A photograph of the Flinders Street Station in Melbourne, Australia, featuring a large central dome and ornate facade. The station is surrounded by a busy street scene with pedestrians and tram tracks. The title text is overlaid on a semi-transparent white box in the upper half of the image.

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Victoria University
PO Box 14428
MELBOURNE VIC 8001
AUSTRALIA

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Journal of Business Systems, Governance and Ethics

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Editorial

From ethics and governance to small business and Higher Education

This volume of the Journal includes articles examining each of the topics that are the focus of the Journal: ethics, business systems and governance. They demonstrate the multidisciplinary nature of the Journal and of course how almost every discipline claims ownership of these areas of research.

Ownership of governance is a good example. Governance is about structures, systems of control and risk management, but also about leadership, the composition of boards and relationships among stakeholders. It is driven by values and strategic directions that impinge on ethics and corporate social responsibility. In respect to governance, because of the regulatory functions of corporate law, the discipline of law claims ownership of the concepts; accountancy has a claim because it is the discipline that designs systems of control and accountability; and management cannot be left out because of the roles and relationships of managers with boards, staff and so on. Researchers from any of these disciplines will develop explanations from agency, dependency, institutional and other theories to support arguments about why governance is important from their individual disciplinary perspective and how it applies in so many different contexts.

This is well illustrated in the range of papers presented in this volume of the Journal of Business Systems Governance and Ethics. The papers describe research in small and large corporations, public and private sectors, qualitative and quantitative modes of data and analyses and range across ethics, governance and organisational issues. They discuss findings from studies conducted in countries as diverse as the US, Sri Lanka, Kenya, Iran and Australia.

The first paper in this volume by Freeman and Lynch is directed towards the ethical values needed if societies are to survive. It begins with some fascinating comparisons of the economic causes of the demise of ancient civilizations and their empires with the path of the US today. They argue that the messages in the parables of the Bible still resonate today. Examples from the Bible are compared with what happened in the US to cause the GFC (e.g. selling mortgages that people could not afford, rating junk shares as AAA; forged and fraudulent bank loans and accounting, etc). They concluded that if the US is to continue as a super power, it must adopt ethical values that show concern for the welfare of the poor, compassion for workers and consideration for those who have lost their homes and jobs.

Nganga's article also addresses ethical issues. He raises the ethical challenges associated with practices that prevent small businesses in developing countries from participating in global markets. This theoretical paper defines ethical behaviour as the principles and practices that morally affect decisions in ordinary life. Nganga argues that small business activity in developing countries is inhibited by regulation, limited access to resources, skills, and contemporary technology, and restrictions on product marketing access evident in advertising which distorts the value of small business products. An ethical issue is the question of whether public finances should be used to support small business as such a move increases private gain at the expense of public resources. A second ethical issue is equality of opportunity of access to resources for every member of the human race. He proposes a universal code of ethics that disregards race, gender and class, intellectual property protection including long term patent rights for small business, and the use by small business of alliances and networks.

Li et al's article on small business exists and how small business can be assisted fits well with the above paper. Over 300,000 small businesses in Australia close their doors every year. The paper by Li et al is the first in Australia to explore the factors that impact on the demise of small business. It is important because the annually increasing numbers have such a devastating effects o productivity, employment and family well being. Statistical modeling of ABS panel data from over 3000 observations of 577 Local Government Areas in Australia identified variables that positively and negatively affect business exists. Among these size was a major factor.

Regulatory and compliance costs are known to be a disproportionate cost to smaller businesses. In a second paper on small business, Li et al analysed the results of a survey using a non-parametric logit model to determine the impacts and consequences of regulation for future policy.

Many small businesses are family owned. Wellalage and Locke analysed panel data from Sri Lanka to take a new look at ownership structure and its impact on firms' performance. Traditionally shareholder ownership in Sri Lanka was concentrated in families (insider ownership) but more recently there has been a rise in foreign and institutional ownership. Institutional and foreign ownership impacts on firms' performance are largely unexplained. They found that while high insider ownership of the Sri Lankan firms increased performance and management entrenchment, lower insider ownership increases misalignment between the objectives of managers and owners.

The final two articles in this volume by Mehdi and Davodi and De Silva and Armstrong reports the results from research directed towards internal issues, the first investigating employee commitment and the second examining governance and performance in the Higher Education sector.

Organisational citizenship behaviour (OCB) is shown when employees use their discretion to go beyond their formal job responsibilities in the interests of achieving organisational goals. Mehdi and Davodi's study examined the relations between three components of OCB, affective commitment, normative commitment and continuance commitment. From their analysis of 350 employees in Iran using SEM, they found that Affective and normative commitment have a positive influence on OCB but that there was no relationship between normative commitment and OCB.

The final paper by DeSilva and Armstrong examined the impact on the Higher Education Sector following the introduction of Governance Protocols. The study measured compliance with the Protocols by publically funded universities in Australia (an external governance mechanism) and internal governance mechanisms (board size and composition, transparency and reporting) and their impact on performance. The authors ' conclusions were that effective governance structures play an important role in performance, building stakeholder confidence and being demand driven in the competitive university sector.

Professor Anona Armstrong AM
Victoria University

Editor

Preventing the Decline and Fall of America: Messages From the Bible

Hershey H. Friedman and James Lynch
City University of New York, United States

Abstract

Quite a few politicians use pseudo-biblical values to justify their political agenda. The authors feel that many of their values are indeed biblical; they represent core values of ancient empires that have disappeared. If the United States wants to continue as a superpower, it should heed the words of the Bible. This means that concern for the welfare of the stranger, compassion for the helpless members of society, consideration for workers who have lost their homes, jobs, and savings have to be paramount. It may have taken “brimstone and fire” to destroy Sodom and Gomorrah; but America can be destroyed by greed, selfishness, inequality and injustice. Note how much damage was done to the United States and the world economy by the Great Recession of 2008.

Preventing the Decline and Fall of America: Messages from the Bible

Throughout history many great empires have collapsed. These include powerful kingdoms such as the Egyptian, Assyrian, Babylonian, Persian, Greek, Roman, Mongolian, Ottoman, and Soviet Empire to name just a few. In many cases, the decline was due to economic problems. A number of scholars feel the United States is next (Berman, 2012). Ferguson (2009) observes:

This is how empires decline. It begins with a debt explosion. It ends with an inexorable reduction in the resources available for the Army, Navy, and Air Force. Which is why voters are right to worry about America's debt crisis. According to a recent Rasmussen report, 42 percent of Americans now say that cutting the deficit in half by the end of the president's first term should be the administration's most important task—significantly more than the 24 percent who see health-care reform as the No. 1 priority. But cutting the deficit in half is simply not enough. If the United States doesn't come up soon with a credible plan to restore

the federal budget to balance over the next five to 10 years, the danger is very real that a debt crisis could lead to a major weakening of American power.

The precedents are certainly there.

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Habsburg Spain defaulted on all or part of its debt 14 times between 1557 and 1696 and also succumbed to inflation due to a surfeit of New World silver. Prerevolutionary France was spending 62 percent of royal revenue on debt service by 1788. The Ottoman Empire went the same way: interest payments and amortization rose from 15 percent of the budget in 1860 to 50 percent in 1875. And don't forget the last great English-speaking empire. By the interwar years, interest payments were consuming 44 percent of the British budget, making it intensely difficult to rearm in the face of a new German threat.

David M. Walker former United States Comptroller General and currently chief executive of Comeback America, compares this country to ancient Rome. Walker believes that if we do not become fiscally responsible and put our fiscal house in order the future of our nation will be threatened. Walker is concerned that cutting discretionary spending programs alone will not restore our fiscal health. The real problem is with mandatory spending programs such as Social Security and health (Medicaid and Medicare). The amount spent on those programs as well as interest on the national debt will skyrocket and eventually, based on current spending projections, there will be almost nothing left for expenditures that are critical for a country that wishes to remain a superpower – which include but are not limited to education, infrastructure, and R&D (Walker, 2010).

Luce (2012) attempts to explain why America is in serious trouble and its position as a global leader is inarguably fading. In a nutshell, we have lost the ability to solve problems. Some of the problems we are facing include: a shrinking middle class with stagnating incomes, growing income inequality, crumbling infrastructure, an ineffectual system of education, dysfunctional schools, burdensome and growing debt, reduced innovation in business, corrupting influence of the political system by donations and lobbying, and a paralyzed Congress. Obviously Luce is not overly optimistic about the future of America.

Mitt Romney, currently the Republican candidate for President, made the following statement on NBC regarding income inequality:

When you have a president encouraging the idea of dividing America based on the 99 percent versus 1 percent, you have opened up a whole new wave of approach in this country which is entirely inconsistent with the concept of one nation under God (Kruse, 2012).

Kruse (2012) observes that the “freedom under God” phrase, which closely mirrors what Romney stated, was used by the 1 percent of an earlier era to undermine the New Deal and do everything possible to undo what the corporations and elite felt was “creeping socialism.” These corporations and wealthy businesspeople tried to use religion to get the public to reject the welfare state.

While politicians may use God and the Bible for their own political ends, many scholars believe that a substantial amount of wisdom regarding how to live one’s life may be gleaned from the Bible’s enduring truths. The Bible —an important work of literature that has influenced the lives of many— has been referred to as “The Beginning of Wisdom” (Kass, 2003). To the believer and its adherents, it is the word of God and shows the way for individuals to lead a meaningful, spiritual life. Even non-believers recognize the Bible as a useful tool for teaching valuable and enduring lessons to humankind.

Spero (2012) uses the Bible to teach us about capitalism. He feels that the “the Bible’s proclamation that ‘Six days shall ye work’ is its recognition that on a day-to-day basis work is the engine that brings about man’s inner state of personal responsibility.” He also posits that the Bible, in stating that “Man is created in the image of God,” encourages people to be creative. Capitalism allows for a type of innovation and creativity the Bible encourages. Spero also asserts that the Tenth Commandment (Exodus 20:14) —“Thou

shalt not be envious of your neighbor's house... or anything else that is your neighbor's"— is in effect a warning to the 99% not to be envious of the top 1% (Spero, 2012).

This paper will examine the Hebrew Bible and scrutinize the words of ancient biblical prophets in order to determine what a political agenda based on the Bible's precepts should look like. If politicians and others are referring to the Bible, we should at least make sure that they have an accurate understanding of its underlying messages. This paper will demonstrate how the exhortations of the prophets to the earliest empires of the past, especially Israel, are valuable messages for everyone, including Americans of today. This paper is addressed to believers and non-believers alike who want to understand what, according to the Bible, is needed to make a country great. These ancient prophets may have lived 2,500 years ago but their messages still resonate with us today. Their admonitions are as relevant to the people living in America today as they were to an ancient Israelite dwelling in Jerusalem before the destruction of the Temple. Many of the prophets fled for their lives or were killed because of their prophecies. It took great courage to tell kings that the country was doomed because of their leadership.

One prophet actually succeeded in changing an ancient empire. Jonah's prophecy was quite simplistic (Jonah 3: 4): "Forty more days and Nineveh will be overthrown." He made the people believe that if they did not amend their ways they were doomed. Indeed, Jonah was instrumental in getting the people of Nineveh to repent and change their actions. The verse states (Jonah 3: 10): "God saw their deeds, that they returned from their evil ways, and God relented..."

Nehemiah, governor of Judea under the Persian empire, saw how income inequality and injustices to the poor would interfere with his vision of restoring Jerusalem to its former greatness, as in the times of King David and King Solomon. He was given permission by the Persian king to help rebuild Jerusalem; the Babylonians had destroyed much of it and the First Temple. Nehemiah and Ezra wisely worked together to rebuild the country. All the people had to work together to rebuild the destroyed walls, not an easy task given that they were surrounded by hostile people opposed to the rebuilding of Jerusalem. They had to build with one hand and keep a weapon in the other (Nehemiah 4:11). One problem Nehemiah had to deal with was the exploitation of the poor by the wealthy as the following verses make clear (Nehemiah 5: 1-5):

And there was a great cry of the people and of their wives against their brothers the Jews. For there were those that said: 'We, our sons, and our daughters, are many: therefore we must buy grain for them, that we may eat, and live.' And there were those that said: 'We have mortgaged our fields, vineyards, and houses, that we might buy grain, because of the famine.' And there were those that said: 'We have borrowed money for the king's taxes, and that on our fields and vineyards'. Now, our flesh is as worthy as the flesh of our brothers, our children as worthy as their children: yet, see, we bring into bondage our sons and our daughters to be servants! Some of our daughters are brought to servitude already: neither is it in our power to redeem them; for other men have our fields and vineyards.

Nehemiah realized that this injustice had to be corrected and convinced the aristocrats who were the creditors to return the fields to the previous owners and remit the debt. He understood that a new country cannot be built on injustices and that by correcting these wrongs, Jerusalem would be successfully rebuilt.

Message One: Compassion for the Poor, the Needy and the Stranger

A core value of the Bible is the obligation to help the unfortunates of society. This includes helping those who are impoverished. Thus, the Bible makes it quite clear that the landowner has a responsibility to help the indigent. Landowners are obligated to help the poor by leaving the corners of the field for them. For example, during the harvesting, individual stalks that unintentionally fall from the sickle also become the property of the “stranger, orphan, and widow” (Leviticus 19:9). Similarly, vines and olive trees are not to be picked clean: gleanings of the vine and olive tree were left for the destitute (Deuteronomy 24:20-21). A sheaf of grain that is inadvertently left in the field during harvest must be left behind for the indigent (Deuteronomy 24:19).

The landowner is obligated to provide a tithe for the priests and the Levites (Numbers 18:21-32) and a special tithe for the poor (Deuteronomy 14:28-29). There was also an obligation to “open one’s hand” for the impecunious and lend them money (Deuteronomy 15:7-8). The Psalmist declares (Psalms 82:3): “do justice to the needy and the orphan; deal righteously with the poor and the impoverished; rescue the needy and the destitute and save them from the hand of the wicked.” Isaiah (1:17) also makes this very same point: “learn to do good; seek justice, aid the oppressed, defend the orphan, plead for the widow.”

The Bible is also concerned with the welfare of the *ger* (the stranger), an individual whom often can be easily taken advantage of. Indeed, the *ger* is often mentioned together with the destitute, widows, and orphans (Deuteronomy 24:19, 21). The prohibition against mistreating a stranger occurs 36 times in the Bible (Babylonian Talmud, Bava Metzia 59b). Abusing, taunting, wronging, or oppressing the stranger is forbidden (Exodus 22:20; Exodus 23:9); in fact, the Bible obligates one to love the stranger (Leviticus 19:34; Deuteronomy 10:19).

Scripture states (Leviticus 19:33-24): “When a stranger sojourns with you in your land, you shall do him no wrong. You should treat the stranger living with you as one of your native-born, and you shall love him as yourself, for you were strangers in the land of Egypt. I am the Lord your God.” The Bible demands that (Exodus 12:49; Numbers 15:16): “One law and one ordinance shall be both for you and for the stranger who sojourns with you.” The Bible does not permit one to sell land in perpetuity for it reverts back to the original owner during the Jubilee year (Leviticus 25: 23). The reason given is that God declares (Leviticus 25: 23): “the land is mine; for you are strangers and settlers with Me.” Every person who lives on Planet Earth, in effect, is a “stranger” since the entire universe belongs to God.

Destruction of Sodom

A nation that does not have compassion for the weak and helpless does not deserve to prosper. The prophet Ezekiel excoriated Sodom for the following:

“Behold, this was the sin of your sister Sodom: She and her daughters had pride, plenty of bread, and untroubled tranquility; yet she did not strengthen the hand of the poor and the needy”
(Ezekiel 16: 49).

Note that a core value of Sodom was *not* helping the poor and needy. The story of Sodom in Genesis (19) demonstrates the city’s character. It was a city where upon hearing that Abraham’s nephew Lot provided hospitality to two strangers, the Sodomites “young to old” converged on his house. Normally, young people do not go out of their way to engage in activities with senior citizens. However, in Sodom, the desire to harm the helpless spanned generations. The Sodomites demanded send the two strangers out of Lot’s house in order that we may “know” them. The term “sodomize” derives from this incident. The purpose of this rape was to ensure that strangers would never come to Sodom. The “pride,” referred to by Ezekiel, which destroyed the residents of Sodom and Gomorrah resembles contemporary xenophobia

and racial intolerance. Residents of Sodom and Gomorrah viewed themselves as superior to outsiders, justifying their harsh Nuremberg-like laws (introduced in Nazi Germany in 1935).

Josephus, Jewish historian who lived about 2,000 years ago, states (*Antiquities of the Jews*, 1.11.1):

The Sodomites grew proud, on account of their riches and great wealth: they became unjust towards men, and impious towards God, insomuch that they did not call to mind the advantages they received from Him: they hated strangers and abused themselves with Sodomitical practices.”

Josephus stresses that the wealth of the Sodomites, injustices to their fellow, and their hatred of strangers led to their downfall. In the *Wisdom of Solomon* (19:14), which is part of the Apocrypha, the sin of Sodom is described as follows: “Others had refused to receive strangers when they came to them, but these made slaves of guests who were their benefactors.” In other words, the Sodomites were hostile to strangers.

Sodom and Gomorrah passed laws against helping the poor. Anyone caught helping a poor person would be killed. The Talmud —the authoritative source of Jewish religious law consisting of the Mishnah and Gemara— relates the story of a young girl who provided an indigent person with bread by hiding it in a pitcher. When the Sodomites found out about this, the young girl was covered in honey and placed on the wall of the city; she was killed by bees (Babylonian Talmud, Sanhedrin 109b; Midrash Rabbah 49: 6). A different version of this story has Plotis, daughter of Lot, being burned alive for secretly providing food for a poor person. Being married to a noble of Sodom did not help her (Pirkei D’Rabbe Eliezer 25; Book of Jasher 19: 24-35).

The citizens of Sodom had a special bed (similar to the Procrustean bed described in Greek mythology) for strangers who came to visit. If the stranger was too tall, they cut off his legs so that he would fit; if he was too short for the bed, they stretched him out (Babylonian Talmud, Sanhedrin 109a -109b; Book of Jasher 19:3-6). If a stranger came to town to sell merchandise, the entire town — men, women, and children — would get together and steal all of his merchandise, each one stealing just a little. They would even taunt the merchant and show that they took a very small amount (e.g., one grape) and claim it was given to them as a gift or sample. Eventually, they would drive him out of town amidst great rejoicing (Book of Jasher 18:16-17).

Needless to say, the Sodomites were successful in keeping strangers away; the Book of Jasher states (19:7): “And when men heard all these things that the people of the cities of Sodom did, they refrained from coming there.”

It was not only Sodom and Gomorrah that were destroyed because of the way the poor and the stranger were treated. According to Ezekiel (22:29), Jerusalem (along with the First Temple built by Solomon) was destroyed by the Babylonians for wronging the poor, the needy, and the stranger. The “stranger” referred to here was the immigrant who came from another town or country. Isaiah also criticized the leaders of Judah and Jerusalem, prior to the destruction of the First Temple, and referred to them as the “chiefs of Sodom” (Isaiah 1:10). Their crime: the leaders were indifferent to the plight of the widow and orphan (Isaiah 1: 17; Isaiah 1: 23).

The biblical principle of “Thou shalt love thy neighbor as thyself”(Leviticus 19:18) is a core value of all Abrahamic religions. Indeed, the idea of the brotherhood and unity of all mankind derives directly from the verse in Genesis (1: 27): “And God created man in His own image, in the image of God created He him; male and female created He them.” All of mankind can be traced back to Adam and Eve who were endowed by God with dignity and reason. This is why the Bible demands that poor people and strangers must be treated the same as everyone else. Denying them sustenance and healthcare would be a serious

crime and inconsistent with biblical values. For these very same reasons, workers also have to be treated with dignity (Friedman, 2000).

Why did God want the Israelites to be enslaved in a “strange land” before they received the Bible? It seems likely that He wanted them to learn what it felt like to be the outsider. After all, who better than an outsider to understand the need for social justice, helping the needy, taking care of the widow and the orphan, befriending the stranger, etc. Scripture indeed states (Exodus 23:9): “Do not oppress the stranger; you know how it feels to be a stranger, for you were strangers in Egypt.”

Responsibilities of Government

According to Maimonides (Mishneh Torah, Laws of Gifts to the Poor, 10:7), the highest form of charity is providing one with the ability to earn a living so that the individual does not become poor. He derives this from the verse in Leviticus (25:35) that talks about “strengthening” the destitute individual: “if your brother becomes impoverished and his hand falters beside you, you shall strengthen him, whether he is a stranger or a native, so that he can live with you.” This may be accomplished by providing a gift or loan enabling one to start a business, taking the destitute person in as a partner, or helping the individual find employment.

The obligation to take care of the poor and helpless is not merely the responsibility of individuals as some politicians would have us believe, but of the entire society. Individuals, organizations, and government must ensure that all ethnic and religious groups are treated equitably; special efforts should be made to help the poor and the handicapped get jobs. Immigrants also fall under the umbrella of “stranger” and have to be taken care of in a manner in which their dignity is not diminished.

The percentage of Americans living below the poverty line is at 15.1 percent, the highest since 1993; median household income is now so painfully low that it is at levels not seen since 1996 (Tavernise, 2011). It is terribly unfair that between 1993 and 2010, the income of the top 1% of Americans grew by 58% vs. 6.4% for the bottom 99% (Porter, 2012). As the nation began to recover from the Great Recession, 93% of the additional wealth created in 2010 as compared to 2009 went to those at the top 1%. The income of the top 1% increased in 2010 by 11.6% and is over \$1 million (Rattner, 2012).

According to Lawrence Katz, Harvard University economist, “This is the first time in memory that an entire decade has produced essentially no economic growth for the typical American household” (Eckholm, 2010). The median net worth of an American family in 2010 is \$77,300; it was \$126,400 in 2007 (these numbers are adjusted for inflation). The median net worth of an American family is about the same as it was in the early 1990s. After adjusting for inflation, the median American family income dropped from \$49,600 in 2007 to \$45,800 in 2010 (Appelbaum, 2012). The middle class is shrinking and income inequality keeps getting worse: the bottom 50% of U.S. income earners own less than 1% of America’s wealth. The top 1%, on the other hand, currently owns almost double what they had 15 years ago. The wealthiest 1% of Americans own about 43% of the financial wealth of the United States (Domhoff, 2010).

