamwork and the smallest - in the creativity.
- Problem lecture is comparatively the least effective method.
- The students (in the self-evaluation process) evaluated degree of change of possessed abilities after using tested teaching methods highly.
- The highest increase of one of the component competences after using all the methods is 4,17.
- The lowest increase of one of the component competences after using all the methods is 3,67.

## LIMITATIONS OF THE STUDY

The study has some limitations. First, the study has been limited to a selected dean group in the indicted course of studies. The selection was purposeful, with some assumptions. Each Partner specified in the application tested at least one process covering at least 3 practical teaching methods selected for particular processes. The duration of the process had to be longer than one full day (24 h). Each process was tested on at least 3 test groups. Each group was contained at least 5 students, which means that the process was tested at a minimum of 15 students. Object of research was transversal competences, such as entrepreneurship, creativity, communicativeness, teamwork.

Detailed discussion has been conducted that concerned the presented studies and obtained results. It has been concluded that in the years to come the most interesting direction of future studies will be carrying out the testing process at universities located in other regions of Poland.

## CONCLUSIONS

The formulated conclusions, which are the result of the conducted research, confirm the underlying assumption in the project that considering the needs of European employers (particularly in the scope of transversal competences) it is vital to combine various forms of training (formal, non-formal, informal and practical ones)

and heterogeneous training methods. This is important in the context of preparing the students of scientific studies to start employment as well as making effective and optimum decisions in real conditions of their future professional work. This also confirms the necessity to diversify practical training methods and adjust curriculums to the needs of “professional practice”, not only in the local territorial space but also European and even global one.

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# Generic Strategies, Outpacing and Blue Ocean – Discussing the Validity of Three Strategic Management Theories Using Case Studies from Airlines and Grocery Retail

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## SUMMARY

*This article discusses the validity of three famous approaches of strategic management – Porter's Generic Strategies, the Outpacing Concept and Blue Ocean Strategies – by using cases from two industries: airlines and grocery retail. The discussion shows that all three concepts make important contributions to the explanation of the success and failure of existing strategies, but none of the concepts fully describes the reality. While generic and Blue Ocean strategies neglect dynamics, the outpacing approach is still too much imprisoned by the categories of Porter. As a conclusion, first ideas towards a more dynamic theory of market evolution are drawn which include aspects of Blue Ocean and Outpacing and recall a more philosophical approach.*

**Keywords:** *Generic Strategies, Outpacing, Blue Ocean, Market Evolution*

**Journal of Economic Literature (JEL) codes:** *L10, L52, L81, L83, L93*

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## INTRODUCTION

Porter's Generic Strategies and the more recent concept of Blue Ocean strategies belong to the modern fundamentals of strategic management theory, as shown by a special collection of the famous Harvard Business Review (2011). Surprisingly, the connecting and separating elements of both approaches have seldom been discussed. An exception is an article written by the founders of the Blue Ocean Strategy, W. Chan Kim and R. Mauborgne, where both approaches were characterized as rather contradictory (Chan Kim & Mauborgne 2009). Wider room was given to the discussion of whether Porter's hypothesis that a company needs a clear strategic focus to succeed is backed by empirical evidence or not. A multitude of surveys were not able to give a clear answer to that question (e.g. Thornhill & White 2007). The Outpacing Approach, first formulated by Gilbert and Strebel (1987) tried to bring more light into that discussion by adding a new dimension: time. Taking time into consideration, Porter's Generic Strategies, Outpacing and Blue Ocean Strategies seem to be rather different steps in

a general theory of market evolution than opposing approaches.

To outline this hypothesis, a short summary of these three approaches is given in the first part of the following article. The second part discusses the validity of these approaches by means of two case studies from two different industries: airlines and grocery retail.

## PORTER'S GENERIC STRATEGIES AND THE U-CURVE

In his famous book *Competitive Strategy* (1980) Michael Porter introduced the concept of Generic Strategies as a milestone of the discipline. Using the two dimensions: competitive advantage, with the possibilities *lower costs* or *differentiation*, and competitive scope, which can be narrow or broad, he deduced three basic strategy types:

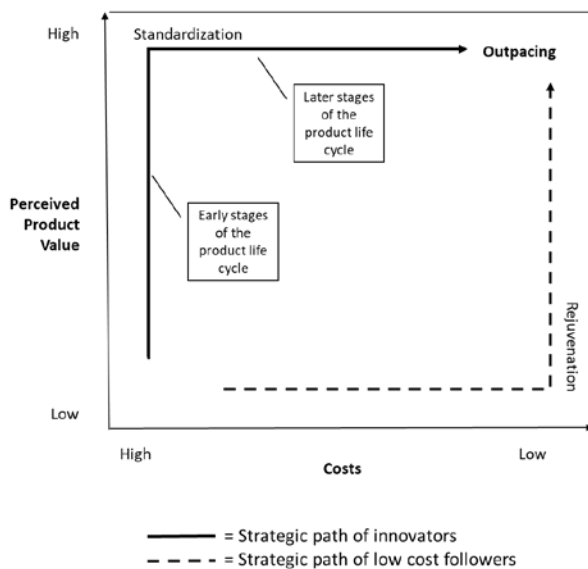
- *Cost/Price Leadership:* This strategy comprises companies that compete by low prices and concentrate on the whole market, trying to get a high market share

for realizing maximum cost savings from economies of scale.

- *Differentiation*: This strategic positioning is built on competitive advantages besides lower prices. Examples are a better functionality, higher quality or superior services. Nevertheless the whole market is targeted and not only a narrow segment.
- *Focus (Niche)*: A niche strategy concentrates on a small and well-defined segment or target group by either offering a customized product or service, which is more often the case, or a special price.

According to Porter, a company has to choose one of these generic strategy types in a pure form, not intermixing them. Companies that have a lack in positioning by not clearly representing one of those types, “stuck in the middle” and will therefore most likely fail.

## THE OUTPACING APPROACH



Source: own representation based on Gilbert & Strebel 1987, p. 32

Figure 1. Outpacing

According to the Outpacing Approach, success does not necessarily mean to exclusively concentrate on a cost-/price-leadership strategy or a differentiation approach; rather, these strategies can be perceived as steps in the process of market evolution. To successfully occupy a superior market position two paths of development exist. Figure 1 illustrates the basic ideas of the approach (Gilbert & Strebel 1987). Typically, markets evolve by innovations. In an early stage of the product life cycle, these innovative companies continuously improve the value of the new product up to a certain level at which a commonly accepted standard is established. This level defines the turning point in the strategic orientation. Competition is now mainly dominated by price struggles. Thus, companies have to change their strategic orientation

towards lowering their costs, which is mainly done through process improvements. The overall aim of all these strategic steps is to be the first to reach the upper right-hand position in the box, which is called the outpacing strategy (see Figure 1). In that position, a company offers a maximum value for reasonable prices. Later market entrants can attack that position by a strategy that first concentrates on low costs and prices. Thereby these cost advantages not only occur through process improvements, rather the quality and functionality of the product is reduced. In a later stage of the development, which implies the achievement of a certain market share, these companies start to invest in product enhancements. This process is called rejuvenation. Gilbert and Strebel (1987) mentioned that these two paths represent idealized generalizations; nevertheless, a company should choose a clear path regarding the two opportunities and not a “middle-of-the-road-strategy”.

In the past, the Outpacing Strategy was often used by Asian companies, e.g. in the car sector (Scheuss 2012) or more recently the solar industry.

## BLUE OCEAN STRATEGIES

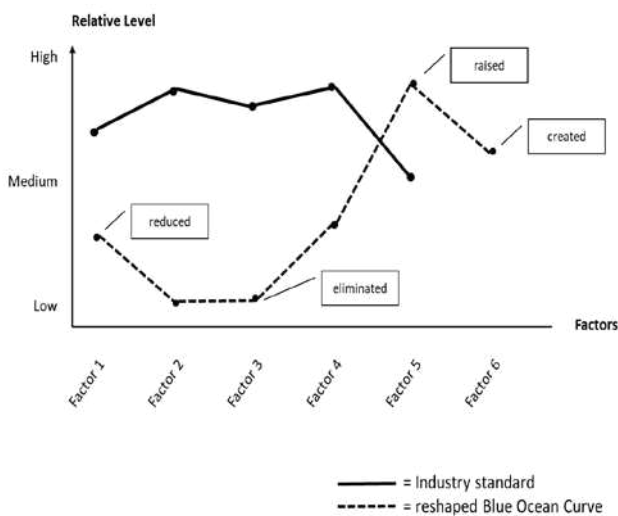
The concept of Blue Ocean Strategy was created by W. Chan Kim and Renée Mauborgne in the late 1990s and further developed ever since (Chan Kim & Mauborgne 2005, 2017). Research regarding the success factors of the Fortune 500, mainly in US-industries, brought the decisive insight that strategies of outperforming companies diverge dramatically from their “normal” competitors, mainly by ignoring common sense and breaking rules set up by industries. Outperformers do not concentrate on competition by surpassing opponents with more and refined product features; rather, they concentrate on creating new quantum leaps in value for the mass of customers. These extra values are often created by new ways to offer a product or new business models and are more seldom based on technological innovation.

The basic instrument of Blue Ocean Strategy is what is called the *Four Actions Framework* together with *Value Curves*. Many industry examples have shown that the typical standard of how to offer a product does not match the needs of the mass of customers in regard to several factors. A famous example is the case of the Canadian Cirque du Soleil (Chan Kim & Mauborgne 2005). Whereas circuses typically include animal dressage, e.g. with elephants or tigers, Cirque du Soleil eliminated this element and instead invested in the creation of a unique atmosphere by better staging, realized by fantastic light shows, music and dance or visible themes around the show. Before Cirque du Soleil launched its new strategy, animal dressage had been taken for granted by the circus industry. But even before the environment had changed, more and more people felt discomfort with the circus-like way of presenting animals. Also, exotic animals are nothing special in a modern world with zoos, people

traveling to Africa or knowing these animals from multimedia. On the other hand, animals belong to the most costly elements of traditional circuses. The abolishment of animal dressage enabled Cirque du Soleil to invest the saved money into the creation of a glamorous staging atmosphere. Finally, new target groups, e.g. business people or people with higher incomes, were attracted by the new format, enabling Cirque du Soleil to charge higher prices for tickets.

To create a Blue Ocean Strategy similar to that example, a company has to answer four questions – the Four Questions Framework (Chan Kim & Mauborgne 2005):

- Which of the factors that the industry takes for granted should be eliminated? (in the example, animal dressage)
- Which factors should be *reduced well below* the industry's standard? (in the example, fun and humor by clowns)
- Which factors should be *raised well above* the industry standard? (in the example, the refined atmosphere)
- Which factors *should be created* that the industry has never offered? (in the example, shows centered around specific themes).