Porter (2012a) observes that a “growing share of Americans have lost faith in their ability to get ahead.” This is one negative outcome of rising inequality. There is convincing evidence that the percentage of families that escape the bottom quintile is declining. Rising inequality, Porter (2012a) feels, can result in political instability. We do not want a country where the poor remain poor and the wealthy control the political process so that they can “game” the system and become even wealthier. It is difficult to accept that the job market for 2012 college graduates is so abysmal that 53.6% of college graduates under the age of 25 are unemployed or underemployed (Yen, 2012).

Workers might be suffering but executives are doing exceedingly well. At larger firms, the typical CEO earned an extra \$10 million in bonuses this past year. Corporate profits have grown spectacularly since the Great Recession of 2008-2009; annual profits for American corporations reached \$1.678 trillion. Median executive pay at the top 200 companies grew by 12.9% over 2009 and surged to \$9.6 million (Costello, 2011). In 1950, the average executive's paycheck to average employee's paycheck ratio was 30:1; today it is between 300 and 500 to 1 (Snyder, 2010).

It is becoming quite evident that if the federal budget is ever going to be balanced, taxes will have to be raised. In fact, if nothing is done, the amount of federal debt held by the public will grow from approximately 67% of GDP to 100% of GDP in ten years (Porter, 2012b). There is a growing body of research that the tax rates paid by the richest Americans can even go as high as 76% without hurting the economy. The belief that a high tax rate would hurt economic growth is based on dubious economic theory. Current research supports the view that 30 years of tax cuts in the United States did a lot to help the rich get richer but provided almost no genuine economic growth (Porter, 2012b).

It is becoming clear that it is quite easy for technological giants such as Apple to take advantage of the tax code which was created with manufacturing in mind. Companies selling digital products can easily avoid taxes by setting up offices and subsidiaries in areas with very low corporate taxes. For example, Apple has a small office in Reno, Nevada (its headquarters are in Cupertino, California) as a way to avoid paying state taxes. State taxes are zero in Nevada but 8.84% in California. Apple also transfers the patent royalty profits to countries [such as Ireland and the Netherlands] with much lower tax rates than the United States (12.5% vs. 35%). iTunes downloads are routed through an Apple subsidiary in Luxembourg to avoid higher taxes that would have gone to the United States, France, and England (Duhigg and Kocieniewski, 2012).

Clearly, government has an obligation to work with business to "strengthen" those in economic jeopardy by providing individuals with training and employment. If a firm finds that it has to close down a plant because of economic conditions, management should do everything possible to find employment for the affected employees in other parts of the company. The economic system has to function in a way that takes care of the poor and the helpless. Politicians who are indifferent to the plight of the poor and helpless are the "new" Sodomites and are following in the spirit and principles of ancient Sodom and Gomorrah.

Galea, et al. (2011) examined six critical social factors in order to determine the number of deaths attributable to each. They found that, in the year 2000, low levels of education were responsible for about 245,000 deaths; racial segregation was responsible for 176,000 deaths; low social support for 162,000 deaths; individual-level poverty for 133,000 deaths, income inequality for 119,000 deaths; and area-level poverty for 39,000 deaths. Overall, poverty does considerably more than contribute to bad health; it was responsible for 4.5% of deaths in the United States. Imagine what the prophets would have to say about a country that was indifferent to a social problem that kills 4.5% of its citizens.

Soerens and Hwang (2009) also make the point that God throughout the Bible is very much concerned about the *ger*. They believe that the Hebrew word *ger*, usually translated as stranger or alien, clearly refers to the immigrant (as well as the proselyte). The Bible demands that immigrants be provided with the same privileges, rights, and benefits as the native-born. Soerens and Hwang feel very strongly that Christians must be concerned with social justice and thus have the obligation to ensure that immigrants are treated with compassion by our legal system.

Government must be concerned about the troubles of immigrants, even illegal aliens. A number of states – 31 at the last count – are passing (or trying to pass) legislation that will make it easy to deport undocumented immigrants. These laws modeled after Arizona's infamous S.B. 1070 law that was passed

in 2010 make it clear that immigrants are no longer welcome here. The desire to pass this kind of legislation is based more on myths than reality. One myth is that the federal government is extremely lax in enforcing immigration laws. Another myth is that the number of illegal immigrants entering the United States continues to skyrocket; it is actually shrinking and is at about 11.2 million (Downes, 2012).

Following in the footsteps of the ancient Sodomites can only lead to disaster. There is evidence that the Great Recession of 2008 was used as an excuse to fire many more workers than necessary. Andrew Sum, director of the Center for Labor Market Studies at Northeastern University observed: “Not only did they throw all these people off the payrolls, they also cut back on the hours of the people who stayed on the job... They threw out far more workers and hours than they lost output” (Herbert, 2010).

A Sodom-like belief that foreigners are all inferior and will therefore tax the resources of a country is likely to bring the destruction of a country. It is also contrary to the biblical view that all of humankind was created in the “image of God.” The way to ensure economic growth is to promote diversity and acceptance of people from all over the globe. Immigrants to the United States, contrary to popular belief, are not all working in very low paying jobs in larger urban areas. In fact, they are as likely to be employed in higher-paying white collar, professional jobs as in low-paying service and blue collar jobs (Preston, 2010). It is a myth, research shows, that immigrants strain our resources and that they are all low-paid laborers.

Immigrants are what made America great and made the economy prosper. There is evidence that overall diversity and a large population base of foreign-born people is correlated with success in high-technology areas (Florida and Gates, 2001). According to Robert Litan, research director at the Kauffman Foundation, “Roughly 25 percent of successful high-tech startups over the last decade were founded or co-founded by immigrants.” Litan also notes that “Between 1980 and 2005, virtually all net new jobs created in the U.S. were created by firms that were 5 years old or less.” Thus, one way to ensure that our economy grows is by encouraging talented immigrants to come to the United States (Friedman, 2010a).

Message Two: Eliminate Systemic Corruption - Legal and Economic Systems

The Bible is concerned with justice. Scripture emphasizes the importance of impartial justice and states quite emphatically (Deuteronomy 16: 20): “Justice, and only justice, shalt thou follow, that thou may live and inherit the land that the Lord, your God, is giving you.” A judge was not permitted to accept any gifts (Deuteronomy 16:19). An elaborate legal system was set up so that everyone would have access to it (Exodus 18). Judges were supposed to be people of truth who hated unjust gain (Exodus 18: 21).

Sodom, on the other hand, did things a bit differently. Isaiah criticized ancient Israel which had become like Sodom. He asserted (Isaiah 1:21-22):

How the faithful city has become a harlot! Once it was full of justice and righteousness lodged in it, but now — murderers! Your silver has become dross, your wine diluted with water. “Your rulers are rebels and associates of thieves; each of them loves a bribe and chases after rewards.

Isaiah observed (Isaiah 1:27): “Zion will be redeemed through justice.” He exhorted the people to (Isaiah 1:17): “Learn to do good; seek justice, and support the oppressed. Defend the orphan, and plead for the widow.” Amos also compared ancient Israel to Sodom (Amos 4:11) and described the various transgressions of the Israelites. He rebuked them for “trampling upon the poor,” “oppressing the righteous,” “taking bribes,” and “[openly] victimizing the destitute by the gate” (Amos 5: 11-12). Amos declared: “Let justice well up like water and righteousness like a mighty stream” (Amos 5: 24).

Apparently, ancient Israel at that time had a corrupt legal system similar to the one in Sodom and Gomorrah.

Isaiah's criticisms of Israel also dealt with unethical business practices. His condemnation indicating that "Your silver has become dross, your wine diluted with water," was not necessarily a metaphor. According to most commentaries, this referred to actual dishonest business practices in ancient Judah and Jerusalem which angered the Lord (e.g., see Rashi and Redak, two major Biblical commentaries). Apparently, even in ancient times, retailers would adulterate their products and government would degrade its currency.

A legal system that does not attempt to prevent injustices would be excoriated by the ancient prophets. The Bible does not have any issue with free markets and competition but certainly opposes markets in which fraud is commonplace. Corrupt business practices such as dishonest weights and measures are an "abomination" to the Lord (Deuteronomy 25: 16; Proverbs 11:1; Proverbs 20:10). The Bible insists on honest weights and measures and a marketplace that promotes business integrity (Deuteronomy 25: 13-16). The prophet Amos also criticized the ancient Hebrews for unethical business practices including "making the *ephah* (a dry measure) smaller and the *shekel* larger and falsifying the scales of deceit." (Amos 8:5). Amos described other ways poor consumers were cheated, e.g., hoarding, and avers that the Lord swears that He will never forget their deeds (Amos 8: 7). In fact, a businessperson who uses dishonest weights and measures is compared to a corrupt judge (Leviticus 19:35-36). The precept demanding the use of honest weights and measures in ancient times would, in our times, also require the use of truthful financial statements as well as authentic regulation of banking and business practices. The Bible (Exodus 23:7) states quite emphatically: "Distance yourself from a false matter."

Micah (6:8) summarized the obligations of mankind to three simple principles: "What does the Lord require of you: only to do justice, to love acts of kindness, and to walk discreetly before your God." Ezekiel declared (22: 29, 31): "The people of the land have perpetrated fraud and committed robbery; they have wronged the poor and needy and defrauded the stranger without redress...I have therefore poured out My wrath over them and consumed them with My fire of fury." Zechariah (8:16-17) also felt very strongly about conducting business in an aboveboard, honest manner: "These are the things that you are to do: Speak the truth every man with his fellow; with truth, justice, and peace, judge in your gates. And let none of you contrive evil in your hearts against one another and do not love false oaths; because all these are things that I hate, declares the Lord."

If we had biblical prophets today, they might very well bemoan the fact that our financial statements have become "dross" and deceptive. Lehman and 20 other financial companies are under investigation by the Securities and Exchange Commission for the use of "creative" accounting to obscure their true financial condition. Lehman used an "alter ego" firm — Hudson Castle — to move risky investments off their books. The purpose of this was to make the company appear stronger while it was taking on more and more risk. In effect, a shadow financial system was being created. Ultimately, Lehman collapsed (largest bankruptcy in U.S. history) but many of the executives became super wealthy (Story and Dash, 2010).

If dishonest weights and measures are an "abomination," what would the Bible call credit rating agencies that, in order to earn high fees, rated mortgage bonds consisting of highly risky, subprime mortgages as AAA. In fact, of the subprime mortgage backed securities that were issued in 2006 and rated AAA by the rating agencies, 93% are currently rated as junk (Krugman, 2010a). Clearly, the conflict of interest created when the rating agencies (Moody's Standard & Poor, and Fitch) are paid by the issuers of the securities, played a significant role in the corruption of the entire rating system. The rating agencies knew that they would lose clients if their ratings were too tough. This is confirmed by emails sent by employees of the credit rating agencies that mention "the ongoing threat of losing deals" and the need to "massage the subprime and alt-A numbers to preserve market share" (Krugman, 2010a). Similarly, New

York State prosecutors are investigating eight major banks. The question is how these banks “created, rated, sold and traded mortgage securities that turned out to be some of the worst investments ever devised” (Schwartz and Dash, 2010).

The banking industry has also had problems with honest practices when it came to foreclosures that resulted from the Great Recession of 2008. Five of the largest mortgage servicers have already agreed to a \$25 billion settlement but did not have to admit to committing any crimes. The regulators are now prepared to crack down on eight additional firms whose foreclosure practices involved “sloppy, inaccurate, or forged documents” (Silver-Greenberg, 2012). The regulators believe that a huge number of documents needed in foreclosures went through the banking system without being checked for accuracy; this practice is known as “robo-signing.” The victims, of course, were mainly the poor. The Psalmist declares (Psalms 146:9): “The Lord protects the strangers; He supports the orphan and the widow, but He thwarts the way of the wicked.” The victims of the foreclosures are waiting for the way of the wicked – our greedy bankers – to be thwarted.

Goldman Sachs has been accused by the SEC of selling mortgage securities that had virtually no chance of being successful (the case was settled for \$550 million—about two weeks of earnings). The mortgage bonds in the portfolio were allegedly selected by John A. Paulson, a hedge fund manager, who was betting against the mortgage market and would only make money if the securities failed (Story and Morgenson, 2010). Krugman (2010b) refers to what Goldman Sachs allegedly did as “looting”; the biblical word *abomination* might be a better term. It takes a great deal of arrogance and hubris to develop and sell securities that are “deliberately designed to fail” in order that a valuable client would enrich himself from the failure. This goes far beyond what a number of Wall Street firms did: marketing securities to various naïve clients all over the world while trying to make exorbitant profits by betting that these risky, low-quality securities would drop in value.

Greg Smith wrote an OP-ED piece in the New York Times explaining why he had to resign from Goldman Sachs (Smith, 2012). He believes that the “decline in the firm’s moral fiber represents the single most serious threat to its long-run survival.” Goldman Sachs has become a firm that does not care about helping clients make money. What the firm cares about is making money for the firm even if it means misleading clients and having them invest in garbage. Clients are referred to as “Muppets.” Terms such as “hunting elephants” were used to describe finding gullible clients and persuading them to make investments that would enrich Goldman Sachs. Another term used was “ripping eyeballs out” another way of saying that the goal was to take advantage of the client in order to benefit the company. Goldman Sachs may not have broken any laws but its reputation for uprightness is gone. Back in 1993, Bankers Trust was doing the same thing to clients and created the term “R.O.F.” (rip-off factor) to describe how it was taking advantage of unsuspecting clients (Norris, 2012a).

There are lawsuits that allege that several banks purposely bundled mortgages that were in serious trouble with other mortgages and then sold these securities to investors assuring them that they were high quality. One accounting consultant made the observation: “How can anyone – regulators, investors or anyone – understand what’s in these financial statements if they have to dig 15 layers deep to find these kinds of interlocking relationships and these kinds of transactions?” (Story and Dash, 2010). The answer to the account’s query is simple – no one can. This strategy is reminiscent of what Enron (now, only the fourth largest bankruptcy in U.S. history) did: off-balance-sheet partnerships to hide huge losses.

The third largest bankruptcy in American history, Worldcom, also involved deceptive and fraudulent accounting. The bankruptcy of Washington Mutual (WaMu), the second largest in American history, was largely caused by the bank’s approval of mortgages to people with little income; the slogan of the bank was “The Power of Yes.” They used adjustable rate mortgages (ARMs) to entice poor people to borrow money and approved almost every mortgage. The people obtaining the mortgages did not realize that the

very low payments would not continue indefinitely and would eventually balloon. The punishment for the executives that nearly destroyed the world economy has been little more than a slap on the wrist. For example, Kerry Killinger, former CEO of WAMU made \$88 million in compensation between 2001 and 2007. His punishment was paying \$275,000 in cash and giving up a claim to his WAMU retirement account of \$7.5 million. Many of the fines paid by executives do not come from their own pockets but from liability insurance policies paid for by the companies (Morgenson, 2011).

Angelo R. Mozilo, former CEO of Countrywide Financial, agreed to settle a civil fraud charge brought by the S.E.C. by paying \$67.5 million. Mozilo also agreed to be permanently barred from serving as an officer or director of any public company (Morgenson, 2010). He was accused of not being honest about his company's financial condition by promoting his firm's mortgages as high quality and by profiting on insider information regarding these mortgages that he knew were toxic. Countrywide Financial was the nation's largest mortgage lender and by 2004 it had revenues of \$8.6 billion. Until 2003, Countrywide specialized in simple, fixed-rate loans. The following year, however, it started offering mortgages to low-income people. To make the loans affordable, Countrywide was giving them pay-option adjustable rate mortgages (ARMs). These loans, which by 2006 accounted for more than 20% of Countrywide's loans, made it very easy to buy homes since during the first few years, the borrowers paid a small part of the interest and none of the principal. The pay-option ARMs, however, meant very hefty payments after the introductory period. The gross profit margins on those type of mortgages was more than double what Countrywide could make on a standard mortgage (4% vs. 2%). He sent emails indicating that the company was "flying blind" on the pay-option ARMs (he also referred to them as "toxic") and sold more than 5 million shares of Countrywide stock from November 2006 to October 2007, netting more than \$140 million (Morgenson, 2010). By 2008, Countrywide was sold to Bank of America at a very low price because it was on the verge of bankruptcy due to a huge amount of bad loans.

One banker, James Theckston, a VP at Chase Home Finance, has taken responsibility for the problems caused by the banking industry. He admits that his bank wrote a huge number of mortgages to people with no evidence of sufficient income. The banks were especially quick to give out mortgages when they were securitized and sold to investors. Theckston asserts: "The bigwigs of the corporations knew this, but they figured we're going to make billions out of it, so who cares? The government is going to bail us out. And the problem loans will be out of here, maybe even overseas"(Kristof, 2011). What Theckston especially regrets is that the banks were very eager to give subprime mortgages to the less educated and less sophisticated and more vulnerable borrowers—mostly Latinos and blacks. The commission was usually seven times higher for subprime loans and they ended up paying significantly higher mortgage rates (Kristof, 2011). To keep one's job, bankers had to increase the number of high-risk mortgages. What is unjust about what happened is that the banks and bankers were protected by the government for their irresponsible behavior; the losers are the vulnerable members of society who have lost their homes. African Americans suffered disproportionately because of the financial crisis. Home ownership among them was 50% in 2004 but dropped to 45% in 2011 (Ruark, 2011).

Banks used a strategy called securities lending to take advantage of their customers, mainly pension funds. With securities lending, mutual funds and pension funds lend their securities to banks; these securities are lent to hedge funds or other banks for a cash security deposit. The banks then trade with the cash security deposits until the securities are returned. The agreement is written so that the banks share in the profits (JP Morgan took 40% of the profits) made on the fund's securities. If there is loss from trading, however, the pension fund takes the entire loss. This strategy is reminiscent of a "heads I win, tails you lose" strategy. There are now numerous lawsuits against banks such as JP Morgan for not warning the funds of the riskiness of securities lending. Funds such as the Municipal Employee Pension Fund took a very substantial loss with securities lending, not realizing how risky it was (Story, 2010).

According to Lichtblau and Wyatt (2010), the financial industry, via political action committees and

private donations, provided congressional candidates with more than \$1.7 billion over the last 10 years. A good part of these funds went to the financial committees that oversee financial regulation and are supposed to protect the public from dishonest financial practices. Even after the financial meltdown that caused a huge catastrophe for most of the world, many politicians, as well as Wall Street and the banking industry, are upset about the new 2010 financial-reform regulation.

Eisinger (2011) notes that the federal government “in ways explicit and implicit, profoundly subsidizes and shelters the banking industry.” First, the government guarantees bank deposits so that people feel that their money is safe. The government also implicitly guarantees the derivatives owned by banks. The banks make a great deal of profit on these derivatives. When the Fed lowers interest rates as part of monetary policy to stimulate the economy, banks benefit greatly since they can borrow money very inexpensively and lend it out at a much higher rate. The government subsidizes the housing market via Fannie Mae, Freddie Mac, and the FHA. Banks can make a speedy profit by making the loan and then selling it to the government agency.

Krugman (2012) feels that banks should not take huge risks that can wreak havoc with the financial system when the government provides them with deposit insurance (e.g., F.D.I.C.). What happened at JPMorgan Chase which lost at least \$2 billion demonstrates that Wall Street does need to be regulated. It is interesting to note that Jamie Dion, CEO of JPMorgan Chase, was extremely vocal in opposing the Volcker Rule which would have prevented banks from engaging in speculative “proprietary trading.” A number of former employees at JPMorgan Chase felt that the desire for higher investing profits is what led to greater risk taking. They warned the bank that it was taking on too much risk but their concerns were ignored (Silver-Greenberg and Schwartz, 2012b).

Porter (2012c) cites studies that believe that the subsidy to the 22 largest banks in the world amounts to about \$1.2 trillion a year between 2007 and 2010. This hidden subsidy relates to the fact that no government can afford to allow a very large bank to fail. This has the effect of reducing the cost of capital of the very large banks who are “too big to fail.” Smaller banks, that are not perceived as “too big to fail” have a significantly higher cost of capital. This may also explain why banks are becoming much more concentrated. In 1990, the three largest banks held 10% of the assets of the entire banking system; by 2008, the three largest banks held 40% of the assets (Porter, 2012c).

Message Three: Ethical, Caring Leadership

Amos (4:1) declared: “Hear this prophecy, you cows of Bashan, that are on the mountain of Samaria, who oppress the poor, who crush the needy, who say to their lords, ‘bring, and let us drink’”. This criticism was directed at the wives of the nobility who encouraged their husbands to be dishonest in order to live a lavish life. This verse could just as easily be directed to the CEOs who through their lobbyists ask their political lords to eliminate financial regulations that affect their ability to make outrageous profits.

It is becoming quite obvious that in many cases, executive compensation has little or nothing to do with competence. Albert Meyer, a money manager, asserts: “Stock-based compensation plans are often nothing more than legalized front-running, insider trading and stock-watering all wrapped up in one package.” He also makes the point that: “When compensation is excessive, that should be a red flag. Does the company exist for the benefit of shareholders or insiders?” (Morgenson, 2011b). Meyer compares the compensation of Helge Lund, CEO of Statoil, a Norwegian company, with what Rex W. Tillerson, CEO of ExxonMobil earns: approximately \$1.8 million vs. \$21.7 million. However, the Statoil’s stock has outperformed that of ExxonMobil (Morgenson, 2011b).

There are many other examples indicating that executive pay has little to do with performance. Citigroup shareholders rejected CEO Vikram S. Pandit's pay package. Apparently, excessive pay has been a problem at Citigroup, a bank that has been paying its top executives quite well despite the fact that the performance of its stock (down 80% since the financial crisis of 2008) has been among the worst in the banking industry (Silver-Greenberg and Schwartz, 2012a). In 1989, the compensation of the CEOs of the seven largest American banks was approximately 100 times that of the median income of the American household; by 2007, right before the Great Recession of 2008, that ratio had skyrocketed to 500 (Porter, 2012c).