Source: own research

Figure 2. The instrument Value Curve

The result of the Four Question Framework can be represented graphically by what are called Value Curves. As shown in Figure 2, first typical factors describing products or services of an industry and the way to offer them have to be defined (x-axis). Next the traditional way of offering, the industry standard, is represented by a value curve showing the relative level of realization regarding these factors (y-axis). It is important to recognize that this relative level should not be confused with customer value. A high level of realization does not necessarily mean that customers really appreciate that or at least would be willing to pay for it (like the animal dressage in the

example used). In a second step a company has to find answers to the four questions and by that to reshape (questions 1-3) or extend (question 4) the value curve – as done by Cirque du Soleil. For reshaping the curve, the need of the mass of customers always has to be taken as a decisive criterion. This customer mass is not only represented by the number of current clients, it can also include people who have not been using a product so far because their needs have not been fulfilled (like business people in the Cirque du Soleil example). The Wii, a game console by Nintendo, is another good example for that insight. Before the launch of Wii, game consoles had been mainly used by young men – a minority of the whole society. Elderly people and women perceived gaming on consoles as something being too passive or, depending on the game, too aggressive, and by that not staying in accordance with their value sets. With Wii, the new factor “movement” was added to game consoles, changing the perception by these two groups and opening the market for game consoles to the real mass of people.

## DISCUSSING CASES FROM TWO INDUSTRIES

In the following, examples from two industries, airlines in Europe and grocery retail in Germany, will be used that seem to represent typical Generic Strategies, Blue Ocean Strategies and Outpacing Strategies at the same time. These two industries have been chosen, because companies showing cost leadership gained a substantial market share. For the airline industry these cost leaders are called low-cost carriers, holding a market share of more than 40% in Western Europe (Powley 2017). The most successful low-cost carrier in the European skies is Ryanair, representing a cost-leadership approach by applying a strategy which broke the traditional standards on how to operate an airline. Therefore, this example will be further examined below. The German market for grocery retail not only shows a relatively high market share of 29.5% for cost leaders, the so-called discount stores (own calculations based on Lebensmittelzeitung, 2018), it also includes the company Aldi, an inventor of the discount principle, that dramatically changed the rules in the German and later European retail industry. Hence, that company was chosen for a deeper inquiry.

Both industries, German grocery retail and European airlines, are highly competitive and consolidated. The consolidation in the German grocery retail sector is extremely high. The biggest five players –Edeka, Rewe, Lidl & Schwarz, Aldi and Metro – account for more than 70% of total turnover in the market (Bundeskartellamt 2014; GAIN report, 2018). In the airline sector, this consolidation is still in process, especially in Europe, where the six leading airlines account for only 43% market share, compared to 90% in the US-market. The consolidation of airlines is not only realized by mergers and acquisitions; more important are strategic alliances,

such as Star Alliance or One World. Star Alliance, for example, with Lufthansa and United Airlines as main players, holds a worldwide market share of 23.9% (Anwar & Chacko 2015).

Whereas the German market for grocery retail can be characterized as mainly saturated (GAIN report, 2018, p. 1), the airline industry is still growing, with growth rates clearly exceeding GDP growth and a positive development of margins in recent years (European Commission 2017). Nevertheless, insolvencies of main players like Alitalia or Air Berlin have occurred recently, showing the high degree of competition in the European market (Powley 2017). Margins in the German grocery retail sector are traditionally low. This is, among other factors, caused by generally price sensitive consumers. However, recent trends show an increasing willingness to pay higher prices

for higher quality or specialties, e.g. fair trade and organic products or ethnic foods (GAIN report 2018).

### *The Example of Ryanair*

According to the company, Ryanair nowadays holds the number one status among European airlines, carrying over 130 million customers each year and connecting 215 destinations in 37 countries (<https://corporate.ryanair.com/about-us/history-of-ryanair/>). Ryan Air was founded in 1985 by the Irish family Ryan, operating as a small and more regional airline. In 1990 Michael O’Leary became CEO of Ryanair and started to successfully copy the strategy of the US low-cost carrier Southwest, becoming the first European low cost airline.

*Table 1*  
*Original and modified strategies in the airline industry*

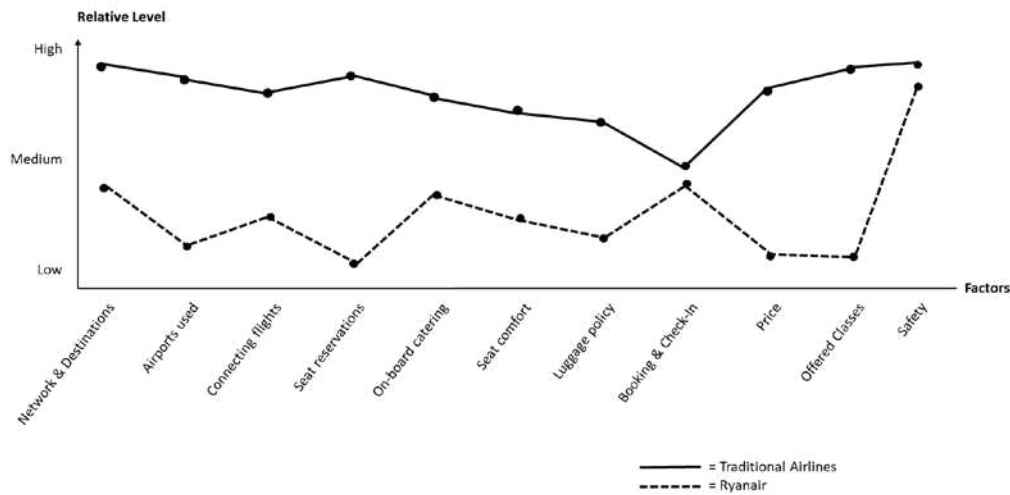
<b>Factors</b>	<b>Traditional Airlines</b>		<b>Ryanair</b>	
	<b>Original Strategy</b>	<b>Modified Strategy</b>	<b>Original Strategy</b>	<b>Modified Strategy</b>
<b>Network and Destinations</b>	Worldwide	No modification	Europe	Europe and neighbouring countries
<b>Airports Used</b>	Mainly bigger airports	No modification	Solely small airports	Also selected big airports
<b>Connecting Flights</b>	Connecting flights with luggage transfer	No modification	Connecting flights without luggage transfer	Luggage transfer available only at a few airports
<b>Seat reservations</b>	Reserved seats included	No modification	No seat reservations	Seat reservations possible (extra payment)
<b>On-board Catering</b>	Warm meals and drinks included	Reduced meals, drinks included	Meals and drinks not included, available for extra-payment	No modification
<b>Seat Comfort</b>	Relatively high comfort also for economy	Reduced for economy	Low comfort	Higher comfort possible (extra payment)
<b>Luggage policy</b>	Luggage up to 20 kg included	Depending on class, luggage paid extra	Only hand luggage included	Extra fee for checked luggage, also for bigger hand luggage (not for Flexi Plus)
<b>Booking &amp; Check-In</b>	Mainly via travel agencies, online booking paid extra	Free online booking as important channel	Solely online (service fee for travel agencies)	No modification
<b>Prices</b>	Rather high	Low to high	Very low	Low to middle
<b>Offered classes</b>	First, Business, Economy	Economy Flex added	Only Economy	Flexi plus added
<b>Safety</b>	High	No modification	High	No modification

Source: based on own research and Thomson & Baden-Fuller 2010; Tungate 2017

The low-cost carrier concept rests on a number of principles which were in clear contradiction to the industry standards used by traditional airlines such as Lufthansa, Air France or British Airways (see Table 1, columns “original strategy”). Thus, Ryanair’s moves can be clearly seen as a kind of a Blue Ocean Strategy, as visualized by the value curves of traditional airlines and Ryanair in Figure 3.

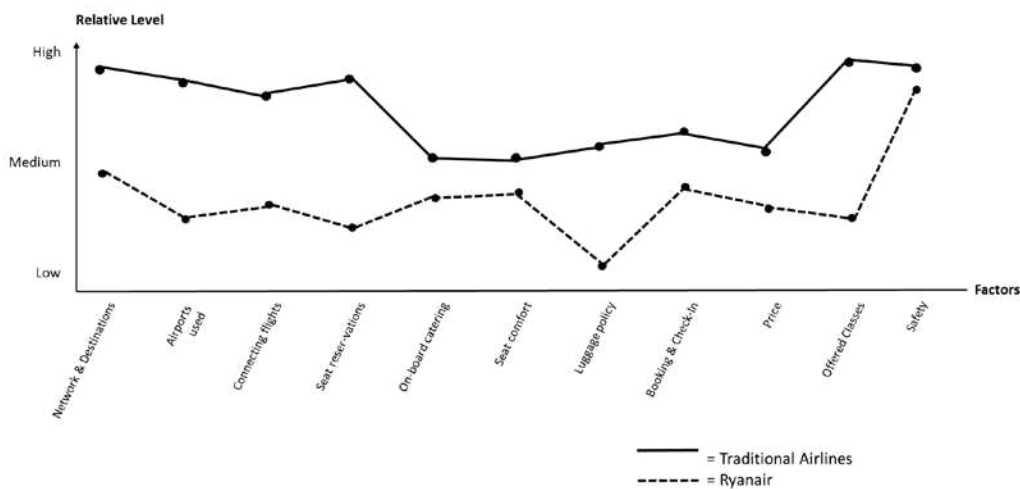
In its pure and original concept, Ryanair broke typical industry standards by eliminating factors like free meals, luggage transfer for connecting flights or seat reservations. Furthermore, it reduced factors like the size of airports, seat comfort or the flight classes. Together with changed internal processes, like the use of only one type of aircraft (Boeing 737), which are not represented in the customer-focused concept of value curve, these changes enabled Ryanair to offer flights for a price well below the standard

level. By that strategy Ryanair not only competed with the existing airlines, but could even attract clients to use flights as a mode of transportation, e.g. for weekend trips, who up to then had preferred to use other modes like cars or trains. This can be seen as another example of the Blue Ocean hypothesis that the mass of potential customers is not limited by the current number. Despite the fact that the target groups of traditional airlines and Ryanair did not overlap much, Ryanair put pressure on owners like Lufthansa by changing the price expectations of clients and showing that open potential for customers existed that had not been detected by traditional airlines. Thus, the traditional airlines started to change their strategies slightly, moving step by step towards Ryanair’s model. Table 1 in connection with Figure 4 shows these reshaped strategies.



Source: own research

Figure 3. Value curves of traditional airlines and Ryanair, original strategies



Source: own research

Figure 4. Value curves of traditional airlines and Ryanair, modified strategies

Visible changes were the reductions in meals offered and seat comfort. Later also the luggage policy changed and, similarly to Ryanair, 20 kg of luggage is not always automatically included. Together with other changes, traditional airlines were enabled to offer at least a certain amount of seats on inner-European flights for reasonable prices, affordable for private travelers. Due to the fact that traditional airlines still kept some advantages, e.g. the use of more centrally located airports and the offer of connecting flights, now some pressure was put on Ryanair. The Irish carrier therefore started to reshape its original and pure cost-leading strategy, step by step towards the traditional players (see Figure 4 and Table 1). Steps in that direction have been the offering of seat reservations, seats with higher comfort or an extra booking class (Flexi plus). However, in Ryanair's pricing policy clients were charged extra for all these offerings. The newest step in the strategic change of Ryanair is the use of selected big hub airports, such as Frankfurt. This can be seen as the first bigger change in the original strategy of Ryanair, because cost savings rested to a large degree on the use of small airports that not only charged Ryanair less, but also

guaranteed smooth and quick handling of processes to shorten the unproductive time of aircrafts on the ground.