The Bible uses the metaphor of shepherd to indicate a leader (Numbers 27:17). This metaphor is used by Ezekiel in Chapter 34. When leaders did not help the people but enriched themselves at their expense, the prophet Ezekiel exclaims (34: 2-4)

Woe unto the shepherds of Israel that have tended themselves [and not tended their flock]! Should not the shepherds tend the sheep? You eat their fat and you wear their wool; you slaughter the healthy ones; but you tend not the sheep. The frail you have not strengthened; neither have you healed that which was sick; neither have you bound up those who were broken; neither have you brought back those who strayed or searched for those that were lost; instead, you ruled over them with force and rigor.

Kantzer (1989) uses this chapter from Ezekiel to demonstrate how a Christian should conduct business; however, it is apt for leaders of any denomination. This passage from Ezekiel describes what an honest leader is supposed to do.

Regulators and politicians that do not protect consumers from predatory lending practices are behaving as true Sodomites as are the bankers who took on huge amounts of risk with subprime mortgages in order to enrich themselves. The subprime mortgages were used to take advantage of poor people in order to enrich the bankers and Wall Street. Our chiefs and rulers also "chase after rewards" and do what the lobbyists and special interest groups want. If Isaiah were around today he would also complain that our rulers are following Sodomite practices and have become "associates of thieves." The same can be said of many CEOs, bankers, and companies that are more concerned with their own self-interest, rather than what is best for the country.

Feiler (2010) feels that Moses is an American icon. Many great Americans, including Abraham Lincoln and Martin Luther King Jr., have compared themselves and been compared to him. According to Feiler, Moses represents "the ideals of American justice" and reminds us that "a moral society is one that embraces the outsider and uplifts the downtrodden." In addition, Moses is an exemplar of a true leader, one who cared more for the people than for himself. Moses had clean hands and was able to say to God (Numbers 16:15): "I have not even taken a single donkey of theirs, nor have I wronged even one of them." How many politicians and CEOs can make this claim? Moses dies alone on Mount Nebo and is buried by God. The Bible (Deuteronomy 34:5) describes him in the simplest terms as the "servant of God." There is no higher praise for a leader.

What would Moses, Ezekiel, Isaiah, and Micah say to the political leaders of the United States who are more concerned about the special interests than the needs of the public? It has become obvious to almost everyone in the United States that our two-party system does not have any interest in solving problems. In the words of Stanford University political scientist Larry Diamond: "with all the vested interests that have accrued around these two parties, they cannot think about the overall public good and the longer term anymore because both parties are trapped in short-term, zero sum calculations" (Friedman, 2010b). Our political leaders are so inflexible, according to Friedman (2010b), that we are in a situation where the parties cannot or will not discuss

education reform, without worrying about offending unions; financial reform, without worrying about losing donations from Wall Street; corporate tax reductions to stimulate jobs, without worrying about offending the far left; energy and climate reform, without worrying about offending the far right and coal-state Democrats; and proper health care reform, without worrying about offending insurers and drug companies.

Sadly, our two parties are following in the footsteps of the Sodomite leaders. Their mantras could be “selfishness and greed are good.” Concern for the helpless is trumped by the need for winning elections.

Conclusion

Political leaders from both the right and left-wing of the political spectrum claim to be sincere about biblical values. Both the right and left, however, do not get the message right (Wallis, 2006). The Bible certainly encourages hard work, self-sufficiency, and humility. One can make the case that the Bible encourages a creative, industrious society where everyone is engaged in productive labor. Indeed, the “woman of valor” described in Proverbs (31: 10-31) is extremely entrepreneurial and industrious (as well as charitable). However, the Bible is even more concerned about loving one’s fellow human and caring for the unfortunates of society. An economic or political system that ignores the plight of the stranger, orphan, and widow — archetypes of society’s helpless individuals — as well as the worker is modeling itself after Sodom, Gomorrah, and other ancient empires that failed. Isaiah (10: 1-4) had the following to say about people in power who are not concerned about the powerless members of society:

Woe to those who make unjust laws, to those who issue oppressive decrees, to deprive the poor of their rights and withhold justice from the oppressed of my people, making widows their prey and robbing the fatherless. What will you do on the day of reckoning, when disaster comes from afar? To whom will you run for help? Where will you leave your riches? Nothing will remain but to cringe among the captives or fall among the slain. Yet for all this, his anger is not turned away, his hand is still upraised.

Political leaders who partner with special interest groups and lobbyists to the detriment of the public and primarily to enhance their own selfish interests are acting like the “chiefs of Sodom.” It is difficult to comprehend that a significant proportion of politicians can care more about preventing the richest 1% of Americans from paying the higher tax rates they paid prior to the Bush tax cuts than helping the middle class and poor get back on their feet. These politicians seem to have no problem with allowing the moral and physical infrastructure in the United States to crumble.

While the Bible has little definitive to say about the ideal economic system and about free markets and competition; it does have a great deal to say about an economic system that encourages fraud and an unjust marketplace. It also has much to say regarding an economic system that shows no compassion for the helpless. Indeed, a government that allows the working and middle classes to remain on an economic treadmill with no hope for advancement but with many opportunities for becoming unemployed is taking its cues from ancient evil empires that disappeared. The Bible would not be happy with CEOs and boards that are willing to close plants and offshore jobs in order to purportedly save a few million dollars yet have no problem giving outrageous multi-million dollar bonuses to executives for less than mediocre performance. Millions of Americans may have lost their jobs and homes during the Great Recession but hundreds of CEOs collected spectacular bonuses (Brush, 2009). There was a great deal of fraud going on in the banking industry. So called “liar loans” were given to individuals with no income verification. The banking executives who issued these kinds of mortgages have not been prosecuted. Individuals who

supposedly completed the forms (in many cases the forms were completed by the mortgage brokers) are being prosecuted. In fact, no executive has gone to jail for these fraudulent mortgages (Nocera, 2012a). Jeremiah (9: 22-23) makes it quite clear that what matters to God is not wisdom, strength, or wealth; it is kindness, justice, and righteousness. Isaiah (61:8) also stresses that God loves justice. Right now, we do not have any of the above. Virtually no leader is willing to tell the American people the truth, i.e., that the road we are on now is not sustainable and will lead us to another financial nightmare.

Nocera (2012b) has made it clear that two kinds of capitalism are slugging it out now. One approach, “moral capitalism” as exemplified by Starbucks whose mission is more than just making profit. Starbucks believes in helping the United States recover from the Great Recession and considers the needs of stakeholders such as customers, employees, and coffee growers. The other kind of capitalism – the “rip-your-eyeballs out” capitalism – demonstrated by companies such as Goldman Sachs, is only concerned about profits and see customers (and the rest of America) as suckers to be taken advantage of. America has to decide which type of capitalism to choose. The Bible has already told us which path to choose.

Can the decline of America be prevented? The ancient prophets would answer in the affirmative. However, we have to be a society that is compassionate and concerned with the unfortunates of society. We need honest leaders who are not afraid to tell us the truth and understand the importance of justice and equitable treatment for all. It is not about 99% vs. 1%, but about a level playing field where everyone who works hard will have the opportunity to succeed.

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The Ethical Dilemma in Globalising Small Businesses

Jacob C. Ng'ang'a

Abstract

This paper is largely a theoretical exposition of ethical challenges that stifle the participation of small businesses in the global value chains with particular reference to businesses in developing countries. Small-business clusters in developing economies, remain locked in low-quality products and low-income markets. With little innovation, small business lack capacity to produce goods that can attract foreign demand. Yet, small enterprises must provide productive employment for an increasing number of job-seekers in these countries. Innovation growth in small enterprises is normally limited to apprenticeship process and as such, results in a dead-end to progress of indigenous technology. To promote creation and growth of small business, efforts are required to put the small business clusters in a global value chain as this enhances possibilities of new market avenues and as well as benching market indigenous innovative efforts to international standards. Exposure of small business to global market also encourages networks formations which are conduits of skills for quality improvement and valuation of products from the sector. However, the quest for improving the participation and market share of small business is faced with challenges that stem from the way the process of globalization has taken place over time. To overcome these globalization challenges, policy makers must contend with ethical issues that require to be addressed through consultative efforts at international arena.

Key words

Small business, globalization, ethics, networks, value chain.

Introduction

While there are many definitions of globalization, one may take note of the words of Held et al (1999) which suggest that the concept of globalization implies, first and foremost, a stretching of social, political and economic activities across frontiers such that events, decisions and activities in one region of the world can come to have significance for individuals and communities in distant regions of the globe (p.15). Nevertheless, the actors in social, political and economic arena impact on global development only if barriers, tariff and non-tariff, that make nations exist as exclusive enclaves are removed. Thus, this

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paper takes globalization as a term used to describe a situation where there are reduced barriers to information flow, international trade, foreign investments, technology development and transfer, human resource mobility and democratic choice.

Small businesses play a significant role in world economies, contributing substantially to employment creation in developing economies and to exports in South East Asia (UNCTAD, 2004). However, the globalization process

constitutes challenges and opportunities to small businesses. For instance, globalization brings new opportunities for small businesses due to increased access to new markets and wide knowledge based on technology developments (Goldin, 2010). However, ethical issues are now emerging in relation to how globalization affects the operations of small businesses within economics, social relations, politics, media and technology contexts (Stephens 2011, Lyons 2005). In discussing these issues, this paper conceptualizes ethics as principles and practices that morally affect our decisions in the ordinary business of life. Ethical behavior in a globalization process therefore relates to fairness in interpersonal and inter-group interactions that maximizes the gains for all participants.

Ethical issues on how Globalization influence Economic Performance of Small Businesses

One cornerstone of the globalization process is market liberalization which emphasizes removal of all tariff and non tariff barriers to product and resources mobility, including elimination of all impediments to competitive practices in economic activities (Cornia, 1999). Those who advocate for liberalization argue that on the supply-side, small businesses will benefit through better access to efficient technologies and cheaper raw materials². Consequently, small business would optimally allocate resources and enjoy scale economies which will ultimately bring new employment opportunities and better incomes for a country's citizens. On the demand-side, market liberalization enables business to get "vent-for-surplus" since removal of tariffs widens market from within-the-country boundaries to the global arena.

The ethical issue that arises within this context is embedded in the assumption implicit in the theoretical foundation of market liberalization. What is assumed is that market liberalization improves both productive and allocative efficiency of a firm arising from competition among economic units (Cornia, 1999, Goodhue et al, 1998). What then can be construed from the assumption is that any existing small business possesses a competitive edge which makes it thrive in a liberalized world of perfect knowledge and free resource mobility. However, small businesses in different economies face varying constraints due to different business environments influenced by the level of development and the policy setting of a country (Haltiwanger, 2011). Further, the entry of any business to global market is subjected to laws, regulations and quarantines in the form of the entry permits (Greenaway et al., 2008) but excessive operational restrictions overly oppress small business, make it difficult for it to take advantage of global market opportunities.

Small businesses in Less Developed Countries (LDCs) face inherent problems that make them globally uncompetitive. First, they have resource limitations in term of physical resources, skill competencies and technology (Hussain et al., 2012). Further, information flow is costly and not choice-free as small businesses are characterized by ineffective networks (Ng'ang'a, 2008). Some small businesses sometimes have the know-how but lack resource capacity to drive the innovative idea to other stages of product's value chain (KIPPRA, 2009). As Pierre-Andre (1996) observes, globalization bring along it "complexification" of production systems which can be detrimental to small businesses since they do not have the enormous resources of multinational businesses to adjust to the increased competition in a globalized environment. Pierre-Andre (1996) further notes that globalization brings forth intense competition and shorter life cycles of products, resulting in high mortality of businesses, reduced employment and increased incidences of poverty in LDCs. Thus, even if globalization allows wider product choices to consumers in LDCs, small businesses may be driven out of market by big foreign

² See IMF issue brief No. 08/02 - May 2008 on IMF's work on globalization <http://www.imf.org/external/np/exr/key/global.htm>

firms or through flooding of cheaper import substitutes (Ahmad and Shamsudin, 2008). Failure of local firms in any economy finally results in reduced incomes creating of a consuming society without means to consume. For instance, it is not a surprise to watch an African child wearing a shirt with a label “Coca Cola enjoy” but queuing for food donation. Is it ethical to enrich businesses in developed world at the expense of businesses and individuals in developing economies? Is globalization a gospel of prosperity or death to small businesses in third world countries?

Another fundamental ingredient of globalization is privatization of public corporations. As Goodhue et al (1998) mentions, market liberalization and privatization are considered to complement each other in a transition economy. Farazmand (2002) argues that privatization is not a haphazard phenomenon but a deliberate design of globalization of capital. Public enterprises in most LDCs are characterized by excess capacity production of low-quality products and inefficient costing (Republic of Kenya 2010). This is normally attributed to lack of profit-motive which makes the public businesses not to strive for competitive performance. Competition is healthy for the economy as it leads to cheaper high-quality products and wider consumer choices. Thus, bilateral and multilateral agencies encourage LDCs to privatize their public corporations so that resources are efficiently utilized, creating new employment opportunities in a competitive environment.

The ethical issues that arise here is not so much on the validity of theoretical exposition of privatization benefits but on public versus private ownership of wealth. The first concern is whether all public businesses should have profit-goal orientation. If not, how do we then compare performance of private and public enterprises? The other issue to consider is the redistribution of wealth that emanates from the privatization process. Assuming an efficient system of governance, the proceeds from public enterprises should be used for public goods or utilities. Individuals own private enterprises and the benefits thereof. Is it ethical to redistribute wealth from public ownership to individual persons in the privatization process? Beyond the wealth distribution issue, small businesses may require government protection in the infancy stage as an incubation process. The quest for reducing direct government participation in economic activities therefore compromises the government capacity to support emerging small businesses.

The possibility of redefining the goals of public corporations and then re-structuring the management should be explored. Moreover, a worrying trend is that most of the public enterprises are being sold to multinational corporations that out-compete locally owned small enterprises. Local resources, particularly through savings and credit schemes, can be redirected to ownership of privatized public corporations. Thus, governments of LDCs should question the rationale for, and the approach they take in, privatization.

Understanding the Social Context of Small Business in a Globalization Process

Global economy has evolved as result of interplay of a complex set of social, ecological and cultural developments that have direct impact on human and natural resources (Stohl, 2001). For instance, globalization raises global incomes due to enhance market outlets but redistributes income occasioned by resource mobility. Consequently, the focus on globalization should not only be on profit-making, but also on how to balance economic growth with equity. Perceiving the world as a global village hosting more than six billion members, ethical principles would aspire for practices that facilitate equal opportunity to access and utilization of resources for each member of human race. The very fact that the world is divided into continents with differing morphological compositions negates the postulate of equitable distribution of the natural resources. The geographical zones endowed with better natural resources like minerals and arable lands are likely to have higher concentration of wealth based on utilization of available resources.

The ethical question that arises therefore is whether a mechanism exists that promotes equitable allocation of resources amongst the nations, regions and individuals of the world. Naturally, sections of world population with financial and technical capability exert control over the limited resources. Further, the natural distribution of population across nations and regions with distinct cultures presents patterns of resource distribution pegged along levels of education, health, wealth and skill competencies. For a small business in a developing country with no scale economies to its advantage, market liberalization pushes it into the periphery of resource ownership. Access to global resources is likely to be riddled with biases and prejudices against businesses that cannot competitively survive in a globalized world, which in turn impinge on what is ethical and what is practical.

Assuming that morality is the basis of individual ethics, perception on what is moral among the world population differs from faith to philosophy, resulting in never-ending lists of irresolvable concerns (Robertson, 1992). In such a context, it is difficult to define what is morally acceptable to guarantee fairness in global markets. At global level, ethical behavior should pursue codes of practice which charge every individual with responsibility for their actions, and applications of standards that protect against infringing of other people's value systems. Ultimately, a universal code of ethic should strive for fair practices that disregard race, gender or class. Where ethical question point to the wrong decisions that have been made, such developments should be used as learning experiences and give direction on global interventions for a fair and just systems all over the world.

Business development agencies focus on the small businesses only as just hatcheries for large enterprises, with firm size influencing the business strategies in market expansion and product breadth (Hoang, 1998). This view misses the reality of emerging small businesses in developing countries. Small businesses in developing economies sometimes define the very essence of life to the entrepreneurs, since the businesses are the only available means of livelihood. For instance, a general observation of small businesses in Kenya shows that there are an increasing number of informal enterprises which, in most cases, stem from the need to escape from the joblessness and starvation facing desperate and unemployed people. Therefore, the question of who becomes an entrepreneur goes beyond entrepreneurial traits of opportunity identification and risk taking. The small business may define the very essence of an entrepreneur's existence and not McClelland's (1961) perception of "needs achievement" activity. In trying to develop an entrepreneurial culture in a population, analysis of what motivates a potential entrepreneur should contextualize the grounds that drive the need for self-employment. Brockhaus (1982) argues that the need for independence and control is a transitional step in overcoming odds. For this reason, internal locus of control positively correlates with business success which then becomes a symbolic and emotional reality for the small business owner. Therefore, participation of small business in a global value chain is a global human right issue.

Schumpeter (1934) explains that upsurges in the level of small business start-ups are an indication of labor market turbulence. Thus, self employment is especially strong for individuals who do not have other opportunities of achieving social distinction. Where the market does not guarantee such opportunities, struggle for survival leads to unethical means of self-employment that include drug trafficking (its spill-over effects is now a global problem) and commercial sex workers (addressing the HIV infection is a burden to world population health budgets). The small business owner consequently faces challenges of labor productivity arising from unhealthy labor force.

The influence of Political Globalization on Small Business Performance

Political globalization may be perceived as a process that works to put the 'global village' in a system based on democratic principles. Democracy is taken to mean 'the rule of the people by the people for the

people'³. Theoretically, globalization promotes democracy in the sense that market liberalization precipitates clamor for free flow of information, openness of state institutions, an end to corruption and the application of the rule of law and order (Richard, 1995). However, from a general observation of countries where liberal democracy is practiced, one notices that people do not rule themselves as the principles of democracy state, but instead a small number of influential people exist within the community to rule the majority. This small group has immense wealth which they use to control resources and media, thereby entrenching their political power. Democracy becomes the relevant and easier way to rule directly or through proxies. Subsequently, the small group of ruling elite increases its wealth and mid-wife reforms to perpetuate themselves in power. This perspective of political development, particularly observable in Africa, mirrors what Hyden (2003) calls neo-patrimonialism, that is, the use of public resources for private economic or political gains. As Stephens (2011) notes, since early 1980s many African dictators have held sham elections to transform themselves into 'democratic leaders,' for purposes of getting aid and receiving international recognition, but cunningly used the colossal debts to entrench themselves in power. In the long run, conflicts arise between groups in 'democratized' economies, between the winners (the ruling class) and the losers (the general population).

Meanwhile, the ruling elite portray economic inequality-based conflict as conflict arising from differences in race, tribal, culture, religion or political parties⁴. Reality on the causes of social upheavals therefore becomes blurred. Within this environment, small businesses are affected in either one of the two ways. Small businesses associated with the ruling party/group gets fiscal support (financial or otherwise) and later use part of their proceeds to strengthen the ruling party or group to stay in power (Hyden, 2003). The other group of small enterprises hardly gets any support from the government but are subjected to "regulations" to steer them away from pursuing growth that threaten the benefits of multinationals or industries owned by the members of ruling group.

Ethical Aspects in Technology Development for Small Business in Global context

A close scrutiny of transfer, and acquisition, of technology to the small-business sector reveals crucial ethical aspects that demand attention if the sector is to play a significant role in the emerging global market. One ethical issue touches on price. Beyond capturing the value of a technology as a product, pricing may be designed to keep out a certain category of potential users, scaling down competition from emerging businesses (Gürak, 2003).

The second ethical issue is the patents rights given to innovators to help them recover costs of research and development related to a particular technology. Obviously, a patents system stimulates innovative activities since research efforts get rewarded. However, no standard criteria exists for defining the time period applicable to a patent except for estimation of a time interval long enough for the innovating entity to recoup the costs. Thus, there could be cases where long periods are embedded in patents rights given to technology innovators such that by the expiry of most patents, the technology may be obsolete and information asymmetry may result in small businesses purchasing such technologies.

The third ethical issue relating to technology transfer to small businesses is the appropriateness of such technology. Technology is mostly developed by large enterprises in the developed world, mostly by multinational corporations, and is oriented to overcoming resource constraints faced by these enterprises

³ The origin of this definition is explained by Mubangizu: <http://www.ajol.info/index.php/ldd/article/viewFile>

⁴ The 2008 post election violence in Kenya depicted this pattern where members of particular tribes were attacked as deemed beneficiaries of skewed allocation of public resources

(Archibugi et al, 2002). Most small businesses in developing countries face an entirely different set of constraints. For instance, whereas high labor costs is a challenge to manufacturers in developed economies, low-cost labor is the competitive advantage that is potentially available to small businesses in LDCs (Wang et al, 2010). Indeed, for these small businesses, the advanced technology available in a global market is inappropriate in the sense that what is useful to them is intermediate technology that makes labor more productive.

The fourth ethical issue is the medium of technological transfer from large enterprises to small businesses. Technology transfer is cost-effective and efficient if networking linkages exist between the two categories of businesses. Previous empirical works show that such linkages do not exist in many LDCs (Ng'ang'a, 2008). This calls for technology policy formulation that promotes sub-contracting arrangements between small and large businesses in developing countries. Gürak (2003) summarizes the predicament that face most LDCs in technology transfer when he notes that "a country with low technological absorptive capacity would not know what alternative technologies are available, what are the most suitable ones for local production, what the best channels of transfer are and how to bargain effectively about the terms of transfer"(pg 10).

Role of Global Mass Media in Growth of Small Businesses

The globalization of mass media may potentially influence the performance of small businesses in developing economies. One ethical aspect of media that affects small businesses in global context is the control of information. The global mass media controls the information the world receives (Gerbner et al, 1986). Therefore, wire agencies such as Reuters and Agence France-Presse (AFP) are likely to determine what the print media is to receive while the leading global broadcasters such as CNN, BBC, and ITN dominate what the entire world watches daily. Lyons (2005) observes that since the global media houses are basically profit-oriented, it is the advertising from multinationals contracts that punctuate all broadcasts from these global mass media. Issues that relate with small businesses are therefore in periphery in global attention and limited to documentary coverage of isolated cases of unique innovations. Beyond inadequate coverage in global media, global advertising skews the markets against products from small businesses. As Lyons (2005) rightly notes, the global mass media has enormous influence on consumer tastes and preferences, particularly when an advertisement is conveyed over and over again. When a message such as "mothers who care use product X" from a certain multinational corporation is transmitted more than a thousand times on radio, television and newspaper each year, the tendency is for consumers to religiously belief the message. The ethical issue here is that the products made by small businesses are consequently viewed to have little or no value in comparison to products promoted by the global mass media.