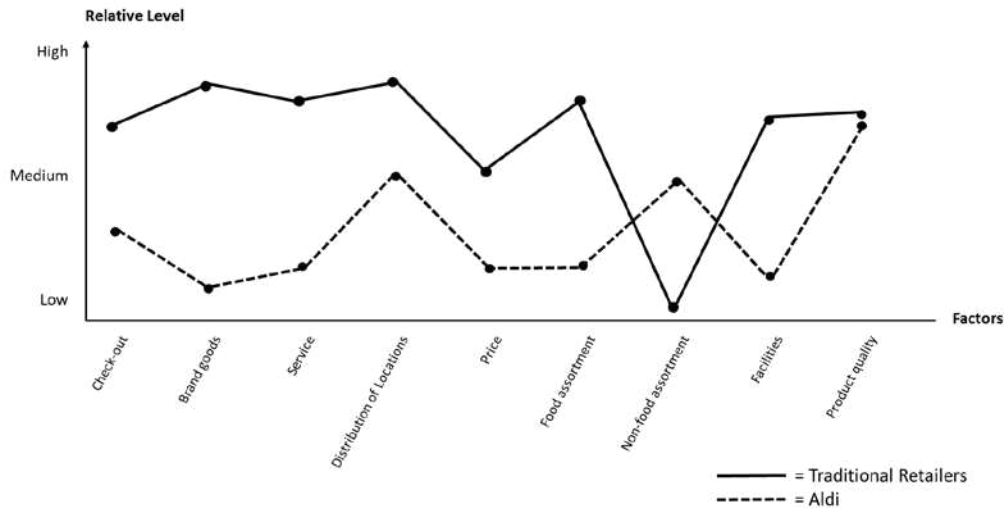
### *The Example of Aldi*

With revenue of more than 30 billion Euro, Aldi (the companies Aldi Süd and Nord together) is currently (2018) ranked number 4 in the German market for grocery retail (Lebensmittelzeitung 2018) and number 1 among the discount stores. The company was founded in 1913 by Karl Albrecht (senior) as a small family-owned bakery and grocery store in the German town Essen (Aldi 2018). In 1945 the two brothers Karl Jr. and Theo Albrecht took the store over and started to open subsidiaries. An important change compared to traditional stores was the introduction of self-service, which led to further expansion. By 1955 Aldi was already operating 100 stores, first concentrating on the German province North Rhine-Westphalia. In 1962 Aldi opened the first store that was fully operated according to the discount principles. These principles are visible in Table 2 and are graphically represented by the value curve in Figure 5.

*Table 2*  
*Original and modified strategies in the grocery retail industry*

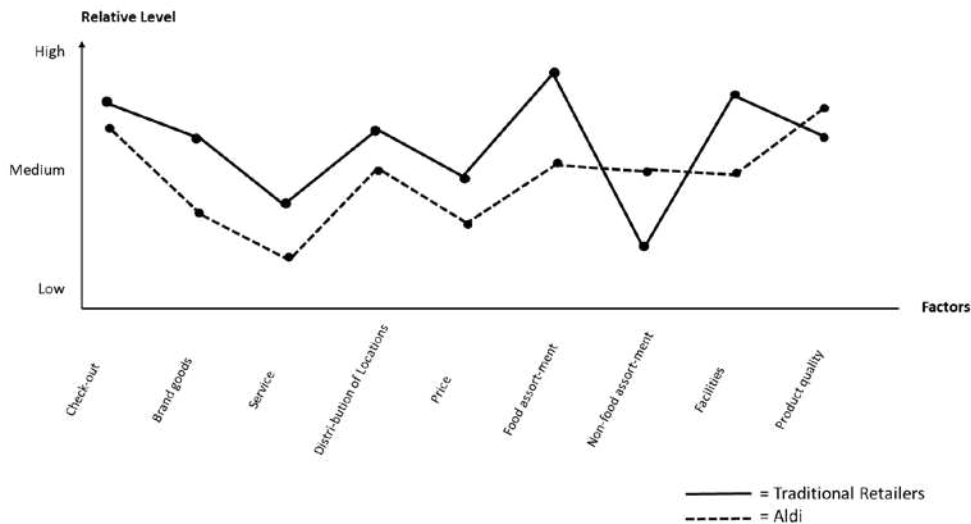
Factors	Traditional Grocery Retailers		Aldi	
	Original Strategy	Modified Strategy	Original Strategy	Modified Strategy
<b>Check out</b>	Cash and bank card	No modification (first trials with self-service)	Cash only	Cash and bank card
<b>Brand goods</b>	Mainly branded goods	Branded goods and more and more retail brands	No branded goods (only own retail brands)	More and more well-known brands
<b>Service</b>	Service for fresh products	Full self-service for fruits and vegetables, more and more self-service for meat products and cheese	Full self-service	No modification
<b>Distribution of Locations</b>	Decentralized in housing areas (few parking facilities)	More centralized in local shopping areas (parking facilities and competition)	In local commercial areas (good parking facilities)	More centralized in local shopping areas (parking facilities and competition)
<b>Price</b>	Medium	Low to high	Very low	Low to medium
<b>Food Assortment (breadth and depth)</b>	Broad and deep assortment (including fresh food)	Breadth and depth further increased (specialties, low cost products)	Small assortment (only 400 items), mainly non-fresh products, everything pre-packed	Bigger assortment (e.g. fresh meat, organic food, specialties), also non-prepacked fruits and vegetables
<b>Non Food Assortment</b>	Very few items	Few items, sometimes promotional products	Non-permanent assortment, promotional products (e.g. computers)	Not modified, but at least two thematic promotions per week
<b>Facilities</b>	Bigger stores	Somewhat bigger stores, somewhat nicer design	Small stores, very crude design (product presentation mainly on pallets)	Bigger stores, nicer design, products mainly on shelves
<b>Product quality</b>	Medium-high	Low-very high	Medium-very high	No modification

Source: based on own research and Brandes 2003



Source: own research

Figure 5. Value curves of traditional grocery stores and Aldi, original strategies



Source: own research

Figure 6. Value curves of traditional grocery stores and Aldi, modified strategies

Besides self-service, the assortment's breadth and depth were decisively reduced. This enabled Aldi to sell standardized goods in high volumes and to gain tremendously from economies of scale. Together with the simple presentation of goods, the realized cost savings enabled Aldi to offer goods of comparable quality at prices well below those of their competitors. By that, Aldi can be seen as inventor of discount strategies in retail. The success not only led to international expansion of the company and to imitation of the concept (e.g. by Lidl); traditional grocery chains, so-called full-range retailers, like Rewe or Edeka in Germany, were also put under pressure. Consequently, they started to modify their strategies towards Aldi's principles (see Table 2 and Figure 6).

One reaction was the foundation of their own discount stores by retail chains (e.g. Penny as a subsidiary of Rewe), but also the original stores went through some changes. The most serious change was the establishment of retail brands, mainly in the low price sector (e.g. the Rewe-brand Ja). These retail brands offered products with prices comparable to Aldi, but mostly in a lower quality. In addition and to save more costs, the degree of service for fresh food was diminished step by step. By these steps traditional grocery chains tried to convince customers that it no longer paid off to visit discount stores, especially because very often customers had to shop twice, first in the discounter with the limited assortment and later on in a traditional grocery store, where they could find the missing goods not available at Aldi.

Aldi had to react to those strategic modifications and started a process in the direction of the traditional competitors. The company increased its assortment by offering more fresh products, frozen products, specialties, fresh baked bread and organic food. Also payment by bank cards was initiated. The latest step in that direction is an upgrade of the facilities with an investment of more than 8 billion Euros (Handelsblatt 2017). New stores present a nicer shopping atmosphere and are larger in size.

## DISCUSSION AND CONCLUSION

Summarizing the insights gained from the two case studies, it is easy to recognize that both industries show the same patterns of development:

1. A predominance of traditional players that were almost all operating according to the same principles.
2. A newcomer, starting a “revolution” (in both cases by applying a discount, cost leadership strategy).
3. An answer to that “revolution” by the traditional players by changing parts of their strategy in the new direction.
4. An answer by the “revolutionaries” in the direction of the traditional industry standards.
5. A result in form of a (partial) convergence of both strategies, as is visible in Figures 4 and 6.

With those insights in mind, a deeper look at the validity and relationship of Porter’s Generic Strategies, the Outpacing Approach and Blue Ocean Strategy is possible.

### *Do Porter’s Generic Strategies Exist?*

The strategies of Aldi and Ryanair seem to belong to the cost leadership category of Porter, and it is not surprising that cost leaders and differentiators like Lufthansa and Rewe can be successful at the same time. Aldi and Ryanair filled existing gaps in the market. This is to some extent true. A deeper look at the strategies of Aldi and Ryanair reveal that it is not absolutely clear whether they follow cost leader strategies in the sense of Porter. Especially Aldi focuses on a high quality of products and was able to create a high degree of trust among its customers (Rentz 2018). The concept of the value curve shows that quality does not simply mean more of whatever the product/service is. Attributes can be divided into those that create higher or lower value to the mass of (potential) customers. Key value creators such as the quality of sold products (in the case of Aldi) or flight safety (in the case of Ryanair) should not be decreased to successfully run a discount strategy. Other examples like the Swedish furniture retailer IKEA show that even in combination with a discount strategy, more “features and functions” (in IKEA’s case more enjoyment through restaurants, shopping for articles besides furniture or amusement for children) may be added. The more evolutionary perspective reveals that the cost leadership strategies were strategic answers to predominant existing strategies that

neglected market potentials by concentrating too much on imitating competitors and creating so-called “Red Oceans”, markets with a destructive high degree of competition (Chan Kim & Mauborgne 2005).

### *Does the Blue Ocean Strategy Tell the Full Truth?*

The Blue Ocean strategy is successful in describing why strategies like those of Aldi and Ryanair were created and able to perform well. The concept of key value creators for the mass of people and the Value Curve shows that quality and reasonable prices do not have to be contradictory. But this works mainly in a world where traditional competitors play to rules that had been developed earlier and no longer fit the needs of the mass of customers or potential customers. Reshaping the value curve means coming closer to a customer-oriented approach and taking one’s eyes away from existing competitors. However, these existing, traditional competitors have the chance to learn which parts of their offer are rather obsolete and to reshape their strategies towards their new competitors. This may erode parts of the competitive advantage created by Blue Ocean Strategies.