The high costs of advertising⁵ in the global mass media compromise the competitiveness of products from small businesses. The costs of placing an advertisement in the global mass media is out of reach for small businesses. The expenses incurred even in one advert may be many times more than the annual sales revenue of many small businesses. Global consumers therefore are probably not aware of the products of such businesses as these products rarely feature in the media.

The media paves the way for acceptance of a certain way of doing things (Strelitz, 2004). Consequently, the global mass media has developed as a custodian of the global culture. Through advertisements in global mass media, culture and values of Western Europe and United States are exported to the rest of the world. Given that ownership of major media houses and multinational corporations is more concentrated

⁵ <http://expenditurereport.warc.com/MediaCostData.aspx>

in few western countries, global media tend to convey that only products that originate from certain economies are of the quality, specifications and standards that are internationally acceptable. The ethical issue in this respect is that small businesses' products are always seen as unacceptable in cultures outside the economies where they are produced.

With domination of media houses in Europe and U.S.A in global mass media, the packaging of news coverage from different areas of the world may deliberately distort market information on products produced on those countries. For instance, global media houses are often awash with news from Africa relating to famine, drought and political upheavals⁶. Rare coverage of wild Africa showing richness of the continent in wild animals complements the news coverage. To global audience, such news portrays Africa as underdeveloped continent prime for minerals exploration, tourism (for risky adventures) and for recording documentaries such as "survival" and "hunger from Horn of Africa". Any product from such a continent must pass "standardization criteria of imports to the European Union"⁷. Similarly global media often report on labor and human rights violations in China and a couple of South American countries with alluded implication that purchase of products from those countries is propagation of those violations⁸. With no international code of ethics that binds all journalists and media houses to adhere to what is ethical, the global mass media actions are guided by what they consider as relevant and in the interests of the client investors. As long this is the sole criteria, the ethical issue is how to sensitize the world on small businesses so that the sector grows to a level it can fairly competes with relatively large enterprises in global market.

Conclusions and Policy Recommendations

The Globalization process affects the extent to which small businesses improve welfare through employment creation and income generation. Moving towards a globalized economy brings forth ethical challenges that affect the performance of small businesses. Removing trade barriers and privatizing public corporations make small businesses compete against foreign firms and influx of cheap imports. Similarly, resource and income distribution are skewed against small businesses in a global context. The poor linkages between multinationals and small businesses in developing countries hamper technology transfer between the two. Unable to influence the global media, market access to products from small businesses is a challenge.

In drawing lessons on how globalization process can be harnessed to promote participation of small businesses in global value chain, this paper revisits Michael Porter's Diamond Model. Porter (1990) suggests that improving the competitiveness of a business requires interventions in four areas, namely the factor conditions, demand conditions, related and supporting industries and business strategies, structure and rivalry. In this study, Porter's Diamond Model is reconstructed in the context of small business's position in the global value chain. To overcome ethical challenges, in economic, social and political spheres, that limit enterprise performance in a globalized environment, small businesses must work on their internal contexts to improve their competencies. This will complement inventions by other institutions to improve demand and supply conditions facing small businesses.

⁶ This can be verified by sampling news on, say, Africa from major media houses on any given day

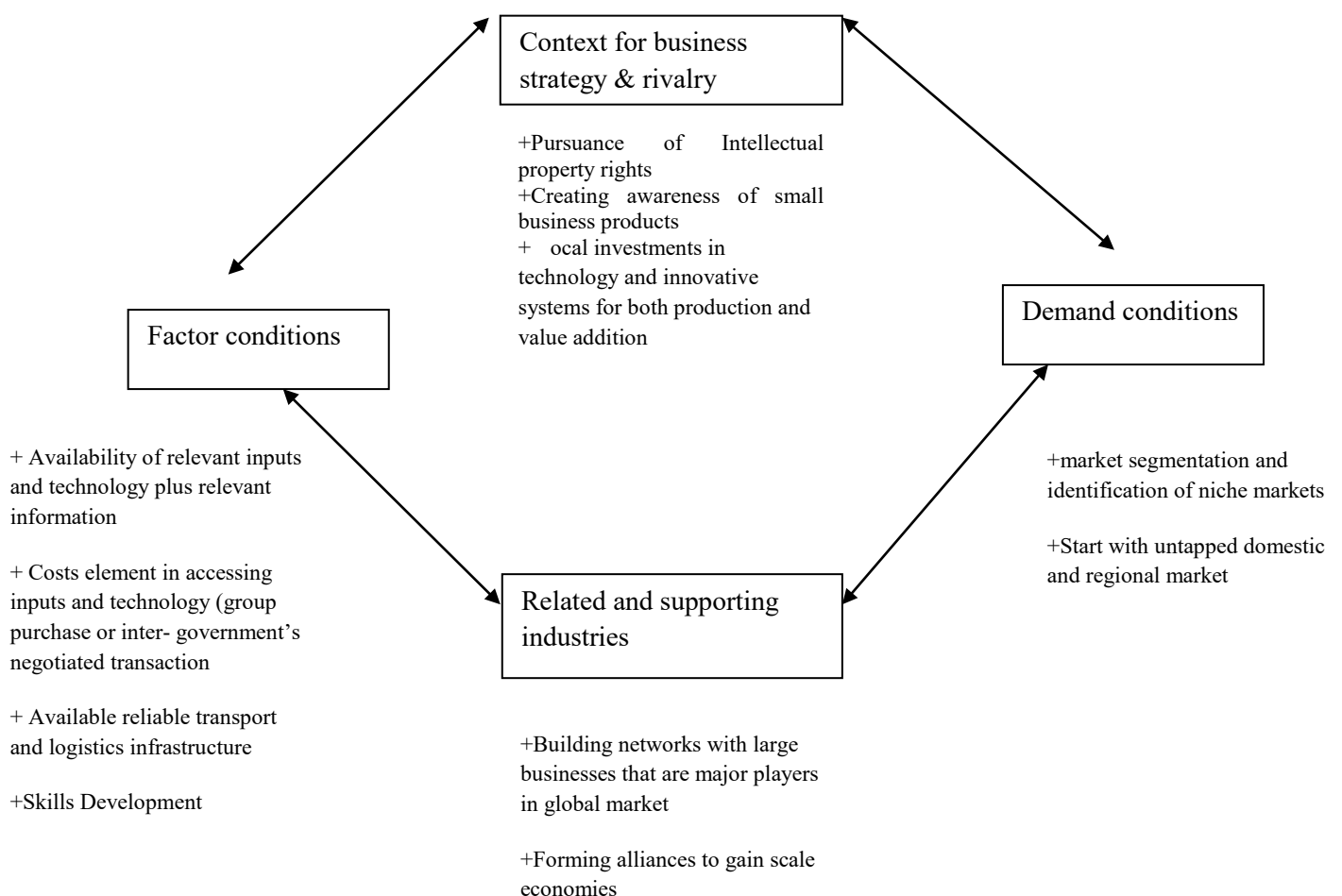
⁷ <http://www.cen.eu/cen/Pages/default.aspx>

⁸ <https://www.chinabusinessreview.com>

Figure 1 illustrates the initiatives that a small business can use to strengthen its competitive edge in a global market. For instance, to upgrade their performance, small businesses must take stock of their innovations and seek intellectual property protection. The ownership of production rights over a technology is a competitive edge that strategically enables the innovator some reasonable market power in transactions relating to the technology. Similarly, for effective technology transfer, skilled manpower training is the key to successful application, adaptation and further development of technology imported from developed to developing economies. Individual businesses should therefore closely work with government institutions through, say, public-private partnership for curriculum development and provision of training facilities. Further, innovative activities are driven by needs assessment of consumers' tastes and preferences. Therefore, it is the indigenously grown and local-developed technology that will capture the technological needs of local industrialization. Innovators in the industrial world are unlikely to be aware of technological gaps in LDCs.

In light of ethical issues raised earlier over global mass media, coverage of local innovations and small business products in global media requires that either the donor agencies or respective national government foot the bill of advertisements, since very few small businesses are likely to afford such advertisements.

Figure 1: Improving the Participation of Small Business in Global value chain: the Diamond



Potentially, globalization offer many opportunities to small businesses that position themselves in specific market niches. Individual businesses must choose to pursue specific innovation-based production, targeted to particular niche market segments. Tapping the unmet demand locally and within the regional economic block should naturally be the starting point so that opportunities are created to refine and perfect the products for international markets. Indeed, while studying 355 New Zealand manufacturing export businesses, Hoang (1998) found out that export performance is significantly influenced by the choice of international marketing strategies which, in turn, is determined by a business's characteristics. Given the existing information asymmetries, small businesses must create information nodes though networks that are well connected internationally particularly with relatively larger businesses with wide knowledge of global markets. Networks are essential conduits of skills for quality improvement and valuation of products from the sector. In addition small businesses can form alliances with similarly local or foreign businesses.

Small businesses may learn by exporting but insufficient resources and an excessive perception of export risks may stifle efforts to participate in global markets. But small businesses may leverage the available local resources in addition to improvements made in infrastructure to minimize costs. Given the prime role of small businesses in employment generation and poverty reduction in developing countries, national governments are morally obliged to provide avail funding and logistical support in skills development, regional consulting and access to relevant information on technology and markets. Interventions that work on both the internal and external environment of a small business will strengthen its productivity and competitiveness and make it overcome the challenges of globalization.

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Determinants of Business Exits in Australia

Yongqiang Li, Anona Armstrong and Andrew Clarke
Victoria University, Australia

Abstract

The annually increasing firm exits have significant financial, legal and social impacts on productivity, employment and economic growth in Australia. However, evidence of the impacts of firm exits is sparse. This paper undertakes a first-ever study that empirically investigates the determinants and their impacts on firm churn. This paper is innovative to the literature in four aspects: (1) Local Region Areas (LGAs) data, rarely available in other countries, has been used for the analysis; (2) using LGAs as the basic analytical unit is able to eliminate the heterogeneity problems encountered by other studies which are based on national and cross-national data; (3) panel data modelling techniques identify robust evidence; (4) systematic statistical tests guarantees the robustness of the results. The dataset, provided by Australia Bureau of Statistics, include 3462 observations of 577 Local Government Areas (LGAs) during 2004-2009. The research identifies variables positively and negatively affecting the exits and finds that size matters in determining business exits. The last section concludes with a discussion of limitations and future research directions.

Keywords

Business exits, determinants, panel data, Australia

Introduction

Most research has been devoted to analysing factors that determines business entries and entrepreneurial engagement. Less has been done to question what drives entrepreneurs toward business exits [11]. This is particularly true in Australia. The number of business exits in Australia as a result of mining boom has been increasing in the past five years and evidence shows that this trend is continue to growth at an accelerated rate [5]. Thus, this paper empirically analyses the impacts of factors that drive business exits in Australian Local Government Areas (LGAs).

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Business exit

Business exit is defined as the number of businesses deregistered in the ABS Registrar. According to ABS [1], business exits are continuously increasing over the past five years and this trend is predicted to continue. Though the

exits are diversified in different regions, it is apparent that in the most populated regions, the exits are far higher.

Business exits have significant impacts on business dynamisms, employment, innovation, productivity and innovation. The reality is there is not much empirical work done to provide solid evidence. This research intends to start the discussion around this area and fill in the gap.

Definition of LGAs

ABS [2] defines LGAs as follows

‘A Local Government Area (LGA) is a geographical area under the responsibility of an incorporated local government council, or an incorporated Indigenous government council. The LGAs in Australia collectively cover only a part of Australia. The main areas not covered by LGAs are northern parts of South Australia, a large part of the Northern Territory, the western division of New South Wales, all of the Australian Capital Territory and the Other Territories’.

Identified research gap and how this paper fills the gap

The extant research leaves the following gaps: (1) panel-data analysis based on pure regional data is not available in most of the countries; (2) previous research only focuses on factors which are partially impact of exits due to the availability of the data. This paper is innovative to the literature in four aspects: (1) Local Region Areas (LGAs) data, rarely available in other countries, has been used for the analysis; (2) using LGAs as the basic analytical unit is able to eliminate the heterogeneity problems encountered by other studies which are based on national and cross-national data; (3) panel data modelling techniques identify robust evidence; (4) systematic statistical tests guarantees the robustness of the results.

The perceived gap in the knowledge about small business exits and research in small businesses, to be filled by this paper, leads to the following research questions.

What are the determinants of business exits in regional Australia?

The rest of the paper proceeds as follows: Section 2 reviews the literature and identifies factors pertinent to firm churn; Section 3 provides details of the sample, data and methodology; Results are discussed in Section 4; Section 5 concludes with some policy recommendations.

Literature review

Exits can be voluntary or involuntary. Voluntary exits can be a function of alternative business options, i.e. to earn wage and salary, to invest, or to live on pension. Involuntary exits can be a function of unemployment and population, business entries, entries of businesses employing, entries of businesses not employing. In addition, the exits may be determined by industry and regional characteristics (). Thus, the literature on the determination of regional business exits can be divided into three strands: the macroeconomic factors, other competing income sources, and industry characteristics.

The impact of churn on the regional economy

There is no consensus in the academia with regards to the impact of economic churn on employment. One stream of researchers for the positive impacts identified empirical evidence

from the Schumpeterian idea of creative destruction. However, they do admit that the employment impact of new firms is not immediate. This line of thinking further argued that the replacement of inefficient and unproductive firms or the expansion of the current plants may potentially associate with increasing demand of labour [10]. The other stream, which is against the positive impacts, argued that higher business churns associates with higher earnings volatility and greater job uncertainties [6].

It is self-evident that negative impacts including decline in productivity, employment, economic growth are all associated with potential social costs, while positive impacts including the increasing dynamism, competition and innovation boost economic growth. Well-designed government intervention can minimise such losses and/or maximise economic gains.

The direct link between SME churn and economic growth has not been well researched in the literature [10]. Andre Stel and Storey [12] find that total entrepreneurial activities influences GDP growth. It follows that if churn has a positive impact on productivity and entrepreneurship, it would positively influence the economic growth in the long run.

Macro-level factors and exits

Flynn [7] empirically tested the US cross-sectional data of the manufacturing sector and found that low income fosters exit. In Flynn's model, exit is defined as the gross number of firms that have exited from an industry during the period 1978 to 1984 [7]. However, he admitted that the empirical test against the widely accepted, whilst barely tested, significance of exits to the competitive models is mainly hampered by the availability of data. And Flynn's study suffers from aggregating the firm-level data to industry level data without given consideration to the heterogeneity of the firms.

Another macro-level factor identified in the previous research is unemployment, or employment [10]. Measuring the relationship between unemployment and churn is complex because data for the numbers of jobs created and destroyed will include the employing of new entrants as well as increased employment from the growth of existing plants. And high business exits are always associated with high unemployment [6].

The role of working population, normally defined as population at the age of 15 – 65, is another factor affecting the exits. Love used a UK dataset covering 64 British countries over the period 1980-1988 and found that population is positively determining the exits in UK [8].

Competing income sources and exits

Apestegua and Ballester extend the behaviour science research on human preference given consideration to the reference of peers [4]. Among various options, Wages & salaries income, own unincorporated business income, investment income, superannuation income are alternatives to becoming an entrepreneur. Thus they are important factors to be considered.

Industry and regional factors

Total number of businesses operating in the region indicates competition and dynamism. Flynn and proceeding research identified that the total number of businesses within the industry is an positive factor affecting the exits [7; 10].

Business entries in the region are a critical factor determining the exits in that a large number of the new entries become sources of exits [6; 10]. Anyadike-Danes et. al. added to this argument that both business entries and business entries rates are pertinent to business exits [3].

Overall, theoretical and empirical work on exit is sparse. Studies focus more on the dynamic aspects of entry and exits, partially due to the availability of the data, and partially due to the research objectives [7]. Most of the evidence gathered is from the analysis of cross-section data, which is largely generated on an aggregated basis. This research attempts to fill such gaps.

Sample, data and methodology

Sample and data

The dataset is provided by Australia Bureau of Statistics. It includes 3462 observations of 577 Local Government Areas (LGAs) during 2004-2009. This study looks at the exits determination of non-employing businesses, micro-businesses and comparatively larger businesses.

Exits are defined as counts of trading businesses as at June in each reference year. Exits of non-employing business are defined as counts of trading businesses as at June in each reference year which are not employing people. Exits of employing business are defined as counts of trading businesses as at June in each reference year which are employing people. All the exits data are from the ABS business Register. The other dependent variables follow the ABS definition [1], including average income, population, wages & salaries income, own unincorporated business income, investment income, superannuation income, non-employing businesses, number of business employing one-to-four, number of business employing five or more, entries of non-employing business, entries of employing business.

Models

The relationship between exits and its determinants can be mathematically put as follow

$$y_{i,t} = f(x_{i,t}) + u_{i,t} \quad (1)$$

, where $y_{i,t}$ is a vector of dependent variables, consisted by total exits, exits of non-employing businesses and exits of employing businesses, $x_{i,t}$ is a vector of exogenous variables; $u_{i,t}$ is the error term. Index i denotes panels, or LGAs here; t denotes year.

The model can be specified in four explicit forms in Eq. (2)-(5).

$$y_{i,t} = \alpha_i + \beta x_{i,t} + u_{i,t} \quad (2)$$

$$y_{i,t} = \beta x_{i,t} + \lambda_t + \xi_i + u_{i,t} \quad (3)$$

$$y_{i,t} = \alpha + \beta x_{i,t} + u_{i,t} \quad (4)$$

$$y_{i,t} = \alpha + \beta_1 x_{i,t} + \beta_2 w_{i,t} + u_{i,t} \quad (5)$$

, where α_i is the intercept; β is a vector of coefficients to be estimated; λ_t is the time (year); ξ_i is fixed effect and is the LGA fixed effect; $u_{i,t}$ is the error term; α is the average exits for the entire population; β_1 is the vector of coefficients to be estimated for exogenous variables; $w_{i,t}$ is the vector of instruments, including number of business by industry by region by year.

Eq. (2) is using Ordinary Least Squares (OLS) estimator based on cross-sectional data, controlling year and clustering LGAs. Eq.(3) and Eq. (4) is the fixed- and random- effect model respectively based on panel data (Stock and Watson 2009). Eq. (5) is the instrument variable (IV) model based on panel data. The number of businesses within each industry is used as

instruments⁹. Eq. (5) has also been estimated by using Generalized Methods of Moments (GMM) as the estimator.

In order to obtain robust results, all the models applied cluster analysis to minimise the heterogeneity among banks in different countries. In addition, robust option has been selected to correct heterogeneity.

The STATA 11.2 software is used to empirically specify the above models. Recently release XTIVREG2 package is couple GMM and fixed effect together for IV models using panel data.

Results

Model selection and robustness tests

Though OLS produces higher R^2 , ^{panel} data based models are preferred as they are able to capture both the 'between' and 'within' panel effects. Thus OLS can be used as a baseline model for comparison purpose. The Hausman Test shows that random effect models are better than fixed effect models in specifying the models respectively.

It is widely acknowledged that traditional models, including fixed- and random effect models suffer from three problems, namely omitted variable bias, measurement error and selection bias. The remedy to these problems is to use Instrument Variable (IV) modelling. Comparatively, IV models with GMM estimator produces more robust results at the cost of efficiency [13].

There are two main additional tests for IV models, one is to test whether the instrument variable is an instrument; the other is to test whether the model is under-identified, weak- identified, or over-identified. A valid instrument must satisfy two conditions, one is instrument relevance, and the other is instrument exogeneity. The former condition is proven to be valid from the Pearson correlation coefficients tests¹⁰. The later condition is examined in STATA (using 'orthog' option) and proven to be valid too. First stage F values all shown to be significant, meaning that there is no weak instrument problem in all the specifications [9].

The under-identification test here adopts the Kleibergen-Paap rk LM statistic, which is automatically report in STATA 11.2 if 'xtivreg2' package is used. All the results reject the null hypothesis that each of the models is under-identified. The weak-identification test adopts the Cragg-Donald Wald F statistic and the results rejected the null hypothesis that the model is weak-identified. The over-identification test adopts Hansen J-Statistics and all the results were not able to reject the null hypothesis at 5% significant level, meaning that the model is not over-identified. Other robustness tests, such as multi-collinearity and heteroskedasticity, have been corrected by using robust estimators in STATA. Thus the IV-GMM model is selected as the most appropriate model for the given dataset.

⁹ The industry of personal is dropped in the computation due to multi-collinearity. For the sake of brevity, the process of the instruments selection is omitted here, but is available upon request.

¹⁰ Test results are available upon request.

Summary of results

For total business exits within a region, on average, average income is negatively contributing to the business exits. \$1 million increase in average income would result in 1330 less business exits, meaning that the more affluent the region is, the less likely businesses would exit. The coefficient of wages & salaries income is statistically significantly negative, though an increase of \$1 million in wages & salaries income is incurring 0.258 exits, noted that the base for wages & salaries income is larger than average income.

The coefficient of investment income is statistically significant and positive. An increase of \$1 million in investment income leads to 0.367 more exits. The coefficient of superannuation income is statistically significant and negative. An increase of \$1 million in superannuation income leads to a decline of 1.29 exits. Number of businesses employing five or more people has a statistically significant and positive impact on exit, meaning that one increase in businesses employing five or more people resulted in 0.427 increases in business exits. The new entries of employing businesses are statistically significant and positive. One increase of the new entry that employs people leads to 0.445 increases in business exits. The rest of the variables are not statistically significant.

The determination of the exits of employing businesses follows similar statistical relationships for most of the variables, though the magnitudes of these variables are larger than those determined in the 'total exits' model. Using the same data and procedure, a few more variables become statistically significant, including number of non-employing businesses, number of businesses employing one to four people, and entries of non-employing businesses. Number of non-employing businesses has a negative impact on business exit, specifically, one increase in non-employing business leads to 0.129 less exits of employing businesses. Number of businesses employing one to four people has a negative impact on exits of employing businesses, and one increase of business employing one to four people lead to 0.262 declines of business exits. Entries of employing business have a positive impact and one increase in the entries of non-employing businesses leads to 0.472 more exits.

Table 1 Summary of results

Dependent variable	Exits	Exits of non- employing business	Exits of employing business
average income	-1330**	1568**	-2969***
unemployment	-0.0102	0.0155	-0.0115
population	0.00313	-0.00101	0.00241
wages & salaries income	-0.258*	0.484***	-0.741***
own unincorporated business income	0.265	-0.552	0.646
investment income	0.367**	-0.624**	0.977***
Superannuation income	-1.29*	3.34***	-4.04***
non-employing businesses	0.0158	0.1*	-0.129*
no. of business employing one-to-four	0.0632	0.299***	-0.262**
no. of business employing five or above	0.427***	-0.157	0.621**
entries of non- employing business	0.0657	-0.303***	0.472***
entries of employing business	0.445***	-0.624***	1.18***

legend: * $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$

Conclusion

This paper intends to identify the factors determining the business exits in regional Australia through empirically testing the impact of each determinant on the number of business exits. The econometric models yields answers to the research question, as follows

Determinants for the total number of business exits are average income, wages & salaries income, investment income, superannuation income, number of businesses employing five or above, and number of entries of employing business, among which investment income, number of businesses employing five or more people and entries of employing businesses are positive determinants; whilst average income, wages & salaries income, and superannuation income are negative determinants.

Determinants for the total number of exits of business not employing people are average income, wages & salaries income, investment income, superannuation income, number of non-employing businesses, number of businesses employing one to four people, number of entries of both non-employing and employing business, among which average income, wages & salaries income, superannuation income, number of non-employing businesses, and number of businesses employing one to four people are positive determinants; whilst investment income, and number of entries of both non-employing and employing business are negative determinants.

Determinants for the total number of exits of businesses employing people are average income, wages & salaries income, investment income, superannuation income, number of non-employing businesses, number of businesses employing both one to four and five or above, and number of entries of both non-employing and employing business, among which investment income, number of non-employing businesses, number of businesses employing both one-to-four five or more people and entries of both non-employing and employing businesses are positive determinants; whilst average income, wages & salaries income, and superannuation income are negative determinants.

The paper is subjected to two limitations, (1) though this paper tries to identify a whole list of exits determinants, it is only able to identify the determinants which are available in the database; (2) using the absolute number of exits as the only indicator of business exits may not be able to capture the whole story.

Future research can include firm level data to provide a systematic view of business exits. Future research can focus more on the following aspects: (1) values of more variables, in particular size of the business, should be collected and included in the analysis; (2) the research should look in-depth to the fundamental issues of business exits and their potential impacts, i.e. efficiency, employment, regional economic growth, innovation and productivity.

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Determinants of Regulatory Burdens on Non-Listed Small Corporations in Australia: Perceptions of Small Corporations' Owners/Managers

Yongqiang Li, Anona Armstrong and Andrew Clarke
Victoria University, Australia

Abstract

Small corporations are the engine room whilst the forgotten corner of the Australian economy. Regulatory burdens are hampering the small corporations from performing to their optimal, which consequently impairs the economic growth of the nation. For policy decision makers, quantifying the regulatory compliance cost is the first priority for evidence-based de-regulatory reforms. Thus, policy options proposed are of practical imperative to future de-regulation reforms. Prior research supporting the estimation and determination of regulatory compliance cost are at a dearth. This paper fills the gap by estimating the regulatory compliance costs of small corporations using the firm level survey data. A non-parametric logit model, Generalised Ordered Logit/Partial Proportional Odds Model (gonlogit2), is developed to estimate the impacts of determinants on regulatory costs. The paper concluded with a discussion of policy implications and future research directions.

Key words

Regulatory compliance costs, generalised ordered logit model, small corporations

Introduction

The issue of exhibitiv regulatory compliance cost and its adverse effect on businesses have been noted by governments and appealed by the business community in the past decades worldwide reported in the World Bank report (Loayza and Serven 2010). In Australia, the Australian Chamber of Commerce and Industry in 2005 estimated that myriads of regulatory compliance requirements cost Australian businesses \$86 Billion annually, accounting for 10.2% of the GDP (ACCI 2005). The former chairman of Australian Competition and Consumer Commission, Alan Fels told the Australian Financial

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Review that, “despite the ideology of deregulation, the fact is regulation has been increasing for the last 70 years” (Kehoe 2010).

Regulatory reforms have been undertaken by various levels of governments in Australia in the past decades. However, there is still little evidence articulating the potential impact of regulatory on the performance of small corporations. Neither is any evidence on the determination of the regulatory costs, which may be minimised by properly designed regulatory reform vehicles. Failure to understand how regulation affects business means that policy interventions are likely to produce unwanted consequences because they do not identify the full range of mechanisms shaping small business performance nor the conditions which support or hinder the exercise of these mechanisms and the generation of their expected effects.

Definition of regulation

The regulation of business activity is a key issue for national Governments and supranational policymakers alike (OECD 2003). The former Ministry of Small Business in Australia, Mr. Nick Sherry commissioned the Productivity Commission to undertake an investigation that identifies the potential regulatory reform opportunities on 12 May, 2011 (Productivity Commission 2011). The Productivity Commission (2011) defined regulation as

“a principle, rule, or law designed to control, govern or influence conduct. Regulatory instruments shape incentives and influence how people behave and interact, helping societies to function well and deal with a variety of problems”.

Regulation can be broadly divided into economic regulation (which can directly influence market behaviour such as pricing, competition, market entry or exit) and social regulation (which protects public interests such as health, safety, the environment and social cohesion). Some economic and social regulations apply widely to the community, while others apply only to certain industries.

Regulatory instruments in Australia can also be classified according to their legal basis:

- Primary legislation consists of Acts of Parliament. (A legislative proposal for enactment of a law is called a Bill until it is passed and receives a Royal Assent, at which time it is a law (statute) and is no longer referred to as a Bill.)
- Statutory rules are any regulations made under enabling legislation, with a requirement to be tabled in Parliament and/or be assented to by the Governor or Governor General-in-Council.
- Other legislative instruments include guidelines, declarations, orders or other instruments that have legal enforceability, but that are not subject to Parliamentary scrutiny.

Apart from these regulatory instruments, there are also codes and standards that governments use to influence behaviour, but which do not involve ‘black letter’ law — these are known as quasi-regulation. Forms of co-regulation, such as legislative support for rules developed and administered by industry, and other instruments such as international treaties, are also used to directly or indirectly influence conduct (PC 2008).

Definition of regulatory compliance cost

The regulatory compliance cost is defined as “all the costs incurred directly or indirectly by regulators”. Marneffe and Vereeck (2011) identified sixteen direct and two indirect regulatory cost types. The direct costs are costs borne by society in preparing and implementing regulations. For the government, they consist of information, decision-making, drawing-up, planning, administrative start-up, operational, monitoring, and enforcement costs. Citizens and businesses, on the other hand, incur rent-seeking,

information, planning, three types of compliance, delay and enforcement costs. The indirect costs comprise the efficiency loss plus, in the event of poorly designed or market-based regulation, also transaction costs.

Definition of small corporations in Australia

This study adopts the definition of small corporations from The Corporations Act 2001 section 45. A small corporation is defined as one which has less than 50 shareholders and satisfying 2 out of 3 criteria in a financial year:

- consolidated gross revenue of less than \$25 million;
- value of consolidated gross assets less than \$12.5 million; and
- fewer than 50 full-time equivalent employees.

Small corporations are the engine room of the Australian economy. In Australia during 2009/10, more than 99% of businesses are small corporations. The small corporations employ more than 60% of the workforce and contribute to about 46% of the national GDP. More than 70% of the Research and Development (R&D) are undertaken by the small corporations (Armstrong et al. 2011).

Though small corporations play a vital role in Australia, they are particularly disadvantaged from enjoying the spill-over effect of government regulatory reforms. Contingencies, i.e. business size, resource limitation, lack of access to finance, skill shortage, lack of power and influence to lobby, constrains small corporations from performing to their optimal (Armstrong et al. 2011). Obviously, the gap between the ideal policy design and practical innate difficulties of small corporations signals an unmet need of reducing regulatory burdens for the small corporations.

Research question

To provide better evidence for the reduction of regulatory burdens of small corporations in Australia, finding answers to the following research question is critical.

What are the determinants of regulatory compliance costs of small corporations in Australia?

Given that the small corporations section has been ignored The paper intends to contribute to the literature in three aspects, (1) a simple metric is developed to measure the regulatory compliance cost borne by small corporations in Australia; (2) rigid empirical approach has been adopted to estimate the impacts of determinants of regulatory compliance costs; (3) based on the empirical findings, policy options are proposed to reduce the regulatory burdens. To such ends, this paper is mainly focused on the determinants of regulatory compliance costs self-reported by small corporations from the survey, which is largely financial costs, whilst that the distinction of finer level compliance costs, i.e. administrative, substantive and social costs (Kitching 2010), are to be assumed by future endeavours.

The rest of the paper proceeds as follows, Section two reviews the literature pertinent to the determinants of regulatory burdens, and hence hypothesis are developed; Section three describes the data and econometric models; results are reported and discussed in Section four; Section five concludes by responding to the hypotheses and future work.

Literature review and hypothesis

The literature on determinants of regulatory compliance costs can be divided into five streams, including business size, business characteristics, owner characteristics, decision making tools, and CSR.

Relatively larger businesses (in relation to turnover or the number of employees) bear larger compliance costs for small businesses and the relative burden is higher for small businesses comparing with the large corporations (Sandford et al. 1989). Sandford further suggested that the first employee will significantly result in a “jumping up” of regulatory costs because of the abrupt increment in fix cost.

H1: The growth of business size increases compliance costs.

The business characteristics are also critical to the compliance cost. It is expected that younger businesses bear higher compliance costs because of the start up costs and learning curve effects (Rametse and Pope 2002; Tran-Nam and Glover 2002).

H2: Younger businesses bear more compliance costs.

In Australia, each state assumes legislative and regulatory power as well, which makes the location of business pertinent to compliance costs (PC 2009, 2011).

H3: Location has an impact on compliance cost.

Different industry structure means different regulatory compliance obligations to comply with. Thus, industry is expected to have a significant impact on the compliance cost (Allers 1994).

H4: Industry has a significant impact on compliance cost.

Different legal type has profound implications on regulatory compliance requirements. The endowment of human capital and financial proficiency enables the large corporations to meet the compliance requirements easily, minimising the possibility of being penalised. In addition, the large corporations enjoy the power to lobby and negotiate with the regulators, which leaves the small corporations into a disproportionately disadvantaged position (Armstrong et al. 2011). This line of argument suggests that the small corporation, in particular private companies, on average, bears more unnecessary¹¹ compliance costs. On contrary, a group of researchers, based on the complexity of the organisation structure per se, argued that small corporations, i.e. individual firms, should incur lower compliance costs (Standford and Hasseldine 1992; DeLuca et al. 2005).

H5: Legal type has a significant impact on compliance cost.

The seven business development stages, including seed stage, start-up stage, growth stage, established stage, expansion stage, decline stage and exit stage, on the business life cycle influences the compliance cost (AG 2007).

H6: Business development stage has a significant impact on compliance cost.

¹¹ ‘Unnecessary’ means there is little justification for the regulation to be introduced to the small corporations in the first place. Consequently, the small corporations are bearing the unintended costs of “one size fit all” model.

The characteristics of business owners affects the perception of them on regulatory requirements, thus the characteristics of business owners are expected to have a significant impact on compliance cost.

H7: Characteristics of business owners/managers has a significant impact on compliance cost.

Marneffe and Vereeck (2011) identified planning, innovation, ICT and social responsibilities extra burdens to all the business entities and thus incur regulatory compliance costs.

H8: ICT has a significant impact on compliance costs.

H9: Innovation has a significant impact on compliance costs.

H10: Strategic planning has a significant impact on compliance costs.

H11: Concerns of small corporations with different stakeholders, including customers, suppliers, investors, employees, philanthropy and environment, have significant impacts on compliance costs.

Armstrong et al (2011) found that small corporations which are members of industry associations tend to incur less compliance costs than those which are not members.

H12: Small corporations which are members of industry associations has a negative impacts on their compliance costs.

Data and econometric models

A convenient sampling approach has been adopted to collect data from an online survey during 2010/11. Small corporations from Australia-wide were invited by numerous industry associations to participate in the survey. The online survey collected 391 responses.

The survey was designed based on literature review and feedback from the experts. The survey covers questions on business size, i.e. number of full-time equivalent employees and total assets; business characteristics, including age of business, industry, location of the business, whether the small corporation is a member of an industry association, legal form, stage on the sever-stage business development cycle; owner characteristics, i.e. prior experience as a owner/manager of the business, education background, gender and age; strategic decision making tools, including information and communication technology (ICT), expenditure on innovation, strategic plan; and corporate social responsibility (CSR), such as customers, suppliers, employees, investors, philanthropy and environment. A detailed description of variables can be found in Table 1 (Appendix 1).

Based on the literature, the relationship between compliance cost and its determinants can be put as

$$P(Y_i) = f(x_i) + \xi_i \quad (1)$$

, where Y_i is the compliance cost, x_i is a vector of determinants, ξ_i is the error term. Compliance cost is the dependent variable and the rest of the variables serve as independent variables.

Given that all the variables are categorical variables and the dependent variable is nominal variable, the Generalised Ordered Logit Model (gologit) is chosen as the specification for the analysis. Following William (2006), Eq. (2) can be re-written as

$$\text{-----} , j = 1, 2, \dots, M-1 \quad (2)$$

, where M is the number of categories of the ordinal dependent variable. Stata12.0 is used to estimate the Generalised Ordered Logit model, including both `gologit` and `gologit2`. Maximum-likelihood is the estimator for all the computations.

Results and discussion

Descriptive statistics

The summary statistics have been reported in Table 2 (Appendix 2). Due to the missing value issue, less than 200 complete records are available for the modelling exercise.

Spearman's rank correlation coefficients

Given that all the variables included in the analysis are categorical variables, Spearman's rank correlation coefficients computation is applied (Refer to Table 3, Appendix 3).

The days on regulatory compliance is positively related to business development stage, meaning that the more mature the business is, the more compliance cost is incurred, *ceteris paribus*. Strategic plan and having a focus on suppliers negatively correlated with the compliance cost. Full-time equivalent employee number is positively correlated with business development stage, indicating that the more mature the business is, the more staff small corporations are hiring.

The prior experience of the owner/manager is positively correlated with total assets, meaning that the longer the business decision maker has been in place, the larger the business is. The legal form is positively correlated with the prior experience of the owner/manager, indicating that experienced owner/managers prone to use private companies as the legal form of the business.

Small corporations which care about customers also care about employees and the environment.

Goodness of fit and validity tests

Both McFadden's R^2 and ML (Cox-Snell) R^2 indicates the models identified have acceptable R^2 values. The χ^2 value, as well as the corresponding p-value, indicates that all the models identified are valid (Refer to Table 4, Appendix 4).

An additional assumption in ordinal logistic modelling is that proportional odds, or parallel lines assumption. All the models identified passed the Wald test, thus violation of parallel lines assumption is not a concern.

Econometric modelling results

Generalised ordered logit model takes up business characteristics, owner characteristics, decision making techniques, and CSR respectively in model 1-4, using business size as the control variable. Model 5 includes all the five strands of factors. The modelling results are reported in Table 5 (Appendix 5).

Business size

Employee number is a positive and significant factor for compliance cost. However, the total assets, or size in financial terms, are not significant. H_1 has been accepted. Thus, the small corporations with greater number of employees, *ceteris paribus*, have a higher likelihood to incur more compliance costs.

Business characteristics

The location of business is a positive and significant factor for compliance cost, meaning that, *ceteris paribus*, relocation of the business may possibly incur extra compliance costs to the business. H3 is accepted.

Being a member of an industry association is a negative and significant factor for compliance cost. On average, small corporations which are members of industry associations tends to incur less compliance costs than small corporations which are not members, keeping the other factors constant. Being a member of an industry association may facilitate the small corporations to expose to regulatory requirements transferred by their industry associations and may communicate good practice of tackling with regulatory requirements. H12 is accepted.

Owner characteristics

Gender of the owner/manager is a negative and significant factor for compliance cost. In this paper, gender is coded as 1 if it is male, 2 if female. Thus, small corporations having a female owner/manager tend to have less compliance cost, comparing with those having male owner/managers. H7 is accepted.

Decision making

ICT is a negative and significant factor for compliance cost, meaning that small corporations adopting new ICT techniques tends to have less compliance cost, keeping the other factors constant. H8 is accepted.

CSR

Small corporations concerning with suppliers has a significant and negative impact on compliance costs. This may because the suppliers are easing the process of meeting regulatory requirements in some ways. H11 is accepted.

The econometric model failed to accept the other hypotheses.

The empirical findings may support policy design toward targeted reduction on regulatory compliance costs, i.e. boosting the application of ICT in small corporations, promoting the role industry associations should play.

Conclusion and future work

This paper analysed the regulatory compliance costs using firm level data. Determinants of compliance costs are estimated using econometric modelling techniques. Factors identified to be statistically significant to compliance costs include employee numbers, location, being a member of an association, gender of the owner, ICT, regarding suppliers as important stakeholders.

This study is subjected to three limitations: (1) a static perspective has been applied in the analysis due to the availability of the data; (2) regulatory compliance cost is simply measured by the financial cost self-reported by the owners of small corporations; (3) missing value is a challenge as well.

Future work should endeavour to collect a longitudinal firm level data with a focus on compliance costs; and develop a regulatory compliance cost index to quantify the compliance costs from a multi-dimensional perspective, coupled with the analysis of qualitative data. In addition, computation approach, i.e. multiple imputations, may be used to handle the missing data problem.

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Appendix 1 Table 1 Definitions of variables

Variable	Definition
Days spent on regulatory compliance	Number of days the business spent on meeting regulatory compliance requirements.
employee number	Number of full-time equivalent employees, ordinal value
total assets	Total assets, ordinal value
age of business	Number of years since the firm was established, interval value
industry	Which industry the business is in, nominal value
location of state	Which state the business is in, nominal value
member of an association	Whether the business is a member of an industry association, binary value
legal form	Which legal form is the business, nominal value
business development stage	One of the sever business development stages, nominal value
prior experience of the owner/manager	Years being as the business owner/manager, ordinal value
education level of the owner/manager	Education level, ordinal value
gender of the owner/manager	Male or female, nominal value
age of the owner/manager	Age, ordinal value
ICT	Whether ICT is important to the business, binary value
innovation	Percentage of expenditure on innovation, ordinal value
strategic plan	Whether the business has a strategic plan in place, binary value
customers	Whether the business regard customers as an important factor for the business performance binary value
suppliers	Whether the business regard suppliers as an important factor for the business performance, binary value
employees	Whether employees are an important factor for the business performance
investors	Whether the business regard investors as an important factor for the business operation, binary value
philanthropy	Whether philanthropy is an important factor for the business performance, binary value
environment	Whether is an important factor for the business performance, binary value

Appendix 2 Table 2 Summary statistics

Variable	N	Mean	Std Dev	Min	Max
days on regulatory compliance	391	2.757033	1.567227	1	6
employee number	206	2.5	0.981537	1	5
total assets	391	1992.074	16.66401	1884	2011
age of business	391	11.59335	5.487128	1	19
industry	391	2.176471	1.475287	1	10
location of state	391	1.265985	0.442422	1	2
member of an association	391	2.429668	0.831767	1	5
legal form	391	4.28133	1.119814	1	7
business development stage	205	5.204878	3.583319	1	16
prior experience of the owner	391	3.987212	1.265859	1	5
education level of the owner	391	3.736573	1.765675	1	8
gender of the owner	391	1.276215	0.447697	1	2
age of the owner	391	2.705882	1.02679	1	5
ICT	196	1.204082	0.404061	1	2
innovation	205	3.682927	1.968365	1	9
strategic plan	209	1.569378	0.496352	1	2
customers	203	1.068966	0.254022	1	2
suppliers	199	1.281407	0.45082	1	2
employees	202	1.094059	0.292637	1	2
investors	391	2.332481	0.752394	1	3
philanthropy	391	2.350384	0.725007	1	3
environment	391	2.163683	0.893745	1	3