### *Does Outpacing Fully Explain the Development?*

Outpacing is the only one of the three approaches that includes the dimension time. Outpacing forecasts a convergence of discount and quality strategies over time, which can be clearly seen from the examples used above. Also, the order of market entry, first by quality leaders, later by cost leaders, seems to support the approach. The only problem is that this convergence does not necessarily lead to a status where companies end as quality and cost leaders at the same time. The following arguments support this conclusion:

- The convergence is not total. The different strategic players still have a tendency towards cost leadership and differentiation, only the gap is smaller.
- The remaining gap is smaller in grocery retail than in the airline industry. This might be caused by the earlier appearance on the market of Aldi compared to Ryanair. Future developments will show if the gap between traditional retailers and Aldi will be further closed or not.
- The development can lead to different situations. In grocery retail, changes by discount stores like Aldi in the direction of traditional retailers seem to be bigger than the convergence from the other side. In the airline case it is the clear opposite. Lufthansa has, up to now, changed its former offering much more in Ryanair’s direction than the other way around.
- Convergence does not always mean that the higher value strategy adopts parts of the low cost strategy and vice versa. In some cases also a value increase by both

strategy types may occur. A good example is the distribution of locations in grocery retail. Both types, discount stores and traditional retailers, have changed their strategy in the same and new direction. Whereas Aldi stores were often located in mixed commercial areas and traditional grocery stores in the neighborhood of housing areas, both turned to a preference for new established shopping areas, which offer a selection of different competing grocery retailers, drug stores and fashion shops, mainly located at the periphery of cities and offering bigger parking facilities.

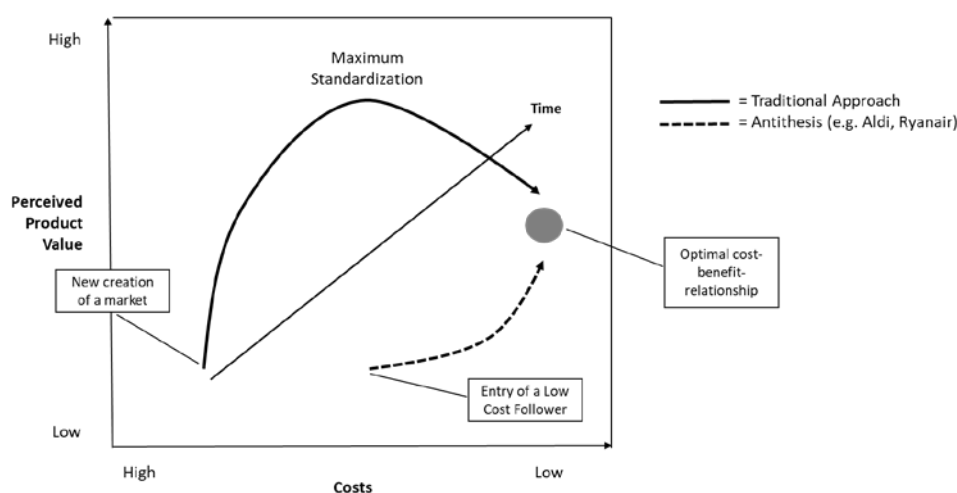
The question of in which direction the convergence mainly runs seems to be a question of the special situation in the particular industry. Another famous work of Porter, the Five Forces (Porter 2008), may contribute to an explanation concerning the direction.

Moving away from famous approaches of strategic management theory, one can clearly see parallels to the philosopher Hegel's dialectics (Maybee 2016). Social and political developments of all types are described by an order of thesis, antithesis and synthesis. Blue Ocean strategy shows how an antithesis can be found in an industry as an answer to existing concepts (theses) that lag behind recent developments. The synthesis is a convergence of thesis and antithesis. This might be one of the basic principles of market evolution, mainly where technological developments do not play a decisive role (in these cases, a full substitution of former products and markets is more likely to occur, as examples like streaming substituting CDs and DVDs show).

Figure 7 illustrates the typical development, exemplified by the case studies Aldi and Ryanair. The figure uses the framework of Outpacing, although the upper right-hand corner is not the end point of the development. Indeed, this can be found somewhere on the

right side of the box and represents a kind of optimal cost-benefit-relationship in the eyes of customers, which at the same time also enables companies to make enough profits. As described by the Outpacing concept, the point of standardization plays a major role in the evolution of markets. It marks a starting point for the appearance of new competitors, mainly those who have a low-cost strategy, resulting in price-leadership. The latter aspect is not compelling. As the above example of Cirque du Soleil reveals, increases in prices may also occur. The more important point is that the strategy can be seen as an antithesis to the former standard, eliminating and reducing factors that have been taken for granted but do not (or no longer) contribute enough to the customer value. This aspect is clearly shown by the Blue Ocean Strategy. The likelihood for the appearance of those revolutionary strategies is especially high under the following two conditions:

- Prices in the industry are too high for the mass of (potential) customers, there is a so-called price umbrella, and enough room for an aggressive pricing strategy is left (a circumstance described by Gilbert and Strebel 1987).
- Industry standards have not been changed for a while and simultaneously the market environment has moved in another direction. Coming back to the example of Cirque du Soleil, exotic animals were a sensation in the 19th century, but did not only lose attractiveness in the late 20th century, but more than that evoked negative feelings among the spectators who may be more sensitive to animal rights nowadays. Also in grocery retail the influence of environmental change is visible. Aldi used the trend towards self-service and a price-sensitive mentality of customers, but had to adapt its strategy to trends like organic food later on.



Source: own research

Figure 7. The evolution of markets as a combination of Outpacing and Blue Ocean strategies

Based on only two cases, these insights are a first hypotheses on the way to a more general theory of market evolution. Similar developments can be seen in many other cases like McDonald's reacting to the success of Starbucks

by inventing McCafé and currently also offering more service, more like traditional restaurants. Nevertheless, more research is needed to support and further develop the theory.

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# Innovation Cooperation: Buyer-Supplier Relations

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## SUMMARY

*The business marketing literature of the past few years has mostly examined business relationships on a value basis. In addition to the strategic importance of relationships with customers, cooperation with suppliers is also a priority. Relationships have shifted from aggressive, competitive, superficial relationships with many suppliers to long-term partnerships with fewer suppliers. Using two-step research – a case study and questionnaire survey conducted in Hungary – this paper examines how the extent of the buyer's contribution affect the success of the innovation market and how this depends on the supplier's innovation value.*

*Keywords: innovation, cooperation, supplier-buyer relationship, innovation value of supplier*

*Journal of Economic Literature (JEL) codes: L14, M11*

*DOI: <http://dx.doi.org/10.18096/TMP.2019.01.07>*

## INTRODUCTION

One of the most common issues of today's business practice is the existence and operation of business relationships and networks and their impact on economic activity and competitiveness. Starting from the mid-1970s, marketers started to deal more deeply with the ' market operation of organizations. The results of primarily European empirical research have led to the recognition that procurement behaviour, supply chain management and buyer and supplier relationships are to be interpreted as a complex process and must be considered together with the interactions between the parties. These findings led to the establishment of the Industrial Marketing and Purchasing (IMP) Group. The IMP Group is an informal, international network of hundreds of scholars who approach marketing, purchasing, innovation, technological development and management from an interactive perspective, in a B2B and a B2C context. Their work includes research on public-private networks, policy, and science-technology-business issues. With its extensive international research, the group has formed one of the most decisive theories of business relationships and networks.

As a distinctive feature of business marketing, it is considered that the marketing field is the most representative of "theory-driven practice management" and "problem-driven theory management". Looking at the research trends, besides sales management, purchasing

behaviour, new product development, marketing strategy management and distribution concepts, buyer-supplier relations were the focus of interest (LaPlaca & Katrichi, 2009).

Business practice has drawn attention to the need for a deeper understanding of business relationships for the sake of development. Deeper understanding and mapping of dyadic business relationships, placing them in a network context – especially those where cooperation and value creation take place – has been in the focus point.

The relationship based marketing approach has two basic directions, market-based and network-based (Möller & Halinen 2000). The market as a networking approach is becoming more and more developed today, and one of the effects of this trend is the growing openness of innovation processes. According to Backhaus et al. (2013), relationship-based marketing approaches and innovation are evaluated and are becoming a key to success.

## THEORETICAL BACKGROUND

A co-creation concept or philosophy can provide a sort of solution to a company's ever-increasing efficiency and compliance competition. The company must step out of a company-centred way of thinking and find where common value creation and common innovation levels can be achieved. Emphasis should be placed on personal relationships, focusing on common thinking, sharing value, experience and experience for the buyer and

stakeholders to seek this kind of cooperation. It is important to assess the impact of relationships and to clarify roles and tasks (Prahalad & Ramaswamy, 2004).

The business marketing literature of the past few years has examined business relationships mostly on a value basis, highlighting the factors and characteristics of relationship marketing. On this basis, the key question of long-term survival and success of companies is the creation of a premium customer value (Anderson & Narus 2004). Not only is the strategic significance of relationships with customers emphasized in the literature, but also the relationships with suppliers. The nature of the relationships has shifted from very aggressive, competitive and superficial relationships with many suppliers to long-term partnerships with fewer suppliers. The supplier's choice and determination of the supplier's value have become a question of competitiveness.

Over the past decades, an increasing number of theories and practices have examined the impact of collaborative supplier relationships and the sources of competitive advantage. Thus, the 1980s marketing literature concluded that these relationships should be considered as a strategic issue. Relations with suppliers and buyer-supplier relationships are important for a company. The importance of relations with suppliers was observed in the 1980s, beginning with the success of Japanese car and electronics companies. It was thought that one of the keys to success was the close relationship with the suppliers (Liker et al. 1996).

Of course, since the importance of the supplier relations strategy has been established, many studies have looked at the benefits and effectiveness of relationships. At the same time, practice began to change its basic attitude to supplier relationships, and through the strategy of hostile relationship management, we reached towards thought-built, long-term relationship with key suppliers, employing a large number of suppliers (Narayandas & Rangan 2004).

Most studies agree that tactile, nominal involvement of suppliers does not guarantee a real improvement in innovation performance (Liker et al. 1996; Freytag et al. 2012). A poorly selected supplier (with inadequate capabilities) can lead to lower innovation performance or even business failure (Zsidis & Smith 2005). Buying companies can increase their innovation performance by working with the most innovative suppliers. Of course, these vendors cannot provide all of their customers with the same resources (Gulati et al. 2000). Thus, if competing companies rely on the innovativeness of the same supplier, it will be very difficult to gain a competitive advantage through the common supplier chain (Dyer & Hatch, 2006). Without reciprocal linkage and commitment between the supplier and the buyer, companies may lose the innovation contribution from suppliers and thus the competitive advantage (Takeishi, 2001). In order to get innovation value from the supplier network, buyer companies need to know which vendors they need to work with, what kind of vendor skills they need to pay attention to, what kind of

relationship they need to develop and what marketing skills a buyer needs.

The change in customer-supplier relationships poses challenges for both parties. The buyer should be able to distinguish between qualified suppliers and be able to determine the best supplier base possible. To do this, the supplier has to adapt and has to find the customer base where can become a key supplier and work together.

The most common reason for collaborations is the broader experience and knowledge that can be gained (Romijn & Albaladejo 2002). So the innovation capacity of suppliers is a key asset for companies (Möller & Törrönen 2003; Azadegan & Dooley 2010). Many potential innovation partners can be distinguished and several types of innovation results can come from these relationships. Von Hippel (1988) was one of the first to find that customers and suppliers are the primary source of innovative product ideas. Not only is maximizing operational performance important, companies are seeking innovation potential to create value for their customers through this capability (Kibbeling 2010). Chesbrough (2003) also emphasized in his open innovation theory that the growing power of transport companies, their influence also contributed significantly to the spread of open innovation.

The assessment of value co-creation, the relationship value of the supplier is the basis for other research. Most research basically investigates the impact of relationships on innovation outcome with in-depth interviews and case studies (Nambisan and Baron 2009; Bowonder et al. 2010). At first, the model of the value of relationships was based on reflective measurement models (Lapierre, 2000). In later research the formative measurement model was increasingly applied (Ulaga & Eggert 2006; Schiele et al. 2012; Yan et al. 2017).

Based on international and Hungarian literature, the research studies examine the impact of the supplier's technological and networking properties on the tightness of innovation co-operation. The main objective of the research is to identify a supplier innovation value that helps the customer to identify the most appropriate suppliers and key suppliers, focusing on the differentiating effect of resource-based and network-based innovation value.

On the basis of a summary and synthesis of literature a theoretical framework has been formulated by me that is the basis of my qualitative research. The framework is based on Möller's (2003) theory of innovation and technology, which explains that network properties are as important as technological properties. In formulating the involvement of suppliers in the buyer innovation process, the theoretical model of Schiele et al. (2012) was the basis. The more robust appearance of network attributes and network thinking was provided by Yan et al. (2017).

However, companies have other resources outside the organization, in the form of partnerships and associations (Lavie 2006). Integration and collaboration with external partners can benefit companies in the innovation process.

(Gemünden et al. 1996) The company is embedded in a network of potential partners and its innovation process, so innovation must be interpreted from a network perspective (Gemünden et al. 1996). Examining corporate competencies, innovation is also greatly enhanced by technological excellence in networking (Ritter & Gemünden 2003; Piskóti 2016a). Thus, it is important to examine the impact of cooperation with different stakeholders on innovation and types of innovation.

According to the resource-based approach, the basis for company differentiation is the company's unique resource base, which cannot be imitated by competitors (Barney, 1991). In fact, the innovation value of suppliers is based on their own internal corporate resources (Sjoerdsma and van Weele, 2015). In the resource-based approach, the buyer company is looking for suppliers that are similar, technologically advanced, and able to establish a strong relationship with the buyer when searching for innovation partners.

According to the network-based approach, the value of innovation can be created by the supplier's value-added network, which is made up of the supplier's chain and innovation partners. According to the theory, the supplier's network is an innovation resource for the buyer company. It is important to emphasize that the network-based innovation value approach builds on and goes beyond the resource-based approach. Beyond corporate capabilities and dyadic relationships, the customer company and the supplier company are also embedding networks into networks. Some approaches suggest that testing should be placed at the level of the "dual-ego network" and focus on how the value network of the buyer company crosses the value network of the supplier company (Yan et al. 2017).

Based on literature, the research examines the impact of supplier involvement on the tightness of innovation cooperation. The main objective of the research is to determine the value of an innovation supplier, which helps the buyer to identify the most optimal suppliers, key suppliers, and to prioritize the differentiating effect of resource-based and network-based innovation value.

My research is based on the findings that collaborations are playing an increasingly important role in innovation development (Yan et al. 2017), and that cooperation and joint development with customers and suppliers are common among innovation partners. Innovation cooperation with the supplier, its content and impact on the market success of innovation are highlighted.

The supplier's innovation value was first formulated by Barney (1991), according to which the supplier's potential contribution to customer innovation is by sharing and making available its resources. In our case In this study, the supplier's innovation value - reconsidering the previous definition - I adopt a different formulation of the supplier's innovation value: innovation value becomes a real, realized value because the potential supplier value - which consists of the supplier's own resources and supplier

network capabilities - meets the customer's innovation demand, creating a real supplier innovation value.

The success of innovations is determined by the strategic combination of business and process and product factors. Innovation is no longer simply an internal, secret matter for businesses, but a multi-faceted, multi-actor collaboration. The success of innovation is increasingly determined by how a business can manage its relationships and collaborations in this process. Market success can be measured using indicators; Piskóti (2016a, 2016b) proposes ten indicators for this purpose: market share, revenue, profit amount, share, reputation, number of customers, satisfaction, loyalty, brand equity and license fees).

The supplier's innovation value is unique, and each supplier has a different innovation value for the buyer, just as a supplier can have different innovation value for different customers. In the course of the study, I was interested in the factors that are most important in selecting a supplier, which are the ones that most influence the formulation of the supplier's innovation value. My assumption is that the supplier's innovation value depends on the technological capabilities of the supplier's own resources, from which a resource-based innovation value can be formulated. It depends on the supplier's ability to communicate, which can be a network innovation value, which is not only the proper formatting and transfer of own resources to the buyer, but also the transfer of other network resources to the buyer company. Third, the supplier's innovation value depends on how close the innovation cooperation between the parties is, how much the customer's innovation needs and expectations match those of the supplier.

In this paper I examined the assumed basic relationship between supplier innovation value and market success of innovation. So, on the basis of exploratory research and theoretical synthesis I formulated the following hypotheses:

1. The extent of supplier involvement in the buyer's innovation processes has a positive effect on the market success of the buyer's innovation.
2. The supplier's innovation value has a positive impact on the market success of buyer innovation.
3. The extent of supplier involvement in the buyer's innovation process has a positive impact on the supplier's innovation value.

For testing the external model and performing reliability and validity tests, I performed confrontational factor analysis and then removed the 0.5 factor weight indicators, observing the higher validity that can be obtained by removal.

## DATA AND METHODS

The research consisted of two elements: a case study analysis and a corporate questionnaire survey. During the sampling, the economic branch chosen was the machine

industry and, more specifically, the production of parts. This industry, besides playing an important role in the Hungarian economy, is traditionally characterized by networking. A close relationship between assembler and supplier companies is typical of this industry worldwide. (Kim, 2014) For many components, development, deployment, and open innovation processes are shared with external partners. The main population is made up of large and medium-sized enterprises that start with the TEÁOR number 28–30. (It means companies whose main activities: manufacture of machinery and equipment, manufacture of motor vehicles, manufacture of other transport equipment.)

The exploratory research was a case study analysis of business relationships between a machine tool manufacturer and its customers. During the data collection, I conducted structured interviews with procurement managers working in manufacturing in the North Hungary region. Nine large and medium-sized enterprises located in Hungary were included. Each of the companies in the sample is engaged in the production of vehicle and automotive parts. Respondents have years of experience in procurement, logistics and production planning, make purchasing decisions and influence supplier selection.

Then I conducted a corporate questionnaire. The written questionnaire was distributed to all other companies in Hungary in the sampled sector. The population is made up of large and medium-sized enterprises that start with the number of TEÁORs 28–30. The number of companies contacted was 516. There were 58 responses to the questionnaire, giving a response rate of 11.24%. Each of the responding companies has been carrying out some innovation activity in the last five years. Data collection took place between February and April 2018. The data was processed and the hypotheses tested by PLS-SEM.

The main topics of questionnaire were: general innovation activity and main supplier and supplier characteristics, supplier capabilities - costs of technology and relationship, innovation relationship, supplier contribution to innovation process and value of innovation, market success of innovations. Measuring scales were a 5-step Likert scale in each case.

## RESULTS

Based on the exploratory research it can be said that similarly to business relationships, the supplier's

innovation value is unique in each relationship and will be characterized by a specific relationship. Companies have different weight weights for individual factors that influence value creation.

The supplier participates in several and continuous cooperation, but manages the relationship with some customers as a priority and relies not only on its own resources but also on the resources of its own suppliers.

Depending on the factors that are of greater importance, and the extent to which the customer's innovation needs and supplier competencies match, we can distinguish the value of innovation driven by customer demand as well as the supplier value-based innovation value that carries a core innovation value or some additional innovation value.

A proper meeting of customer innovation needs and supplier capabilities (technology, network) creates value for supplier innovation that has a major impact on the success of the innovation process in the market.

The supplier's innovation value depends on the customer's innovation need, the supplier's resource-based innovation value, and the supplier's network-based innovation value. Improving and influencing these dependent factors is the common interest and responsibility of the partners; based on these, different supplier innovation values can be classified into larger groups.

As confirmed by the previous findings, the information generated and obtained through daily cooperation with suppliers increasingly helps companies turn innovation into new innovation (Berghman et al. 2013). Innovation collaborations appear as value for companies.

Analyses show that indicators and variables meet expectations. Factor weights are in most cases above 0.7 but in no case lower than 0.4. The latent variables correspond to the thresholds for CR (>0.7), AVE (>0.5), and Cronback alpha (>0.7), as illustrated in Table 1. When examining the reliability and validity of the above-mentioned four indicators, the variables and their indicators are above the minimum levels required. When checking the discriminatory validity, the cross-weight validity (the correlation between the indicator and the latent variable was always greater than the correlation between the indicator and any other latent variable), and the Fornell-Larcker criterion was met (latent variables were sufficiently separated) and the HTMT index was acceptable (all values were below 0.9). Since the indicators and the variables meet the required criteria (Henseler et al., 2009; Hair et al., 2011, 2012, 2017), I decided to accept them.

*Table 1*  
*Testing validity and reliability*

Variables / Indicators	Factor weight	CR	AVE	Cronbach alpha
	>0.5 (min. 0.4)	>0.7	>0.5	>0.7
<b>Innovative Value of Supplier</b>		<b>0.876</b>	<b>0.638</b>	<b>0.874</b>
kél_1	<b>0.774</b>			
kél_3	<b>0.747</b>			
kél_4	<b>0.874</b>			
kél_5	<b>0.796</b>			
<b>Market Success of Innovation</b>		<b>0.908</b>	<b>0.529</b>	<b>0.915</b>
ksl_1	<b>0.762</b>			
ksl_2	<b>0.786</b>			
ksl_3	<b>0.837</b>			
ksl_4	<b>0.558</b>			
ksl_5	<b>0.533</b>			
ksl_6	<b>0.846</b>			
ksl_7	<b>0.743</b>			
ksl_8	<b>0.608</b>			
ksl_9	<b>0.794</b>			
<b>Supplier Contribution</b>		<b>0.923</b>	<b>0.675</b>	<b>0.930</b>
bi1_1	<b>0.924</b>			
bi1_2	<b>0.886</b>			
bi1_3	<b>0.655</b>			
bi1_4	<b>0.721</b>			
bi1_5	<b>0.628</b>			
bi1_6	<b>1.032</b>			

Source: own data

*Table 2*  
*Testing the significance of path coefficients*

Path	Original Sample	Sample Mean	Standard Deviation	T Statistics	P Values
<b>Innovative Value of Supplier -&gt; Market Success of Innovation</b>	<b>0.716</b>	<b>0.738</b>	<b>0.060</b>	<b>11.845</b>	<b>0.000</b>
<b>Supplier Contribution -&gt; Supplier Innovation Value</b>	<b>0.687</b>	<b>0.705</b>	<b>0.101</b>	<b>6.799</b>	<b>0.000</b>
<b>Supplier Contribution -&gt; Market Success of Innovation</b>	<b>0.492</b>	<b>0.522</b>	<b>0.095</b>	<b>5.165</b>	<b>0.000</b>

Source: own data

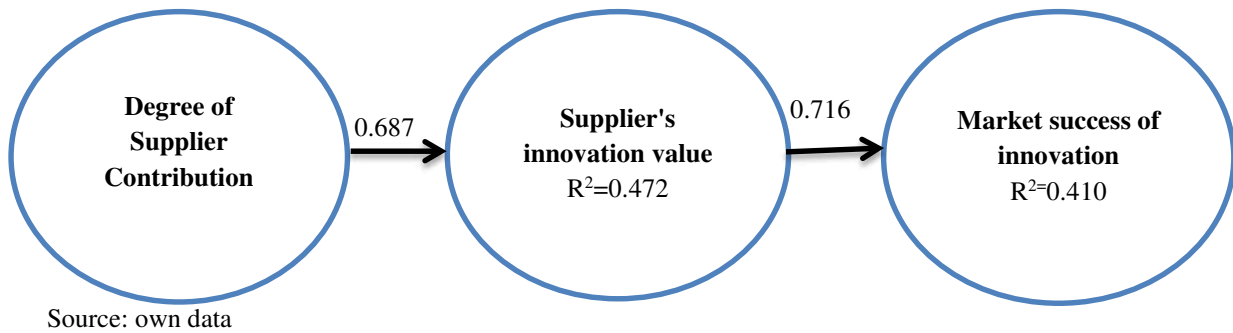
After validity and reliability analyses, it can be concluded that the external model's reliability and validity criteria are adequate, so the resulting relationships can be generalized.