Appendix 3 Table 3 Spearman's rank correlation coefficients

	days on regulatory compliance	employee number	total assets	age of business	industry	location of state	member of an association	legal form	business development stage	prior experience of the owner	education level of the owner	gender of the owner	age of the owner	ICT	innovation strategic plan	customers	suppliers	employees	investors	philanthropy environment						
days on regulatory compliance	1																									
employee number	0.2040*	1																								
total assets	-0.1614*	-0.2845*	1																							
age of business	-0.0628	-0.1079	0.2362*	1																						
industry	0.0581	0.0158	0.1954*	0.0542	1																					
location of state	-0.1443	-0.0735	0.1389	-0.0851	0.1976*	1																				
member of an association	-0.0952	-0.1894*	-0.0947	0.0014	-0.0522	0.0634	1																			
legal form	0.1592*	0.1328	-0.4739*	-0.0642	0.0194	-0.0833	0.1663*	1																		
business development stage	0.2925*	0.5020*	-0.2925*	-0.2391*	0.0507	0.0108	-0.0325	0.0667	1																	
prior experience of the owner	0.0779	0.0093	-0.5654*	-0.1168	-0.0242	-0.0287	0.0835	0.4772*	0.0477	1																
education level of the owner	0.0282	0.012	-0.2596*	-0.2717*	-0.3410*	-0.1039	0.0708	0.1803*	-0.0251	0.2446*	1															
gender of the owner	-0.0051	0.0985	-0.0756	-0.0974	0.1139	-0.0713	0.2099*	-0.0022	0.1484*	0.0227	0.1236	1														
age of the owner	0.0024	-0.0768	-0.2290*	-0.0609	0.1075	0.0551	-0.0217	0.0981	0.0238	0.3506*	0.0698	-0.1031	1													
ICT	-0.2360*	0.0603	-0.0243	-0.2127*	-0.022	0.0682	0.0939	0.0622	-0.0049	-0.0254	0.1136	0.0359	0.0843	1												
innovation	-0.0167	0.0377	0.1603*	0.1609*	-0.0392	0.0481	0.0265	-0.116	0.0569	-0.1393	-0.1752*	-0.0004	-0.1175	-0.2690*	1											
strategic plan	-0.2208*	-0.2188*	-0.0976	-0.034	-0.2567*	0.0131	0.2087*	0.0774	-0.2528*	0.1610*	0.1830*	-0.0133	-0.0085	0.1091	-0.0779	1										
customers	-0.1601*	-0.0204	0.0468	-0.1012	-0.0275	0.1284	0.0008	0.0051	-0.0119	0.07	0.0359	0.1284	0.0073	0.2715*	-0.0756	0.0344	1									
suppliers	-0.2315*	-0.0523	0.0712	0.2001*	0.1601*	-0.0363	-0.0737	0.0071	-0.0906	0.0105	-0.0985	0.0507	0.0376	0.1974*	-0.0623	0.1735*	0.2508*	1								
employees	-0.2620*	-0.1953*	0.0294	0.0658	-0.0219	0.0072	0.0909	0.059	-0.1663*	0.0529	-0.0025	0.053	0.1704*	0.2753*	-0.1904*	0.114	0.4090*	0.3662*	1							
investors	-0.078	-0.3224*	0.0424	-0.0352	-0.042	0.0891	0.1292	0.0641	-0.1382	0.1115	0.1069	-0.1301	0.0466	0.1522*	-0.1096	0.2477*	0.129	0.0926	0.2176*	1						
philanthropy environment	-0.1301	-0.0417	0.0153	-0.1143	-0.1349	0.1642*	-0.0827	-0.0225	0.0121	0.0464	0.2053*	0.0496	-0.0246	0.3008*	0.0039	0.1533*	0.1660*	0.1654*	0.1174	0.2675*	1					
	-0.2002*	-0.0075	-0.0277	0.0883	0.0102	0.1023	-0.055	0.0464	-0.0562	0.0341	-0.0809	-0.0318	0.0228	0.3417*	-0.1668*	0.0691	0.2796*	0.4108*	0.3205*	0.128	0.2749*	1				

Remark:

*denotes 5% significance level

Appendix 4 Table 4 Goodness of fit results

Model	Chi2	p-value	McFadden's R2	ML (Cox-Snell) R2
Model 1	96.95	0	0.152	0.392
Model 2	45.429	0.035	0.071	0.208
Model 3	59.405	0	0.102	0.281
Model 4	125.786	0	0.212	0.497
Model 5	271.770	0	0.468	0.781

Appendix 5 Table 5 Econometric results

Dependent variable	days spent on meeting regulatory compliance requirements	Model 1	Model 2	Model 3	Model 4	Model 5
business size	employee number	0.547* (-2)	0.421 (-1.78)	0.36 (-1.48)	0.502 (-1.92)	0.403 (-1.07)
	total assets	0.0641 (-1.09)	0.0797 (-1.41)	0.065 (-1.13)	0.0502 (-0.86)	0.0862 (-1.03)
business characteristics	age of business	-0.00715 (-0.41)				-0.0166 (-0.62)
	industry	0.00742 (-0.21)				0.107 (-1.95)
	location of state	0.510* (-2.45)				0.897** (-2.87)
	member of an association	-0.908* (-2.24)				-1.261* (-2.15)
	legal form	-0.233 (-1.00)				-0.299 (-0.92)
	business development stage	-0.103 (-0.57)				-0.532 (-1.91)
	owner characteristics	prior experience of the owner		0.137 (-0.93)		
	education level of the owner		0.00688 (-0.07)			0.0831 (-0.56)
	gender of the owner		-0.765 (-1.84)			-1.745* (-2.48)
	age of the owner		-0.185 (-1.06)			-0.384 (-1.50)
Decision making	ICT			-1.146** (-2.75)		-0.0784 (-0.12)
	innovation			-0.0221 (-0.23)		0.024 (-0.17)
	strategic plan			-0.479 (-1.29)		0.446 (-0.74)
CSR	customers				-1.128 (-1.52)	-0.486 (-0.50)
	suppliers				-1.235** (-2.89)	-0.78 (-1.30)
	investors				0.348 (-0.92)	-0.312 (-0.50)
	philanthropy				-0.275 (-0.64)	-0.559 (-0.91)
	enviornment				-0.152 (-0.40)	-0.065 (-0.12)
	constant	14.58 (-0.42)	0.384 (-0.39)	1.932 (-1.86)	2.269* (-2.04)	36.97 (-0.68)
N		195	195	180	183	179
Remarks						
(1) t statistics are in parentheses;						
(2) * p<0.05, ** p<0.01, *** p<0.001						
(3) Model 1-3 are estimated using gologit2 technique; Model 4 and 5 are estimated using gologit technique due to the constraint of computation compacity.						

Ownership Structure and Firm Financial Performance: Evidence From Panel Data in Sri Lanka

Nirosha Hewa Wellalage and Stuart Locke
University of Waikato, New Zealand

Abstract

This study investigates the effects of equity ownership structure on financial performance of Sri Lankan listed businesses. Using dynamic panel generalised method of moment this study finds an inverse hump shape relationship between insider ownership and firm financial performance. The results of this study confirm that the effect of insider ownership on firm performance is more positive and significant where legal protection for investors is weak. It suggests that although new legislative reforms have been enacted, Sri Lankan companies are highly dependent on internal governance mechanisms. There is potential merit in promulgating new rules to control the expropriation of minority shareholders.

Keywords

Ownership structure, financial performance, endogeneity, emerging market, Sri Lanka

Introduction

This study seeks to determine whether their ownership structure affects Sri Lankan companies' financial performance. Ownership structure is analysed in terms of insider ownership percentage, ownership type (institutional or board) and ownership identity (local or foreign). The impact of ownership on financial performance has been thoroughly explored in the corporate governance literature and the causality linkages between ownership and performance are discussed in traditional agency theory. This may be very important as ownership structure plays a key role in corporate governance, especially in developing countries. The literature indicates that highly concentrated ownership is more widespread in developing economies and developed countries outside the Anglo-American countries (Shleifer and Vishny 1997; La Porta et al. 1999). In spite of economic and legal differences, almost all Asian companies have concentrated stock ownership reflecting a predominance of family ownership (Chakrabarti 2002).

In Sri Lanka, highly concentrated insider ownership is present in many listed companies and research backs this up. Samarakoon (1999), using listed firms in Sri Lanka, reports share ownership in Sri Lanka is highly concentrated and a small number of shareholders with large shareholdings control a

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significant portion of voting rights. Usually the weakness of investor protection and the absence of well-developed markets for corporate control lead to highly concentrated inside ownership in Sri Lanka. Although this highly concentrated insider ownership reduces the effect of conflicting interests among managers and owners, moral hazard, and adverse selection due to asymmetric information (Christmen et al., 2004), it enhances the managerial entrenchment problem in

emerging markets.

As a result of the concept of opening the economy, recent tax and tariff exemptions for foreign owners and corporate governance reform activities have attracted foreign investors in Sri Lanka. As a result of these changes, companies in Sri Lanka have high institutional and foreign ownership. An example is the Sri Lankan telecommunication industry: in April 1998, foreign institutional investors owned 61% of total outstanding shares (Hashim, Munir, & Khan, 2006). Moreover, similar to other emerging economies, most individual investors' are not willing to invest in emerging markets due to the weak legal protection and uncertainty of the environment. This may be the reason for a high prevalence of institutional ownership in Sri Lanka; Heaw-Wellalage and Locke (2011) stated that institutional ownership is predominant in Sri Lanka, and approximately 95% of multinational subsidiaries are owned and operated by institutional investors.

Using listed firms in Sri Lanka, this study finds an inverse hump shape relationship between insider ownership and firm financial performance, indicating higher insider ownership increases management entrenchment, and lower insider ownership increases misalignment of the interests of management and owners. Furthermore, the study provides empirical support for the hypothesis that foreign ownership is more efficient than local ownership. This paper adds to the empirical evidence concerning the relationship of ownership structure and firm financial performance regarding insider ownership, ownership type and ownership identity. Moreover, most existing studies use data from the US, UK or other mature markets with high investor protection. Although the role of ownership structure on firm performance has been investigated in South Asia, including Sri Lanka, institutional and foreign ownership effects on firms' financial performance in emerging markets remains unexplored. Hence, it is important to consider how differences in institutional and governance systems between countries may affect the differences in ownership structure and firm value. Furthermore, this paper undertakes the first direct study of firm performance and ownership structure in listed Sri Lankan companies representing all industries except the financial sector. Consequently, the analysis provides a greater robustness than prior research.

The next section reviews prior research and develops the hypotheses. Then there is discussion of the data, variables, method and procedures used for this empirical study. The results and conclusion follow.

Literature Review

In recent decades research has given increasing attention to the issue of corporate ownership structure and its effect on the financial performance of firms. According to Zeitun and Gary (2007), corporate ownership structure depends on a country's social, political, economic and cultural factors. In an emerging market, these factors are likely to be entirely different from those of developed countries, which may limit the application of empirical models tested in mature markets. Sri Lanka, most Asian countries and some Latin American countries follow emerging market corporate governance mechanisms. The distinguishing features of these economies are that ownership is highly concentrated in the few directors of firms. In such firms, the traditional principal-agent agency conflict is alleviated due to the large shareholders' greater incentives to monitor the manager. However, conflict emerges as large shareholders exercise their substantial control and influence over firm matters and, as agency theory suggests, they have incentives to consume the firm's resources at the expense of the minority shareholders (Anderson and Reeb 2004). This is because an individual or a family will have incentives for both expropriation and monitoring, with a potentially greater incentive for expropriation. Families and individuals are capable of expropriating wealth from the firm through excessive compensation, related-party transactions, or special dividends (Anderson & Reeb, 2004). While families/individuals may pursue actions that satisfy their own personal goals and happiness, such actions may lead to poor firm performance relative to dispersedly owned firms and impact negatively on the firm's other owners, creating principal-principal agency costs (Anderson & Reeb, 2004).

Hypotheses development

It is now well understood that insider ownership has an important impact on corporate financial performance. One solution to the moral-hazard problem is to give management to shareholders, thereby helping to align managers' and shareholders' interests (Fama and Jensen 1983; Jensen and Meckling 1976). Studies by Ang, Cole and Lin (2000) and Singh and Davidson (2003) confirm higher insider ownership reduces the misalignment between shareholders and managers and lowers agency costs in large US listed firms. McKnight and Weir (2009) find some evidence that higher managerial ownership reduces company agency costs, supporting the earlier findings of Coles, Lemmon and Mescke (2005). This may be because higher personal shareholding by directors bonds them to the company and acts as a method for mitigating agency costs in listed companies. Using 648 German firms, Kaserer and Moldenhauer (2008) also found a positive relationship between insider ownership and stock performance. Insider ownership may improve company performance, because working owners are less inclined to divert resources away from firm value maximisation by decreasing monitoring costs based on the convergence of interest hypothesis (Fama and Jensen 1983; Jensen and Meckling 1976; Shleifer and Vishny 1996). However, an optimal level of insider ownership is determined by firm size, industry, investor protection level, and performance of the firm (Hu and Izumida 2008).

Previous studies find mixed results for insider ownership and company financial performance. A possible explanation for these different results is that some studies were not controlled for the endogeneity of the insider ownership variable and for endogeneity due to fixed effects. Demsetz (1983) and Demsetz and Lehn (1985) argue that insider ownership and company financial value have endogenous effects and that there should be no systematic relationship. However, controlling the endogenous effect of insider ownership and company financial performance, Bohren and Odegaard (2001) find a positive relationship between insider ownership and company value in the Norwegian context. Hence, the first hypothesis, which is formulated regarding insider ownership and financial performance in Sri Lankan listed companies, is:

H₁ : Insider ownership has significant positive impact on firm's financial performance.

Lee (2008) considers the Korean context and identified that ownership identity is another important factor in determining firm performance. He explains that due to foreign ownership, some companies have more superior corporate governance mechanisms than local firms, suggesting foreign owned companies may have higher financial performance. Furthermore, using Turkish non-financial firms, Gurbuz and Aybars (2011) find that minority foreign ownership firms' financial performance is superior to locally owned firms in terms of both return on assets and operating profitability. Huang and Shiu (2009) find that foreign ownership is significantly and positively related with firm research and development expenses and contemporaneous and subsequent firm performance. Ferreira and Matos (2008) suggest that foreign institutional ownership is positively associated with firm value and performance outside the US. This may be because foreign ownership brings technology, research and development, and managerial skills. In the South Asian context, Chhibber and Majumdar (1999) found that foreign owned firms display relatively high performance compared to domestic firms. Since the mid-1980s, the Asia region and other emerging markets have been good prospects for direct foreign investments for large multinational companies. Sri Lanka was the earliest South Asian economy to introduce economic reforms to attract foreign investments. The extensive use of foreign capital is high in manufacturing and service sectors in Sri Lanka. Due to the high existence of foreign ownership in the Sri Lankan market, identifying its impact on firm financial performance is important. A second hypothesis regarding ownership identity and financial performance proxies in Sri Lankan listed firms is:

H₂ : Foreign ownership is positively associated with firm financial performance.

There is increasing interest in how institutional ownership impacts on corporate governance and firm financial performance, which is associated with the growing volume of equity controlled by

institutions. Hayashi (2003) shows that in 2003 US, estimated institutional ownership was responsible for 60% of all outstanding equity in the country, compared to 8% in 1950. As a result of the growing volume of equity controlled by institutional owners, the role of institutional investors has changed from passive investors to active monitors. Navissi and Naiker (2006) find institutional owners have greater incentive to monitor management in New Zealand context, and it positively affects firms' financial performance. This may be due to fact that unlike boards of directors, institutional investors have increasingly used their power to pressure managers to come into line with the shareholders' interests (Cornett, Marcus, Saunders, & Tehranian, 2007). Also, Cornett et al. (2007) explain institutional shareholders have more opportunity, resources and ability to monitor and influence managers. Moreover, higher institutional ownership is always associated with higher board remuneration and incentive-related executive compensation, and it reduces the likelihood of CEO duality on the board (Henry, 2010). Gürbüz, Aybars and Kutlu (2010) analyse 164 firms from the Istanbul Stock Exchange and demonstrate a positive relationship between corporate governance and institutional ownership on firm financial performance. Using 1,914 US companies, Clay (2001) finds a significant positive relationship between company performance and institutional ownership percentage, where a 1% increase in institutional ownership leads to 0.75% increase in company financial performance. Similar results were found by Lin (2010) who posits that when the institutional ownership is higher than 81.2% in Taiwanese companies, firm values start to increase. Hartzell and Starks (2003) find that institutional ownership mitigates agency costs between shareholders and managers, because it increases the monitoring. In line with the above findings, using firms from the North American casino industry, Tasi and Gu (2007) posit a negative agency costs relationship between institutional ownership and agency costs.. Recently, Henry (2010) employed Australian listed companies' data and found similar results.

Prior research provides evidence of four alternative possibilities concerning the relationship between the firm value and institutional ownership, being "efficient monitoring" (Shleifer and Vishny 1997), "cost of capital" (Fama and Jensen 1983), "strategic alignment" and "conflict of interest" (Pound 1988). The efficient monitoring hypothesis provides for a positive relationship between institutional ownership and firm value, while the others indicate a negative relationship. According to the efficient monitoring hypothesis, as shareholders of the company, the institutional owners' primary objective is profit maximisation. In contrast with family or individual owners, institutional owners are multiple owners and can themselves provide clear examples of good or bad corporate governance (Belev, 2003). Hence, institutional owners enhance firm financial performance. Therefore, the third hypothesis regarding ownership type (institutional ownership or board) and financial performance proxies in Sri Lankan listed firms is:

H₃: Institutional ownership is positively associated with firm financial performance

Ownership structure in Sri Lanka

Corporate governance mechanisms vary around the world and can produce different ownership effects on firm financial performance. Emerging market corporate governance is typically characterised by high insider ownership and a predominance of family ownership. Nevertheless, emerging corporate governance models have not been deeply discussed in corporate governance literature. Masulis, Pham and Zein (2009) study 45 countries and report that family business groups are more predominant in emerging economies. Among that sample, Sri Lanka had the largest family ownership in listed companies at 64%. Emerging markets, where there is concentrated ownership, family ownership and weak legal protection, family members with majority shares are able to engage in window-dressing, tunnelling and expropriate minority shareholders. The concentrated family ownership is the root cause of principal-principal agency problems in Sri Lankan public listed companies. According to Young et al. (2008), there are two main reasons for prevalent inside ownership in emerging economies. The first reason is that founder managed firms are reluctant to share core competences and vital information with outsiders (Zahra and Filatotchev 2004). Weak-legal protection is the second reason for the prevalence of inside ownership in developing countries, including Sri Lanka (Chakrabarti

2002; La Porta et al. 1997, 1998, 1999, 2000). The underdeveloped nature of financial markets restricts access to external financing and results in family predominant, highly concentrated insider ownership (La Porta et al. 1997, 1998; Pistor et al. 2003). Moreover, consistent with the view of Bolbol, Fatheldin and Omran (2008), the high market uncertainty in Sri Lanka has resulted in companies having high levels of insider ownership, which impacts on corporate governance mechanisms. Almost all the enterprises in Sri Lanka were state-owned (SOEs) in early 1970s. The corporate reform process has brought about a shift from state-owned companies and central planning to a market orientation. The open economy policy was introduced in 1977, and privatisation and restructuring of SOEs has occurred. As a result of these liberalisation activities, public enterprise ownership has switched to private ownership, though ultimately this private ownership has ended up with a few concentrated family owners, individuals and political leaders.

To attract new business, and especially foreign inflow, the Sri Lankan government started free trade zones in the late 1970s. Foreign ownership gradually increased from the early 1980s in Sri Lanka. Compared with the South Asia region, Sri Lanka offered more benefits than India to attract foreign investors. This included 100% foreign ownership, and the elimination of tariff and quotas. In addition, in the late 1990s, the Sri Lankan Government provided interest free loans of up to 20 million Sri Lankan rupees to start-up businesses in the rural free trade zone. The growth of multinational companies, particularly from 2006 onwards, has resulted in an increased awareness of the foreign ownership in Sri Lanka.

Apart from the foreign ownership, institutional ownership is also highly prevalent in Sri Lankan listed companies. Manawaduge et al. (2009) suggest that a very high percentage of shares on the Sri Lankan stock market are owned by institutional investors. Lee (2010) explains that due to the undeveloped equity market and weak investor protection, domestic investors are reluctant to invest in emerging markets with low levels of corporate governance reform. This may be one reason why foreign institutional ownership is dominant in Sri Lanka. An increase in institutional investor activities in the Sri Lankan share market is positively influenced through sound governance practices.

Data and Methodology

Sample

The sample consists of all companies, except financial sector firms, listed on the Colombo Stock Exchange (CSE) over the period 2004 to 2009. Ownership data are drawn from company annual reports and financial data obtained from a CD issued by the CSE. Some listed companies were deleted due to missing. The final sample consisted of 152 companies. Table 1 reports the summary statistics for the sample data. The mean value for insider ownership is 20%, the highest percentage of insider ownership is 81.15%, and the lowest insider ownership representation is 0. This is consistent with the view that insider ownership of listed companies in Sri Lanka is relatively high. Nevertheless, Bhabra (2007) reports an average insider ownership for her sample of larger New Zealand firms were at 9.34%, and Short and Keasey (1999) report an average insider ownership of 13% in their UK sample. Overall, companies listed on the CSE have higher insider ownership compared to companies in developed markets. The mean institutional shareholding is 86%. This indicates that a very high percentage of shares on the Sri Lankan stock market are owned by institutional investors. About 56% of the sample is represented by local firms. This indicates a considerable amount (44%) of Sri Lankan listed firms are owned and operated by foreign investors. The market based financial performance measure, Tobin's Q, has a mean of 0.57. Compared to developed markets, this mean value of Tobin's Q is significantly low. However, the return on assets (ROA) mean value is 0.84; it indicates CSE listed companies perform well. The control variables, log of sales turnover, leverage and log of firm age are also listed.

Table 1: Descriptive statistics

Variable	Obs	Mean	Std.dev	Min	Max
TOBIN'S Q	912	.5728633	.4912968	-1.470926	5.371239
ROA	912	.844678	.093799	0	11.25642
INSIDER	912	19.73784	17.32761	0	81.14924
LNINSIDER	776	-.2661282	3.486301	-10.52338	4.39620
NIL (INSDIER=0%)	912	.1491228	.3564049	0	1
LOW (INSIDER 0-30%)	912	.7434211	.4369846	0	1
MEDIUM (INSIDER 30-70%)	912	.0855263	.2798168	0	1
HIGH (INSIDER>70)	912	.0219298	.1465348	0	1
OWNER (Institutional)	912	.8633094	.3520284	0	1
LOCAL	710	.5611511	.4369184	0	1
LNSALES	912	20.3809	2.049169	14.93163	24.78508
DEBT	912	.5076976	.6602301	-.1422054	9.023855
AGE	912	32.99671	25.11845	3	118
LNAGE	912	3.261634	.6740605	1.098612	4.770685
INDUSTRY1	912	.0986842	.2984012	0	1
INDUSTRY2	912	.3092105	.4624217	0	1
INDUSTRY3	912	.0657895	.2480498	0	1
INDUSTRY4	912	.3092105	.4624217	0	1
INDUSTRY5	912	.2171053	.4125011	0	1

Variables

Financial performance is measured with Tobin's Q and ROA in this study. Since Demsetz and Lehn (1985), most studies use Tobin's Q and ROA to examine the relationship between ownership structure and firm financial performance. Tobin's Q is defined as the market value of a firm divided by the replacement value of its assets. The next performance metric is ROA, calculated as the ratio of the earnings before interest and income tax (EBIT) to total assets, and reflects an accounting based performance measure. Proxies for the ownership structure of the company use three variables. The first is the percentage of shares held by board members, i.e. insider ownership (INSIDER). This variable is further categorised as 4 groups (NIL, LOW, MEDIUM and HIGH) according to the level of insider ownership that exists. The second variable is the dummy variable (OWNER) that takes a value of one when ownership type is institutional and zero otherwise. The third variable is LOCAL, if LOCAL is equal to one when the company has a local owner, otherwise 0 (when company is foreign owned). Similar to previous studies, some control variables are included in the estimated models. Total leverage (DEBT) is measured as the ratio of total debt to total assets and is used as a first control variable in the models. Firm size (LNSALES) accounts for economies of scale, measured by the natural logarithm of total sales. Log of firm age (LNAGE) is also included as a control variable. Based on the industry type, the study divides all firms into five major categories and uses an industry dummy (INDUSTRY) to capture industry-specific characteristics. Appendix 1 provides a glossary of variable definitions.

Method

Panel data covering six years of variables for 152 companies is prepared initially. One of the debated issues in recent research is whether or not ownership structure is determined endogenously. Demsetz and Lehn (1995) support an endogenous ownership argument, showing that ownership structure can be determined by firm size, intangibility of profit rate and so forth, concluding that ownership may be endogenous.

The Durbin-Wu-Hausman (DWH) test is used as a diagnostic test for endogeneity of financial performance proxies and other variables. The results of the DWH confirm an endogeneity effect for insider ownership. This finding confirms that ordinary least square (OLS) coefficient estimates will be unreliable and biased. The result of the DWH test for endogeneity suggests that the dynamic panel generalised method of moment (GMM) estimator is preferable.

Results

Table 2 and Table 3 presents regression results of the dynamic panel GMM estimator with dependent variables (Tobin's Q and ROA) respectively. The coefficient of INSIDER variable is positively and statistically significant at 1% level for Tobin's Q and ROA, indicating working owners increase firm financial performance. This is in line with Bhabra (2007), who finds a positive relationship with insider ownership and firm value for New Zealand listed companies. Conceptually, the result is consistent with Jensen and Meckling's (1976) proposed 'convergence of interests' hypothesis, which explains that the manager's value maximisation is an increasing function of insider ownership. Furthermore, as can be seen from Tables 2 and 3, both the higher percentage of insider ownership ($\geq 70\%$) and the lowest percentage of insider ownership (0%) are negatively related to financial performance proxies. This indicates that higher insider ownership increases the problem of management entrenchment and lower insider ownership increases a misalignment of management and owners.

Consideration of the OWNER (institutional ownership or not) variable in Table 3 reveals it is negatively related with ROA at the 5% significance level, indicating institutional ownership has a negative impact upon Sri Lankan companies' financial performance. However, the institutional ownership variable is not correlated with the Tobin's Q measure of financial performance. This result is in keeping with Lee (2008), who finds an insignificant relationship between institutional ownership of Korean listed companies and Tobin's Q. The ownership identity variable (local or foreign ownership) is significantly negatively related to both financial performance metrics, indicating local ownership negatively impacts on company performance. This is consistent with the Turkish study of Gurbuz and Aybars (2011).

The debt-to-assets ratio is positively related to Tobin's Q ratio, at 1% significance level, indicating that with more debt there is a greater increase in company financial performance, although it is insignificant on ROA. The difficulty caused by historical costs assets having low written down values and debt being at market value distorts the numbers and introduces an ageing bias. Furthermore, it can be seen from Tables 2 and 3, firm performance is related to industry type. Firm size has a negative effect on Tobin's Q at 5% significance level, indicating small firms have higher Tobin's Q than larger firms. On the other hand, firm size is positively related with firm ROA at 1% significance level, indicating larger firms, perform better than their smaller counterparts. Firm age is positively related to firm financial performance at 1% significance level, suggesting older firms are more efficient than younger firms.

The auto regressive (AR1) test is reported in Tables 2 and 3, for all variables, detecting no serial correlation order. There is no serial correlation in the original error, as desired. The second specification test also reported at the bottom of Tables 2 and 3 is the overidentification test. The Hausman-Sargan J statistics are not significant at the 5% significance level for financial performance metrics, which means that the instruments are valid.

Table 2: Dynamic panel GMM estimator regressions of Tobin's Q

Variables	912 GMM (1)	912 GMM (2)	912 GMM (3)	912 GMM (4)	912 GMM(5)
Number of obs ^a =584					
Number of groups=118					
Regressor					
L ₁	-0.0361997*** (.009896)	-0.232141*** (.0066522)	-0.0057865 (.0069533)	-0.0316269*** (.0068414)	-0.0167717** (.0074066)
Ownership structure variables					
Percentage of working owners (INSIDER)	0.0762555*** (.005184)				
Insider ownership=0 (Nil)		-0.192617* (.0358785)			
Insider ownership (0> & <30)(low)			.0554375** (.0252269)		
Insider ownership (30≥ & <70)(medium)				.063174** (.0365404)	
Insider ownership (70≥) (high)					-0.0011837* (.0507782)
Ownership type(OWNER)	0.0023462 (.0760708)	-0.110765 (.0360959)	.0322604 (.0283984)	.011658 (.0432123)	-0.0003655 (.0367781)
Ownership identity (LOCAL)	-10.62284*** (1.996309)	-0.55581 (.0384555)	-0.165336 (.0348009)	-0.0445925 (.0366698)	-0.0241616 (.0374237)
External monitoring variable					
Debt-to-assets ratio (DEBT)	.1052908* (.0604825)	1.247985*** (.0167473)	1.264386*** (.0139562)	1.236373*** (.013889)	1.239704*** (.017627)
Control variables					
Log of sales (LNSALES)	-0.095593** (.0471746)	-0.147922*** (.017483)	-0.1649303*** (.0151801)	-0.1493288*** (.0146361)	-0.1565816*** (.0169931)
Maturity of firm (AGE)	.0300357*** (.0042615)	-0.3046198*** (.0365627)	-0.2378039*** (.0355976)	-0.2790546*** (.0412363)	-0.2617337*** (.0458502)
INDUSTY1	-2.719878 (6.850228)	-0.4444803 (21.30893)	-5.309174 (6.377154)	2.120349* (2.375565)	1.613652 (1.901137)
INDUSTY2	-1.88293* (1.387981)	1.614251** (7.094247)	2.377053 (4.651403)	7.715639 (1.027152)	2.284834* (2.011767)
INDUSTY3	-4.433248 (14.4329)	1.651456 (12.2501)	7.889891 (1.535804)	1.89362 (2.036426)	-5.671782 (6.966044)
INDUSTY4	-3.305854** (1.885668)	3.185817** (1.781768)	-5.614032 (9.708146)	2.000195 (11.83169)	-3.185334 (3.894367)
Regression summary statistics					
AR(1)	0.0000	0.0000	0.0000	0.0000	0.0000
J-statistics	40.69284	34.10576	32.51258	26.71748	30.1016

^a Balanced panel; * Significant at 10% level; **Significant at 5% level; ***Significant at 1% level; This model provides standard errors which are in parentheses

Table 3: Dynamic panel GMM estimator regressions of ROA

Variables	912	912	912	912	912	912
Number of obs ^a =584						
Number of groups=118						
Regressor	GMM(1)	GMM(1)	GMM(1)	GMM(1)	GMM(1)	GMM(1)
L ₁	-0.0085717 (.0071483)	.0450008 (.0342555)	.0201189 (.0346515)	.0044154 (.0363667)	.0241851 (.0349986)	
Ownership structure variables						
Percentage of working owners (INSIDER)	.0008135*** (.0000735)					
Insider ownership=0 (Nil)		-.0078742 ** (.0031042)				
Insider ownership (0 > & <30)(low)						
Insider ownership (30 ≥ & <70)(medium)						
Insider ownership (70 ≥) (high)						
Ownership type (OWNER)	-.0115554** (.004697)	.0169118** (.0096616)	.0119188 (.0095934)	.0109502 (.010223)		
Ownership Identity (LOCAL)	-.1530024*** (.0284557)	-.0246761 ** (.0089041)	-.0241268** (.0092959)	-.0347151*** (.0084148)		
External monitoring variable						
Debt-to-assets ratio (DEBT)	-.0004954 (.0008471)	-.0607709*** (.0115139)	-.0661718*** (.011152)	-.0546588*** (.0118014)		
Control variables						
Log of sales (LNSALES)	.0008135*** (.0011673)	.0362108*** (.0047315)	.0351569*** (.0040239)	.0340027*** (.0045552)		
Maturity of firm (AGE)	.0001917*** (.0000447)	-.046918*** (.0154812)	-.0470396*** (.0153251)	-.0571003*** (.0141923)		
INDUSTRY1	-	-.0612716 (.1080994)	-.3373165** (.1819308)	.0651849 (.1575562)		
INDUSTRY2	.0015962* (.038298)	-.048707 (.0432921)	-.2292212** (.1011494)	.065506 (.0649815)		
INDUSTRY3	.107478 (.1562945)	-.1961038 (.2171487)	-.1261489 (.3738131)	-.0498122 (.2761176)		
INDUSTRY4	-.0134249* (.0537334)	-.1238274 (.0497911)	-.2867397** (.1339693)	.0152665 (.0402413)		
Regression summary statistics						
AR(1)	0.0000	0.0000	0.0000	0.0000	0.0000	
J-statistics	21.89754	22.72483	16.98967	22.82684	17.04659	

^a Balanced panel; * Significant at 10% level; ** Significant at 5% level; *** Significant at 1% level; This model provides standard errors which are in parentheses

Limitations

Notwithstanding the findings, the current study does have limitations that point to potentially fruitful further research opportunities. First, this empirical result sheds new light on the importance of ownership structure and firm financial performance, but the current study uses only a few aspects of ownership structure (inside ownership, ownership type and ownership identity). Further studies could consider broader aspects of firm ownership structure. Secondly, the findings are based on research in a single country and may not be generalisable. Further studies in both mature and emerging markets will be helpful in terms of international comparability.

Conclusions

Using a panel of Sri Lankan listed firms during the period 2004 to 2009, this study examines ownership structure and firm financial performance. The results indicate a significant relationship of insider ownership and financial performance. Furthermore, these findings suggest an inverse U-shape relationship of insider ownership and performance, indicating higher insider ownership increases management entrenchment and lower insider ownership increases misalignment of the interests of management and owners.

The results of this study have important implications for the ownership structure and company performance in Sri Lanka. It confirms that the effect of insider ownership on firm performance is more positive and significant where legal protection for investors is weak. It suggests that although new legislative reforms have been enacted, Sri Lankan companies are highly dependent on internal governance mechanisms. Due to high insider ownership, managerial expropriation is very likely to exist. There is potential merit in promulgating new rules and regulations to control the expropriation of minority shareholders.

The results also point to a significant positive relationship between the companies' Tobin's Q and debt ratio, which indicates firm debt level has significant positive impacts on firm financial performance. This may be due to the fact that the level of debt increases a firm's monitoring by banks, hence reducing agency conflicts. The Sri Lankan debt market is not developed, which is similar to the situation in other developing countries. Corporate debt in Sri Lanka is mainly supplied by the banking sector. Given evidence of the global financial crisis relating to curtailment of bank credit, it is important to enhance fund diversification in Sri Lanka and develop the debt market.

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Appendix 1

Variable name	Definition
<i>Performance proxies</i>	
Tobin's Q	This ratio is calculated as equity market value plus liabilities book value divided by equity book value plus liabilities book value.
Return on Assets(ROA)	This ratio is calculated as earned before interest and taxes divided by total assets
Insider Ownership percentage(INSIDER)	This ratio is calculated as total number of shares owned by board members divided by issued shares
Nil	Percentage of working owners=0
Low	Percentage of working owners >0 and <30
Medium	Percentage of working owners >=30 and <70
High	Percentage of working owners>= 70
Ownership type (OWNER)	Dummy variable 1, if the ownership type is equal to institutional ownership
Ownership identity (LOCAL)	Dummy variable 1, if the ownership identity is equal to local ownership
Leverage (bkdbtass)	This ratio is calculated as total debt divided by total assets
<i>Control variables</i>	
lnstaff	Logarithm of number of staff
lnage	Logarithm of number of years operating in the industry
Industry 1	Dummy variable 1, if the industry is equal to Beverage or Chemical
Industry 2	Dummy variable 2, if the industry is equal to health, hotel, information, stores and supply or service
Industry 3	Dummy variable 3, if the industry is equal to trading
Industry 4	Dummy variable 4, if the industry is equal to land and property, plantation, palm oil or motor
Industry5	Dummy variable 5, if the industry is equal to manufacturing

Organisational Commitment and Extra-Role Behaviour: A Survey in Iran's Insurance Industry

Seyed Mehdi Mousavi Davoudi
Semnan University, Iran

Abstract

The present study was conducted in Babol, a city in north of Iran, and aimed to analyze the relationships among Organizational Commitment (OC) components and employees' extra-role behavior which is known as Organizational Citizenship Behavior (OCB). We choose Affective commitment (AC), Normative Commitment (NC), and Continuance Commitment (CC) as the three components of OC; and the analysis was carried out utilizing Structural Equation Modeling (SEM) methodology by LISREL 8.8 software. There were 300 employees in 47 branches of "Iran Insurance". According to Krejcie and Morgan (1970), the minimum number of sample size was determined as 169 employees. A total of 275 questionnaires were distributed among the employees and 190 usable questionnaires were returned. The factors analysis and the findings show that AC and NC have a significant positive influence on OCB. This finding implied that the higher the level of AC and NC, tended to increase the level of employees' OCB. Further, no significant relationship was found between CC and OCB.

Keywords

Organizational commitment, extra-role behavior, organizational citizenship behavior.

Introduction

Employees are known as one of the most important assets of any organization. Managers of organizations should develop effective strategies to motivate their employees to engage in activities that will help in the achievement of predetermined organizational goals (Chiboiwa et al., 2011). Further, organizations should engage their employees to go beyond their formal job responsibilities which are called extra-role behavior or Organizational Citizenship Behavior (OCB).

OCB is an important issue in the field of management and research has paid great deal of attention to it (e.g.

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Bateman & Organ, 1983; Niehoff & Moorman, 1993; Organ & Ryan, 1995; Podsakoff et al., 2000, Davoudi, 2012). According to Organ (1988), OCB is an important factor that can contribute to the survival of an organization. Organ (1988) argued that OCB is held to be vital to the survival of an organization. Organ further elaborated that OCB can maximize the efficiency and productivity of both the employee and the organization that ultimately contribute to the effective functioning of an organization.

Prominent current organizational researchers

supported Organ's position regarding the importance for effectiveness of those extra-role behaviors (George & Brief, 1992). Furthermore, it is widely accepted among contemporary organizational behavior theorists, that

¹² Faculty of Management and Economics, Semnan University, Semnan, Iran. E-mail address: mehdi_mousavi111@yahoo.com

OCB have an accumulative positive effect on organizational functioning (Wagner & Rush, 2000). Further, According to Podsakoff et al. (2000), OCB helps maximize the organizational performance of firms. Since this is the main goal of all organizations, it benefits managers to understand how various factors influence organizational citizenship behavior (Davoudi, 2012).

Among these factors, organizational commitment (OC) is regarded as one of the variables drawing researchers' attention (O'Reilly and Chatman, 1986; Smith et al., 1983; Williams and Anderson, 1991; Paulin et al., 2006; Huang & You, 2011).

It is important to note that the relationships among variables, in this study OC components and OCB, depend on the context and situation where they actually carry on; and the results may vary across different contexts. Moreover, there is little attention given to research on the relationship between OC components and OCB in service industry of Iran, especially insurance industry. Thus, the present study attempts to propose a framework on the mentioned topic among "Iran Insurance" employees in Iran.

Organizational citizenship behavior

Organ et al. (2005) defines OCB as behavior that is discretionary, not directly or explicitly recognized by a formal reward system and that in aggregate promotes the effective functioning of an organization. Examples of this discretionary behavior include cooperation with peers, performing extra duties without complaint, punctuality, volunteering and helping others, using time efficiently, conserving resource, sharing ideas and positively representing the organization (Turnipseed and Rassuli, 2005).

According to Organ (1988), OCBs are behaviors that employees are not explicitly rewarded for exhibiting nor punished for not exhibiting; and are behaviors for which employees do not receive training to perform. Moreover, according to Schnake (1991), pro-social ethical behaviors such as helping new employees to understand the internal workings of the organization, assisting co-workers complete their jobs, attending meetings and volunteering to do things in excess of job prescriptions are some of the behaviors that can be associated with OCB. These non-traditional behaviors are on-the-job behaviors that are not usually captured by traditional job descriptions (Moorman, 1991).

Organizational commitment

Organizational commitment is defined as employees' interest in, and connection to an organization (Hunt et al., 1989; Meyer and Allen, 1997; Mowday et al., 1979). Moreover, organizational commitment is defined as the relative strength of and individual's identification with and involvement in a particular organization (Steers, 1977). According to Hunt et al. (1989), Employees who are committed to their organizations tend to identify with the objectives and goals of their organizations, and wish to remain in their organizations. There have been many definitions of commitment. What is common for all the definitions is the belief that commitment binds an employee to his/her organization and thus reduces the likelihood of turnover (Meyer et al., 2004). Further, it is important to note that the common point of OC definitions is the emphasis on the relationship among employees and organization.

Meyer & Allen (1991) proposed a three-component conceptualization of OC. Meyer & Allen (1984) initially proposed a distinction be made between affective commitment (AC) and continuance commitment (CC), with AC denoting an emotional attachment to, and involvement in, the organization, and CC denoting the perceived costs associated with leaving the organization. Allen & Meyer (1990) later suggested the third discrete component, termed normative commitment (NC), which reflects a perceived obligation to remain in the organization (Huang & You, 2011). The three components model of OC proposed by Meyer & Allen (1991) has provided the predominant framework for OC research during the past decade because it is based on an exhaustive understanding of OC (Cited in Huang & You, 2011).

Literature review on the relationship between OC and OCB

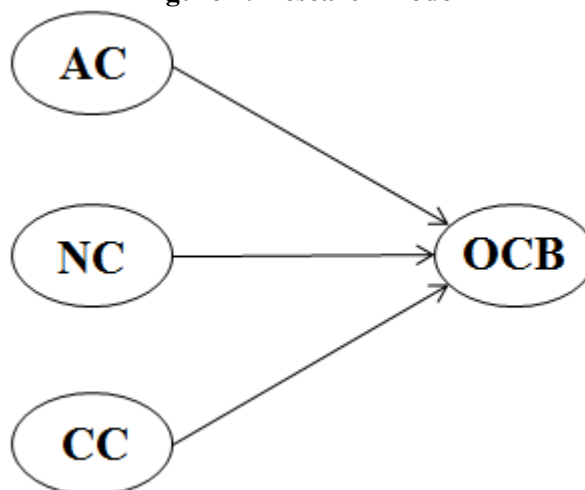
Meyer & Allen (1997) suggested that employees with strong commitment are more likely to engage in OCB than those with weak commitment. Liu (2009) suggests that participating in voluntary behaviors such as OCB is a behavioral response to affective commitment.

The meta-analysis of Ricketta (2008) that investigated whether job attitudes (i.e. job satisfaction and affective organizational commitment) cause performance found that affective organizational commitment has a weak but significant effect on performance (OCB). He also found that organizational commitment was significantly related to extra-role behaviors. According to Cohen & Keren (2008) Employees with high normative commitment are expected to engage OCBs because of the fulfillment of their obligation and their belief that it is right to do so. Further, Kwantes (2003) examining the relationship between OCB and OC within samples from India and USA, found that affective commitment significantly predicted OCB. Becker & Kernan (2003) also provided support for the positive effect of affective commitment on OCB. The study of Morrison (1994) supported that both affective and normative commitment are positively related to OCB. Moreover, Gautam et al. (2005) and Meyer et al. (2002) provided that affective and normative commitment significantly correlated with OCB. Moreover, it has been suggested that CC may be negatively linked to certain work behaviors (Meyer & Allen, 1997). According to Meyer & Allen (1997), one of the explanations is that employees with strong CC believe they are “trapped” in a “no choice” situation; as such, they react with anger toward the situation and, accordingly, behave negatively.

Research model and hypotheses

Taking into account the above mentioned literature, the following model and hypotheses are proposed. The model involved the relationships among Affective Commitment (AC), Normative Commitment (NC), and Continuance Commitment (CC) as independent variables, and Organizational Citizenship Behavior (OCB) as dependent variable.

Figure 1: Research model



H1: Affective Commitment has a significant positive influence on OCB.

H2: Normative Commitment has a significant positive influence on OCB.

H3: Continuance Commitment has a significant negative influence on OCB.

Methodology

Statistical Population

Statistical population in this research includes 300 employees of 47 branches of “Iran Insurance” in Babol, a city in north of Iran. Referring to the Krejcie and Morgan (1970), the minimum number of sample size was determined which was 169 employees; the authors used random sampling for this research. After the distribution of 275 questionnaires, 190 usable questionnaires were gathered. Table 1 illustrates the descriptive statistics of the respondents.

Table 1: Description of the respondents

Item	Description	Frequency	Percentage
Gender	Male	119	63%
	Female	71	37%
Age	Below 30	65	34%
	31-40	66	35%
	41-50	37	19%
	Above 51	22	12%
Education	Diploma	28	15%
	STP	37	20%
	Bachelor	111	58%
	Master & PhD	14	7%

Instrument

In order to collect the necessary data, a questionnaire was used to test the hypotheses of the study. The questionnaire consists of three sections. The first part includes 3 questions about demographic information of the respondents (table 1). In the second part, we used 10 questions to measure organizational commitment components. The organizational commitment questionnaire used in this study was developed by Meyer & Allen (1991). Further, in the third part, we used 10 questions to measure organizational citizenship behavior. We extracted these 10 questions from the original scale developed by Podsakoff et al. (1990) which consists of 24 questions.

We used five-point Likert type scale for all the items. Response categories range from 1 (strongly disagree) to 5 (strongly agree).

Reliability and Validity

The summary statistics of formal survey are shown in Table 2. For reliability evaluation we utilized Cronbach's alpha. The Cronbach's alpha reliability of two scales are more than 0.7 ($\alpha > 0.7$), which indicates the scales demonstrate good reliability.