In the tests of the internal model, the results of the tests of the individual path are first presented, followed by the analysis of the effects between latent variables. According to the model, the supplier's contribution to the innovation of the customer has an impact on the supplier's innovation

value, and the innovation value of the supplier has an impact on the market success of innovation.

The significance of path coefficients was tested by bootstrap sampling. The number of sub-samples used was 5,000, as suggested in guidelines in the literature (Henseler et al., 2009; Hair et al., 2011, 2012, 2017).

In the first step, I examined the interactions between suppliers, the supplier's innovation value and the market success of innovation. The results of the p values (Table 2) show significant effects at 5% significance level.



*Figure 1. Effects of supplier involvement, supplier innovation value and market success of innovation*

Considering the significant effects, it can be said that when examining the standardized path coefficients ( $\beta$ ) of the model, there are direct positive effects between latent variables. The supplier's contribution to the innovation value of the supplier is strongly influenced by ( $\beta = 0.687$ ). The innovation value of the supplier has a stronger impact on the market success of innovation ( $\beta = 0.716$ ) than the supplier contribution to the innovation process ( $\beta = 0.492$ ). Both effects are strong. Supplier co-operation has an indirect impact on the market success of innovation ( $0.687 * 0.716$ ) through the supplier's innovation value. The relations are illustrated in Figure 1.

By examining the indicator  $f^2$ , the significance of the effects can be determined. In this case, both the innovation value of the supplier and the market success of innovation ( $f^2=1.052$ ), as well as the supplier's contribution and the innovation value of the supplier ( $f^2=0.894$ ), are significant.

With regard to the explained variance, the supplier's innovation value in the customer innovation process is explained by 47.2 %. The market success of innovation is explained by 41% of the supplier's innovation value, which can be considered a medium-strong explanatory force.

## CONCLUSIONS AND LIMITATIONS OF THE RESEARCH

Research on network collaboration is increasingly focusing on customer-supplier relationships. Most studies report positive effects on supplier involvement in the customer innovation process. The innovation capabilities of the customer companies are increasingly dependent on the capabilities and resources of their suppliers (Narasimhan, 2013). Therefore, choosing the right supplier is a very important point. The selection process and subsequent decisions and co-operation can be facilitated by an evaluation system that outlines the value of a supplier's innovation in terms of suppliers and relationships. To do this, the following information is needed: the supplier's technology and network properties,

how these capabilities to make collaborations, and how to use and utilize each other's resources to help create shared value, advance innovation, and thus gain competitive advantage.

Innovation cooperation is becoming more and more common in Hungarian companies, and the importance of innovation cooperation with the supplier is increasing. "Traditional" purchasing thinking is still present, but the development of a small and narrow supply chain is increasingly prevalent.

Typical in practice the increasing number of organizational innovations and organizational changes aimed at facilitating joint innovation and the development of a similar network value system. However, it is not enough to create a similar organizational structure; new innovation business models must also be developed.

In general market practice is increasingly showing that companies are outsourcing some of their production, citing capacity shortages. However, this is followed by continuous supplier development, continuous advisory and control activities. Thanks to a closer relationship, the customer's innovation process can be more efficient.

There is a positive, medium-strong relationship between the supplier's innovation value and the level of supplier involvement. Innovation cooperation involves common innovation processes between the supplier and buyer, the continuity and intensity of these processes, the meeting of customer and supplier innovation needs and offers. So the closer the innovation of the two parties is, the higher the value of the supplier's innovation value.

The results reinforce the approach that innovation must become market-driven. It can be stated that technological innovations are still predominant in Hungarian corporate practice, but perhaps the integration of organizational and marketing innovations has started, if not always in a conscious way.

The limitation of the research to the generalization is that the investigation took place among the machine manufacturing companies linked to the Hungarian automotive industry. Further sector inquiries may reveal factors that have additional influencing natures or may reveal sector-specificity to the buyer-supplier relations.

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# Who Communicates a Change – Research Outcomes from Polish Companies

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## SUMMARY

*Organizations today are confronted daily with the need for change, and the way in which this necessity for change is relayed may serve to minimize resistance to change. The aim of the study is to diagnose who is the source of this message for change in Polish profit-making enterprises and how many employees take part in the change process team, thereby becoming part of the change and thus the disseminators of the message on change. Computer-assisted telephone interview (CATI) survey were the method used. The research sample covered medium and large enterprises and was representative. According to the findings, only 7.3% of employees are involved in the change process, the rest are informed by a superior or co-workers, sometimes co-workers from different departments.*

*Keywords: communication, change, organization, organizational behaviour*

*Journal of Economic Literature (JEL) codes: D22, D23, D83*

*DOI: <http://dx.doi.org/10.18096/TMP.2019.01.08>*

## INTRODUCTION

Organizations today are confronted daily with the need for change. Although the readiness of recipients for change should not be taken for granted (Nyagah 2017), the importance of constructive communication during the intended changes has been empirically demonstrated and commonly agreed among practitioners. Moreover, communication is considered to be vital for the effective implementation of organizational changes, as great uncertainty and inaccurate rumours arise in cases of organizational change that were communicated badly (DiFonzo & Bordia 1998). A major challenge then is to develop a culture and leadership strategies that allow organizations to cope with change.

One of the possible approaches in facing this challenge may be the communication process, since organizational change and communication are inextricably related processes (Lewis 1999). Since communication is recognized as an instrument of organizational survival and growth (Schweiger & DeNisi 1991; Wanberg & Banas 2000; Bordia et al. 2004), it supports the change process itself by the development of efficient instruments for the measurement and analysis of communication in organizations (Downs et al. 1994).

The importance of communication to successful organizational change cannot be exaggerated. Unfortunately, in the literature – perhaps because of the

complexity of the concept of effectively communicating change – attention is usually limited to particular aspects of change. Lewis, Stephens, Schmisser and Weir (2003) conducted a content analysis on the top 100 best sellers on “organizational change” books available on Amazon.com. This analysis shows five major themes – change enforced by globalization, changes that would happen anyway, change and the survival mechanism – organizations have to survive - change as a daunting and intimidating concept or companies purposely choosing to change. It does not matter if the change focuses on strategic change or a change in the role undertaken in the workplace). Change has been researched in the areas of employee attitudes towards change (Wanberg & Banas 2000; Washington & Hacker 2005; Lewis 2006; Oreg 2006), its pervasiveness in corporate culture (Keyton 2005), expectations and competencies (Heracleous 2002; Clampitt 2005; Frahm & Brown 2005; Hansma & Elving 2008), benefits of employee participation (Lines 2004; Giangreco & Peccei 2005; Msweli-Mbanga & Potwana 2006), characteristics of the change process (Cushman & King 1995; Salem 1999; Dawson 2003; Bennebroek-Gravenhorst et al. 2006;), the course of the change management process (Elving 2005; Fernandez & Rainey 2006), changes in goal setting (Locke & Latham 2002, 2006; Larson & Tompkins 2005) and the resistance to change (Prochaska et al. 2001; Ervin & Garman 2010).

In addition, the assessment of what successful change communication is differs among researchers. Some consider that effective change communication occurs when employees successfully adopt the proposed changes (Robertson et al. 1993). Others evaluate effective change communication by the level of employee readiness for the change (Elving 2005). However, the problem for organizations is that change is not always communicated effectively (Hargie & Tourish 2000; Fernandez & Rainey 2006; Burke 2008; Cummings & Worley 2009).

Failures in the process of introducing change happen either because of inadequate preparation or poor communication of the need for or goals of change (insufficient information, incorrect communication channels, misinformation of employees, poor information, or an incomplete message (Lorenzi & Riley 2003)). Some research, like that of Beer and Nohria (2000) indicates a failure rate of one-third to two-thirds of major change initiatives and even more pessimistic results were noted by Burnes (2004) and Cope (2003, 2011), with a failure rate of up to 80 to 90 per cent. Researchers have also found that at least half of all organizational change programmes do not achieve the intended results (Bennebroek-Gravenhorst et al. (2006), in Husain 2013).

The relationship between managers (superiors) and employees has an impact on the resistance to change. Resistance to organizational change is higher if lack of trust exists (Oreg 2006). Improper management styles (Oreg 2006), management tactics (Furst & Cable 2008) and leadership strategies (Szabla 2007) enhance the resistance to the change. This also applies to employee's perceptions of management's abilities to achieve change (Stanley et al. 2005) the organizational climate, information received regarding the change, participation in the change process and trust in management (van Dam et al. 2008).

To overcome the resistance toward change it is recommended that employees are actively encouraged to participate in the change process (Lines 2004; Giangreco & Peccei 2005; Msweli-Mbanga & Potwana 2006). According to Giangreco and Peccei (2005), employee perceptions of their participation in the development and implementation of the change were associated with more positive attitudes towards the change and reduced resistance to change. Lines (2004) found links between employee's perceptions of their participation and the achievement of the goal, as well as organizational commitment and reduced resistance to change. According to Msweli-Mbanga and Potwana (2006), there exists a positive relation between access to participation and the willingness to participate, while there is a negative relationship between the willingness to participate and resistance to change.

While members of organizations do communicate during change, they concentrate on themes of uncertainty or a lack of information on specific changes. Uncertainty is "an inability to describe, predict, or explain" (Salem & Williams 1984), and complaints of inadequate information

are common in organizations (Daniels & Spiker 1983), with adequate information not being available through such sources as memos, reports, or websites.

Having that in mind, the research questions have been set – how many employees participate in the management teams for change in Polish medium and large-sized companies? And if they are not directly involved in the process, who communicates the change first – their superior or co-workers (i.e., who is their source of information)?

## RESEARCH METHOD

This study used primary sources. The project was financed by the National Science Center (NCN), decision number DEC-2012/09/B/HS4/02722. For the purpose this research the questionnaire was put together in Polish. The drafted questionnaire was put to consultation in academic society by representatives of the discipline and revised by six competent judges – professors who are considered in the country as best in the discipline. They introduced some modifications to enhance clarity. The question was of close type with three cafeteria answers. It was then pilot-tested on different employee samples and then officially during a final examination. The survey was conducted from April 2015 to January 2016 via telephone by workers trained to facilitate data collection. The companies involved in the survey were randomly drawn proportionally to the number of certain business branches in the country (Statistic Polish Yearbook).

The CATI (computer-assisted telephone interviewing) survey was conducted. The phone calls were directed to 50,212 persons from different companies (chosen randomly), the return rate equals 0.7966 %, which is extremely low. Respondents were randomly selected, and both supervisors and subordinates participated in the survey. Only medium-sized (50-249 employees) and large (more than 250 employees) companies were investigated.

The questionnaire was divided into two parts. In the first part, employees were requested to respond to general and demographic questions about their gender, age, length of employment and position in the company. The second part provided specific questions on the types of communication that employees use. Three issues were of interest to the survey – the sender of the message, who initialized the communication process; the information content of the message, and finally the method most frequently used to communicate in the company.

After collecting data a statistician was engaged to ensure proper data processing. Data were coded and processed into SPSS, a statistical package system. Results were analysed and summarized in order to draw conclusions and make recommendations.

## RESEARCH RESULTS

A total of 2,274 people from 297 companies participated in the survey on communication patterns as organizational behaviour (in production, service and trade sectors). In terms of gender, the sample population was 64.17% male and 35.83% female. 76.04% of the respondents do not manage people at all (directly or indirectly). Further data characterizing the sample are presented in Figure 1.

As far as departmentalization is concerned, the seven typical departments were recognized, repeated in almost every company – the Selling & Promotion Department, Law, HR, Finance & Accounting, Administration, Production and Customer Service Departments. The 8th category, named ‘Other Specialists’, gathers specialists in narrow fields connected with that branch represented by the organization.

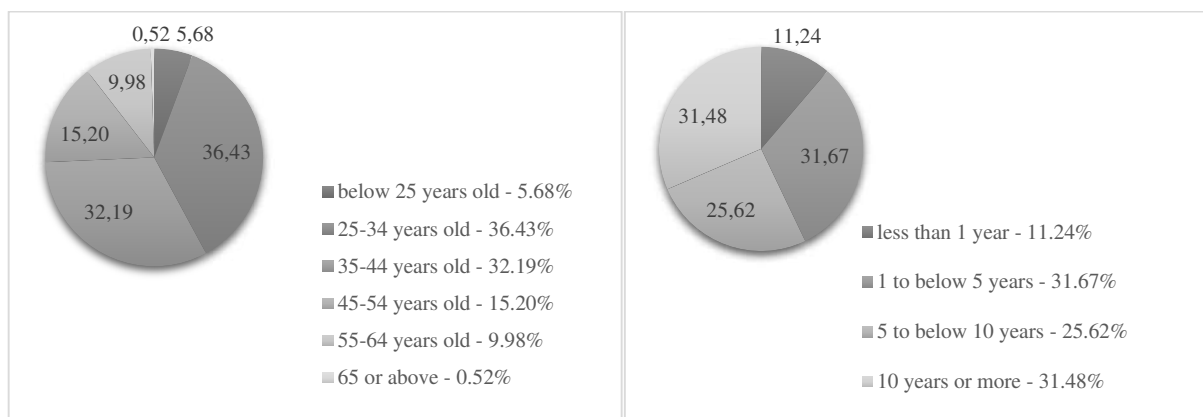
During the research work, three exclusive categories of change advisers were identified. The category of answer named in the figures below as “superior” stands for change order, it means that all changes are imposed and non-

negotiable. The activity is only on the side of the boss with no possibility to alter or modify the change decision.

The category of answer called “superior or co-workers” stands for a managers who project or offers a change, where adjustment and discussion is possible. The essence of the change remains while the details can be discussed and altered. Although an activity to suggest the change is still on the side of the boss, it is negotiable. In the negotiations people from different departments may participate only if they contribute. This category is for imposed and negotiable change.

The category of answer called “team” shows that the activity of suggesting a change rests on both parties – employees and bosses. Suggestions of change can arise from either side and are always discussed before the final change is introduced. The final shape of the change is a result of collaboration. The suggested change may even be rejected if it does not contribute to planned change.

In investigating significant difference, the Pearson Chi-square test of independence was used. If the Chi-square results are significant, post-hoc analysis is then conducted for identifying differences significant at the 0.05 level. The outcomes of the research are presented in the figures below.



Source: own research

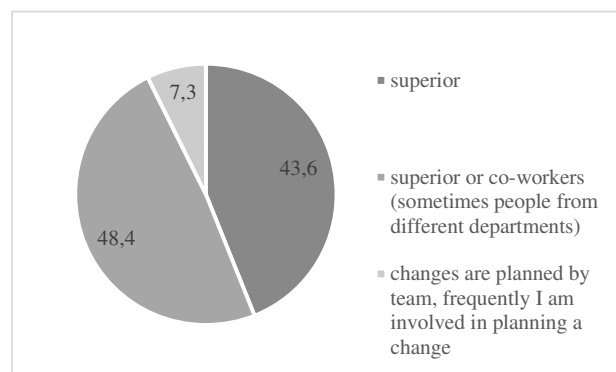
Figure 1. Distribution of age of respondents (left) and length of employment of respondents in the company in which they currently work (right) (%)

A large proportion of the employees – 43.6% – are informed about the organizational change by a superior or are co-designers of a change (Figure 2). Only 7.3% declare that they are co-authors of a change.

In Figure 3, the communicator of the change is shown with regard to the sector. Although this parameter transpired to be statistically insignificant, it may be noticed that employees from service and trade organizations tend to answer that they are part of a change process team and they are co-authors of a change – 8.9% and 8.5% respectively – which is more than 50% higher than occurs in the case of employees from production companies – 5.5%. Employees of production companies say that in 45.9% of cases they learn about change from a superior – this is the highest score out of the three sectors researched. Moreover, 50.2% of employees from the service sector

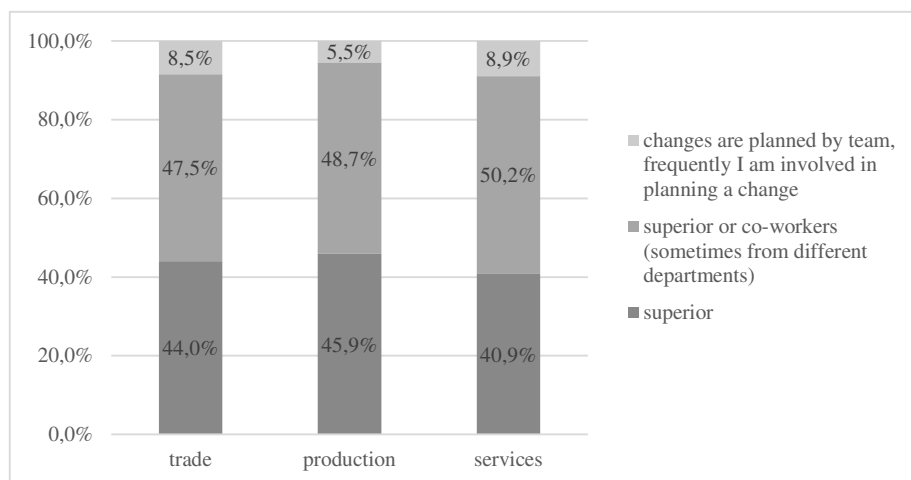
learn about a change from their superior or co-workers. The question then arises of whether the sector itself imposes such behaviour.

The initiator of the communication for change with regard to company size is shown in Figure 4. If the calculation had been done with accuracy to two decimal places, the outcome might have seemed significant. That was the reason the third decimal place was employed. Nevertheless, it is significant – though of no great surprise – that medium-sized companies are more likely than large enterprises to invite their employees to design a change, to be part of a team planning and organizing the change. In addition, information about the planned change in medium-sized enterprises comes from superiors, 44.9%, compared to 40.5% in large companies.



Source: own research

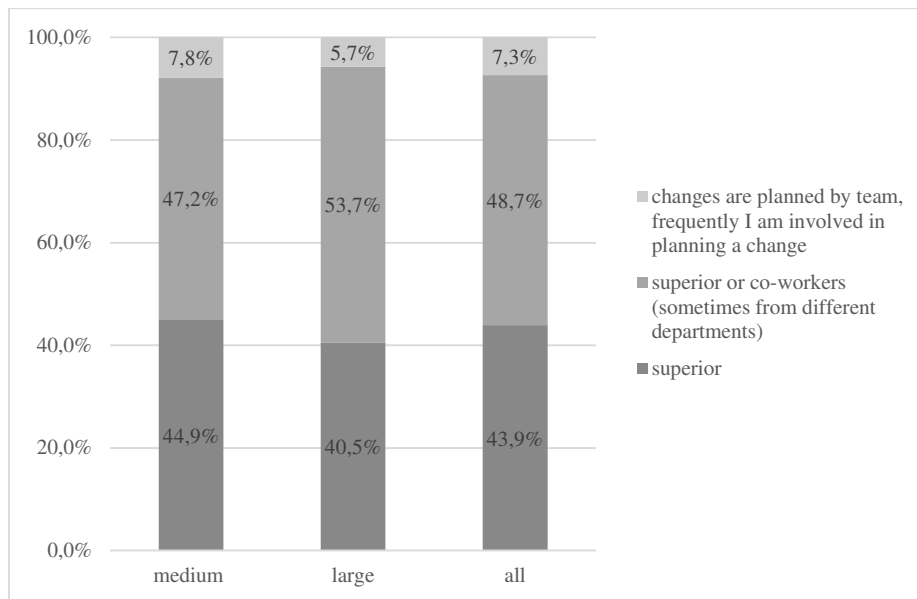
Figure 2. From whom employees learn about changes to be introduced into an organization



$p = 0.068$ ; Pearson's chi-square = 0.033; Cramer's  $V = 0.042$

Source: own research

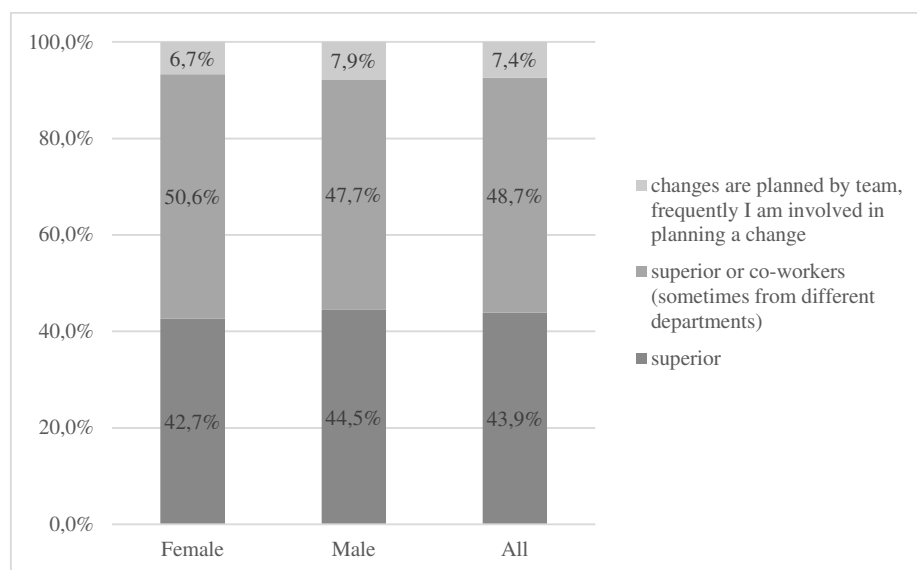
Figure 3. The communicator of the change by sector



$p = 0.058$ ; Pearson's chi-square = 0.022; Cramer's V = 0.058

Source: own research

Figure 4. Communicator of need for change by company size



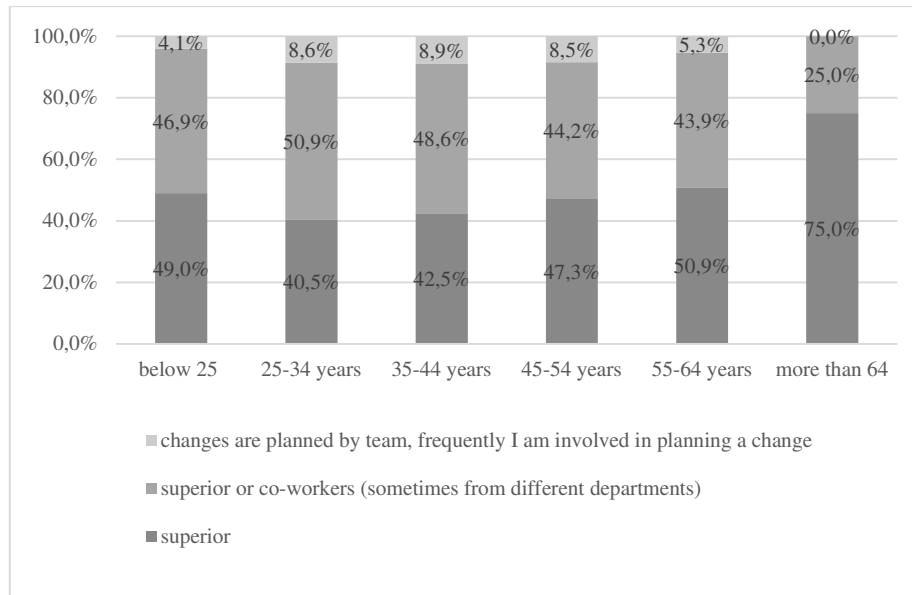
$p = 0.031$ ; Pearson's chi-square = 0.351; Cramer's V = 0.031

Source: own research

Figure 5. Communicator of the need for change by employee's gender

The relationship between the communicator of the need for change and the employee's gender, shown in Figure 5, is statistically significant. Males slightly more frequently answer that they learn about change from superiors than females – 44.5% male to 42.7% female –

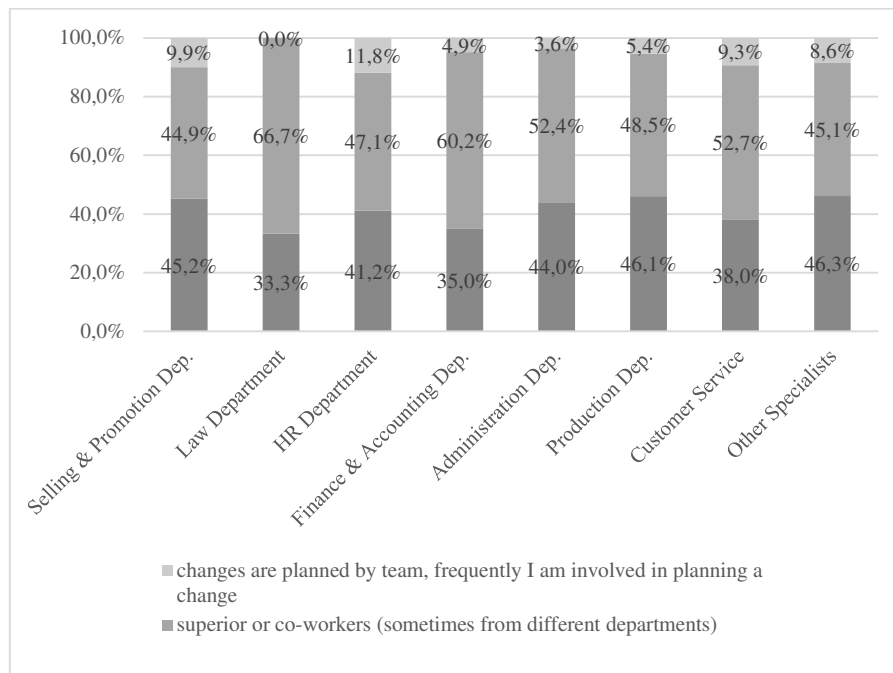
but in the case of learning about the change from a superior or co-workers it is the other way round – 47.7% male to 50.6% female. The strength of this dependence is considered weak.



$p = 0.094$ ; Pearson's chi-square = 0.124; Cramer's V = 0.067

Source: own research

Figure 6. The communicator of change and employee's age



$p = 0.115$ ; Pearson's chi-square = 0.023; Cramer's V = 0.082

Source: own research

Figure 7. The communicator of change and company departmentalization

The relationship between the communicator of the change and the age of the employee is shown in Figure 6. The age feature is here considered as an order scale (not a nominal scale). However, the influence of age on the answers is again insignificant. One must not fail to notice though, that among no respondent over 64 years old reports taking part in designing and preparing for the change; they are not part of the team for change design

compared to the 8.9% of employees between 35-44 years old. The second largest group of employees taking part in the team planning a change is people 45 to 54 years old – 8.5%.

People above 64 years old form the largest group of people informed about a change by superiors (75.0%), which is the highest score of all the research results

(compared to 40.5% of those aged between 25-34 years old).

The research reveals that lawyers do not take part in the team designing the change (0.0%) but this category shows the highest percentage informed about a change from superiors and co-workers – 66.7% (shown in Figure 7 below). They are also less frequently told about changes planned by a superior – 33.3%.

The HR Department – 11.8%, Selling and Promotion Department – 9.9%, Customer Service Department – 9.3% and Other Specialists – 8.6% are involved in teams constructing organizational change far more frequently – the difference between them and the other departments is significant – around 50% more often.

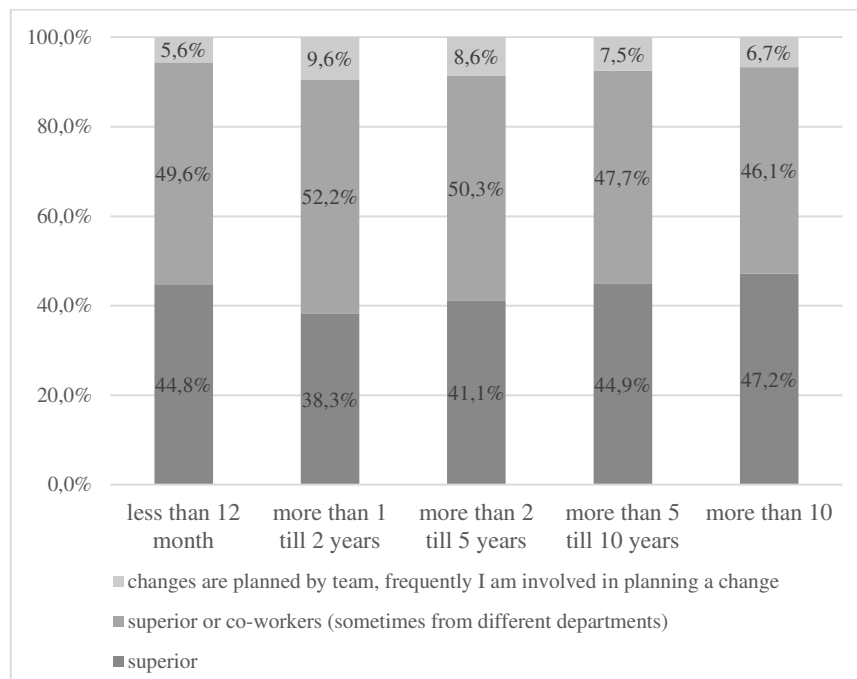
The Selling and Promotion Departments have a roughly equal source of information on change – 45.2% from superiors and 44.9% from superiors and co-workers. A similar situation can be observed in the case of the group of specialists (Other Specialists) – 46.3% from superiors and 45.1% from superiors and co-workers. However, the outcomes are statistically insignificant.

The communicator of change and length of employment in a company employees is also statistically insignificant. Employees working for more than one to two years at their current workplace – 9.6% – are the largest group of employees taking part in designing changes. It is not surprising that the group which is less engaged in those teams is employees having worked less than 1 year for the company – 5.6% - as shown in Figure 8 above.

## CONCLUSION

The way employees are informed about changes introduced in organizations is an important issue for the management of organizations. The main objective of the study was to diagnose who is the initiator of the communication about the change process introduced by the company (no matter the change size – from change at the workplace level to a strategy change of the whole company) made in Polish enterprises. This paper only presents the results of research regarding the communicator of the change – by whom employees are informed about the changes being made or how frequently they are invited to participate in the team designing the change (which is frequently emphasized in change management literature as engaging employees in the design and organization of a change in order to minimize resistance to a change).

On the basis of this research (showing that just 7.3% of employees are invited to participate in change design, the rest (that is, 92.7%), are merely informed about forthcoming changes) it is impossible to comment on the causes of the outcome in a responsible manner; only the state of the situation is presented. However, it is, of course, an impetus for further research – e.g. what notice employees are given about the upcoming change.



$p = 0.067$ ; Pearson's chi-square = 0.308; Cramer's V = 0.047

Source: own research

Figure 8. The communicator of change and length of employment

As the conducted research has indicated, few Polish companies tend to invite their workers to participate in the change, meaning to be the co-authors of a change. It would be interesting to establish the cause, as not asking employees to participate in forthcoming changes was usually considered in the literature as reinforcing the resistance to the change.

On the one hand, it is difficult to ask all workers to participate in designing change – too many people bring too many ideas and concepts, and this, in turn, may create havoc and encumbrances. On the other hand, the modern communication technology in common use nowadays may allow every employee to express their position on the

change process planned and encourage them to be a part of the growth and development of the company. Moreover, since we now live in a world of constant change, should it not be normal practice to involve employees in the change process as a systemic and constant activity?

A question for further research arises: with such constant organizational changes, as well as the ubiquitous state of permanent change: is there no necessity for special communication preparation for change, since changes are a part of our daily lives and should be considered the norm instead? How should we deal with the communication aspects of this ability to change in a turbulently changing world?

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