Table 2: The summary statistics of formal survey

Item	Mean	Std. Deviation	α	
AC1	3.46	.979	0.772	
AC2	3.45	1.000		
AC3	3.20	.927		
AC	3.37		
NC1	3.18	1.020		
NC2	3.35	.980		
NC3	3.09	.924		
NC4	3.38	.978		
NC	3.25		
CC1	1.98	.940		
CC2	2.02	.978		
CC3	2.01	.951		
CC	2.00		
OC	2.87		0.772
OCB1	3.84	1.108		0.860
OCB2	3.93	1.091		
OCB3	4.03	1.051		
OCB4	3.91	1.158		
OCB5	3.87	1.234		
OCB6	3.94	.955		
OCB7	3.96	1.086		
OCB8	3.91	.980		
OCB9	3.90	1.062		
OCB10	3.86	1.085		
OCB	3.915	0.860	

For evaluating the validity of the questionnaires, we used content validity and construct validity. Content validity deals with how representative and comprehensive the items were in creating the scale. It is assessed by examining the process by which scale items are generated (Moon & Kim, 2001). Content validity assured us that all aspects and parameters that impact on main content were evaluated. In order to test the content validity after devising a framework for the questionnaire, we asked 10 experts to modify it if needed. These experts evaluated all the implemented criteria in the questionnaire and modified it.

Construct validity determines the extent to which a scale measures a variable of interest (Moon & Kim, 2001). In this research we used factor analysis for considering the structure of research. Confirmatory factor analysis was used to investigate the construction of the questionnaire. Factor analysis depicted that all the mentioned criteria are measured in these questionnaires. Based on Joreskog & Sorbom (1989), $\text{Chi-Square/df} \leq 3$, $\text{RMSEA} \leq 0.10$, $\text{CFI} > 0.9$, and $0 < \text{IFI} < 1$ show that the measurement model provides a reasonable fit to the data.

Table 3: The structural model fitness indices

Fitness Indices	Measure of Index
Chi-Square/df	2.5302
P-value	0.000
Root Mean Square Error of Approximation (RMSEA)	0.090
Comparative Fit Index (CFI)	0.91
Incremental Fit Index (IFI)	0.91

Results

This study tends to investigate the relationships of AC, NC, and CC with OCB. The influences of the three mentioned variables on OCB were tested using the SEM technique that is explained below. For testing our hypotheses, we performed our structural model applying 10 questions of OC and 10 questions of OCB.

Table 4: Frequency and factor loading

Questions First part = OC, Second part = OCB	Scale					Factor loading
	1	2	3	4	5	
AC1. I feel a strong sense of belonging to my organization.	7	17	76	61	29	0.64
AC2. I feel emotionally attached to this organization.	8	19	70	65	28	0.82
AC3. I feel like part of the family at my organization.	7	26	98	40	19	0.62
NC1. Even if it were to my advantage, I do not feel it would be right to leave my organization now.	7	43	68	52	20	0.53
NC2. I would feel guilty if I left this organization now.	5	29	75	56	25	0.69
NC3. This organization deserves my loyalty.	7	37	93	38	15	0.48
NC4. I would not leave my organization right now because I have a sense of obligation to the people in it.	8	23	69	69	21	0.27
CC1. Too much of my life would be disrupted if I decided I wanted to leave my organization now.	65	80	31	11	3	0.85
CC2. I feel that I have too few options to consider leaving this organization.	66	75	32	14	3	0.83
CC3. One of the few negative consequences of leaving this organization would be the scarcity of available alternatives.	64	79	32	12	3	0.84
OCB1. I help new employees even though it is not required.	5	25	29	68	63	0.62
OCB2. I help others, who have been absent.	6	19	27	69	69	0.68
OCB3. I help others, who have heavy work load.	4	16	30	61	79	0.47
OCB4. I attend at work above the norm.	11	16	22	71	70	0.66
OCB5. I don't take extra break.	10	26	20	57	77	0.57
OCB6. I don't abuse the right of others.	4	12	32	85	57	0.69
OCB7. I try to avoid creating problems for my coworkers.	6	19	22	72	71	0.75
OCB8. I attend meetings that are not mandatory, but are considered important.	5	13	31	86	55	0.67
OCB9. I always focus on positive side rather than what is wrong.	8	15	24	84	59	0.48
OCB10. I take steps to try to prevent problems with other coworkers.	9	14	30	78	59	0.58

Table 4 shows the status of employees' answers to each question. Also, it shows the factor loading of each question which indicates the significance of each question for employees. Further, Figure 1 shows the results of the SEM analysis which indicates the relationships of AC, NC, and CC with OCB. Moreover, figure 2 shows the t-value of the analysis. Based on the results of SEM analysis, the first and the second hypotheses are confirmed and the third Hypothesis is rejected.

Figure 1: Structural equation model for core competencies

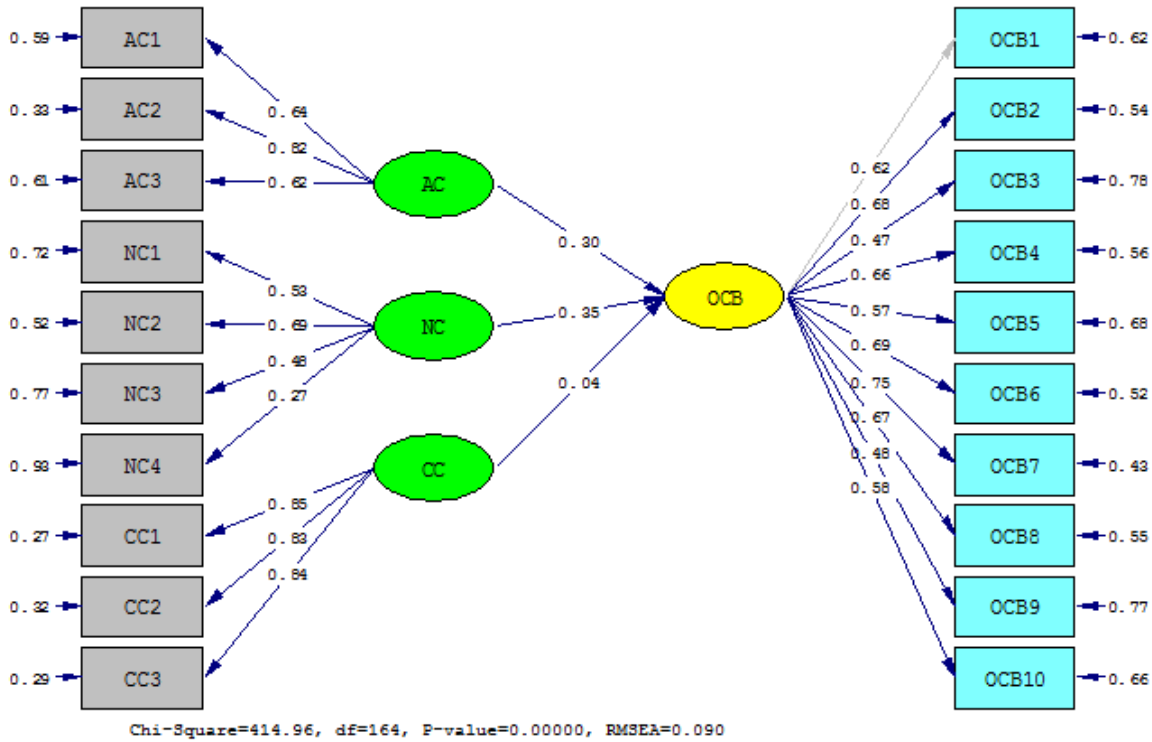


Figure 2: T-value test

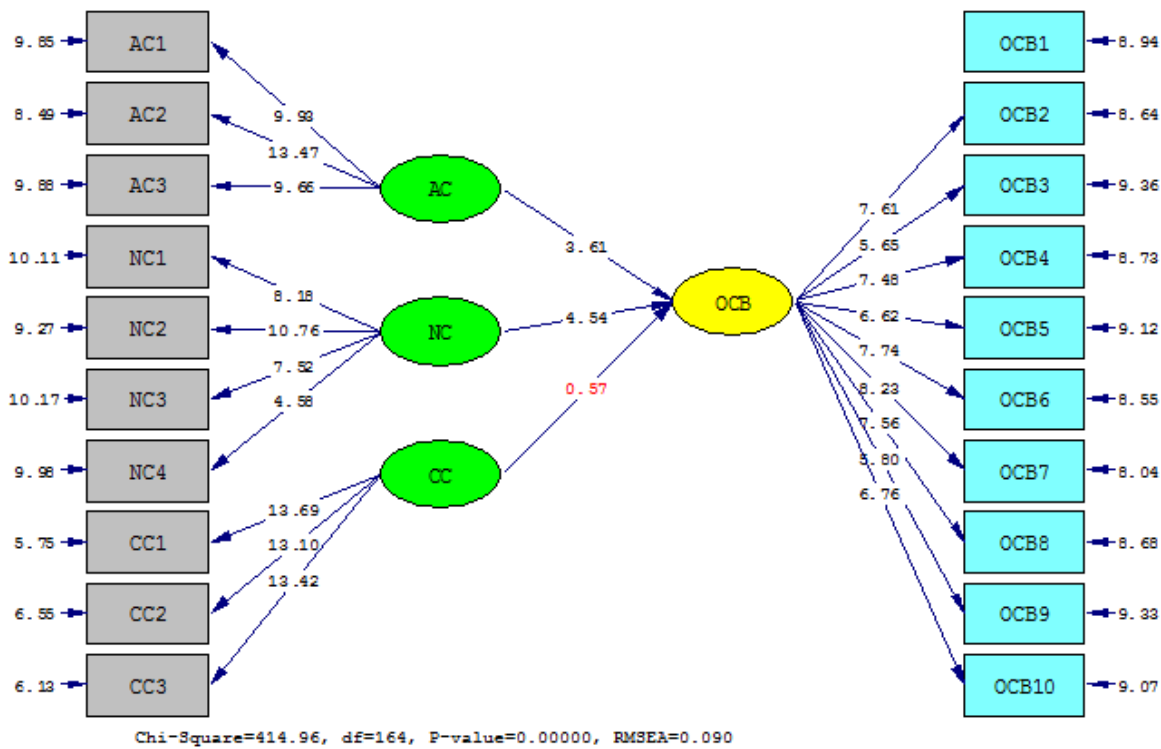


Table 5 summarizes the hypothesis test result in terms of path coefficient (standardized) and t-value in significance level of 0.05.

Table 5: The result of the hypothesis test

No	Hypothesis	Path coefficient	t-value	Result
H1	Affective Commitment → Organizational Citizenship Behavior	0.30	3.61	Accept
H2	Normative Commitment → Organizational Citizenship Behavior	0.35	4.54	Accept
H3	Continuance Commitment → Organizational Citizenship Behavior	0.04	0.57	Reject

Discussion

The aim of the present study is to investigate the relationships of AC, NC, and CC with OCB of “Iran Insurance” employees in Babol, a city in north of Iran. Many previous studies have examined the relationships among these variables in manufacturing companies; however, lack of sufficient research, studying the relationship among these factors in service industry, especially in insurance industry, was the reason this research was carried out. Further, because of the positive consequences of OCB, examining factors lead to improving the level of OCB is an important issue for managers of organizations which was another reason this research was carried out.

The findings show that both AC and NC have a significant positive influence OCB. This study confirms the findings of the previous studies (e.g. Morrison, 1994; Meyer et al., 2002; Gautam et al., 2005). Further, no significant relationship was found between CC and OCB in the Iranian context.

The results of the current study suggest that, as AC and NC increase so will organizational citizenship behavior increases. Thus, managers of organizations should provide appropriate workplace for employees to develop employees' AC and NC to organizations which contribute to developing the OCB of employees. The results also show that the Iran Insurance employees enjoy average level of AC and NC, and a goodish level of OCB (see table 2). The findings suggest that there should be other factors mediated the relationships among organizational commitment components and OCB. Thus, more researches are needed to identify other antecedents of OCB, which help managers to achieve competitive advantages through employees.

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Evaluation of Corporate Governance Measures: An Application to the Australian Higher Education Sector

Chitra De Silva and Anona Armstrong
Victoria University, Australia

Abstract

Governance has emerged as a major concern in the higher education sector. Although evaluation of performance of governance is widely used in the private and public sectors, little attention has been given to the assessment of good governance practices in university contexts. The purpose of this paper was to describe the changes in government policy associated with the introduction of Governance Protocols that have impacted on the higher education sector and to answer the research question: do Australian Universities apply the best practice corporate governance measures?. Data for the study were compiled from annual reports and the Web pages of 37 publically funded universities in Australia and Selected Higher Education Statistics Collection. The assessment criteria were derived from the National Governance Protocols. Findings revealed that Australian universities as independent corporations apply the universal best practice corporate governance indicators as governance measures.

Keywords

Corporate governance; Universities Protocols; higher education

Introduction

Corporate governance issues in both the private and public sectors have become a popular discussion topic in the last two decades (De Silva 2011). In a move to improve on their governance arrangements, legislative changes and provisions have been imposed by governments on public and private organizations around the world (Edwards 2000). Universities have been one of the 'interests caught up in the international surge in governance of organizations' (Dixon & Coy 2007, p. 267), not least in the Australian context. The Australian higher education sector has grown dramatically in the past two decades. Student numbers have doubled from 534,510 student enrolments in 1991 (DEEWR 2009) to over a million in 2009, 813,896 are domestic and 320,970 are international students (DEEWR 2011). According to the Review of Australian Higher Education Report, 2009 (DEEWR 2011) full time equivalent staff load has grown to around 107,221 and total revenue exceeded AUD 19.9 billion in the year 2009. The sector now comprises: 40 universities of which 38 are public institutions and 2 are private; one Australian branch of an overseas university; 4 other self-accrediting higher

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education institutions; and more than 150 non-self-accrediting higher education providers listed on State and Territory registers and accredited by State and Territory authorities. Several universities and private providers operate in more than one State and (DEEWR 2011) thirty five of the 40 higher education providers now have annual incomes of more than \$100 million.

Table 1. Major government policy initiatives in the Australian Higher Education sector**Higher Education Policy Initiatives 1995-2000**

Hoare Committee Review of Higher Education Management (Hoare 1995);
 Victorian Ministerial Committee of Advice on University Governance (Storey 1997);
 West Review (West 1998);
 Victorian Review of University Governance, (Hamilton 2002);
 Auditor General, Victoria, Report on RMIT University's finances (Cameron 2003);
 Nelson Review Backing Australia's Future (2003);
 (Bradley review)Review of Australian Higher Education (2008).
 Transforming Australia's Higher Education System (DEEWR 2009)

Source: De Silva (2011)

Numerous higher education inquiries (Table 1) have resulted in policy changes that have affected the funding and operations of universities. Among the most significant was the *Our Universities: Backing Australia's Future* (Nelson 2003) package of reforms delivered as part of the 2003-04 Budget. The reforms gave universities access to increased funding and, of relevance to this paper, included significant changes to university governance arrangements. The aim of this paper is to discuss the governance reforms that took place in the higher education sector in Australia and analyze the governance performance of Australian universities. This study is of a significant practical importance, because it applies the appropriate corporate governance measures used in the corporate governance literature to evaluate the performance of governance in the university sector

Corporate governance and Universities

Corporate governance is concerned with the structures and processes for decision-making, accountability, control and behaviour at the top of organisations (Armstrong & Francis 2004). Governance can be defined as "the system or structure of rules and relationships, supervision and control of those who exercise the authority, accountability, stewardship, leadership, direction and control that aims to ensure accountability and efficient use of resources in balancing the achievement of goals of corporations, society and individuals" (Armstrong and Unger, 2009, p.47).

Governance Reforms in Australian Universities

According to the 1988 White Paper (Dawkins, JS 1988) the forms of governance in Australian universities were obsolete and had to make way for more efficient and effective corporate models. Further the White Paper (Dawkins, JS 1988) recommended a change in university council structure. Vice-Chancellors were to assume the additional title of Chief Executive Officer (CEO), and universities were to become more 'business-like' and entrepreneurial with smaller council size (10 - 15 members) (Dawkins, JS 1988; Harman, G 2003; Harman, K & Treadgold 2007). The most significant review of university governance and management, *The Higher Education Management Review* by David Hoare was conducted in 1995. The Hoare Review (1995) identified shortcomings in university governance arrangements and recommended clarification of the role of the governing bodies, and changes to the size, composition and methods of appointments of members to the governing bodies (De Silva 2011).

Best practice corporate governance has been defined by a number of international agencies. Among the most significant in the Australian context were the OECD (2004) and ASX Corporate Governance Council (2003, 2007) guidelines and principles for corporate governance best practice. Governance standards introduced into the higher education (HE) sector followed these developments in governance in the corporate and business environment, especially adapting the generic principles enunciated by the Australian Securities Exchange, the

Australian Institute of Company Directors and Australian Standards International (Armstrong and Unger, 2009).

In line with the above guidelines, the 2003 *Backing Australia's Future* reforms introduced governance best practice guidelines for the Australian university sector in the National Governance Protocols for Public Higher Education Institutions. The Protocols referred to: the responsibilities of the 'governing body' (Protocol 2); procedures for appointment and selection, and the duties of members (Protocols 3, 5 and 6), induction and training (Protocol 4); size (less than 22 members of the body, Protocol 5); and risk management in regard to controlled entities and reporting (Protocols 8, 9 and 10).

Many of these requirements reflect governance 'best practice' as it is described in the above codes and standards of best-practice governance (Armstrong 2004).

The National Governance Protocols for Higher Education (Nelson 2003) imposed obligations on universities for: definition of institutional objectives in the enabling legislation; definition of governing body purposes and duties; systematic professional development programs and performance evaluations of governing bodies; systematic procedures for composition of the governing body, including limits on size of the governing body and specifications of expertise; a majority of independent members in the governing body; codification and reporting of business practices and risk analysis.

These initiatives were designed to ensure consistent criteria and quality of standards across Australia in such matters as the recognition of new universities, the operation of overseas institutions in Australia, and the accreditation of higher education courses to be offered by non-self-accrediting providers (Nelson 2003).

The impact of the reforms on universities was substantial (Swansson, Mow and Bartos 2005). They aimed to make the institutions more competitive in maintaining international standards, offering universities the ability to exercise academic freedom and managerial autonomy while requiring the Council, as the governing body, to take primary responsibility for the governance and performance of universities (Nelson 2003). Complementing these were the proposals which emerged from the Review of Australian Higher Education Report (Bradley et al 2009) requiring institutions to consider restructuring, establishing their mission, and adopting more vigorous strategies. It was hoped that greater transparency and accountability would increase funding which would be primarily driven by, first, student choice, and second, the success of institutions in attracting competitive funding allocations and generating revenue from other sources.

In the past governments exercised control over universities through the conditions attached to their funding. The largest share of funding (55%) for a publically funded university in Australia comes from the Commonwealth Government (Universities Australia, 2010, Bradley et al 2009). The reforms introduced in *Backing Australia's future* (Nelson 2003) empowered Universities to assume more autonomy but at the same time required more accountability. The responsibility for the governance and management of a university is typically vested through State legislation in a governing body such as a Council or Senate. Every university's enabling legislation provided for the governing body to have overall control and management of their university (Nelson 2003). The Chancellor and the Vice-Chancellor are equivalent to the Chair of the board and the Chief Executive Officer in the private sector.

Fielden (2008) presented four different models of university governance (Table 2): institutional control, state control, semi-autonomous and independent. The Australian Model was identified as an *independent* model. It was believed to produce better performance, as the Australian universities have the power to make their own decisions and control their own destiny.

Table 2: Four Models from Control to Autonomy

Institutional Governance Model	Status of public universities	Examples in
State Control	Can be an agency of the MOE, or a state-owned Corporation	Malaysia
Semi-Autonomous	Can be an agency of the MOE, a state-owned corporation or a statutory body	New Zealand, France
Semi-Independent	A statutory body, a charity or a nonprofit corporation subject to MOE control	Singapore
Independent	A statutory body, charity or non- profit corporation with no government participation and control linked to national strategies and related only to public funding	Australia, United Kingdom

Source Fielden (2008)

According to Fielden's (2008) model, Australian universities have an incentive to be entrepreneurial and competitive. Any university could choose different ways to respond to national policy goals and they could be more innovative than others particularly by specializing in disciplines or courses, or changing how courses were delivered.

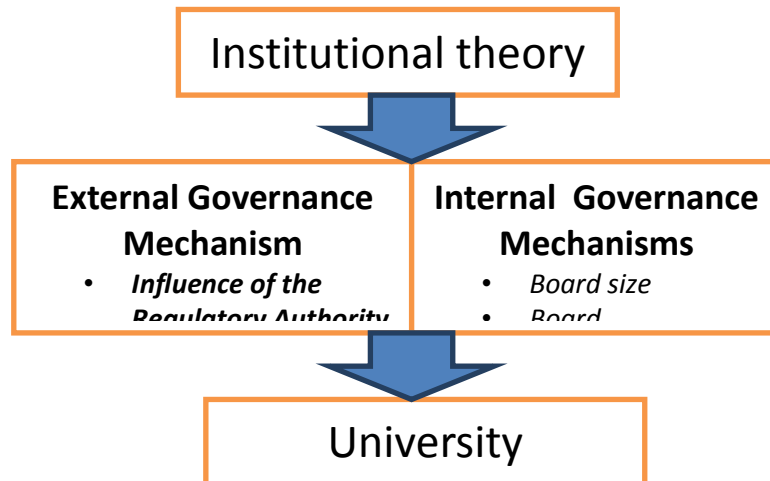
Australian universities have been legally structured as companies or corporations under State or Commonwealth law (Harman, K & Treadgold 2007). The traditional (collegial) model of governance embodied the philosophy of self-governance with little or no direct government interference, except for the indirect influence of ministerial appointees on council (which is not a practice or a requirement of the current context) (Harman, K & Treadgold 2007, p. 13). However, universities cannot enjoy unlimited autonomy, because of their inherent purpose of fulfilling the nation's expectations of providing a quality education and participating in innovative research activities. Hence, within the Independent model there is an implicit acknowledgement that the Commonwealth authorities are entitled to hold the institution accountable in many respects and must retain overall strategic control over the sector. The protocols were designed to meet this need.

Even though the university governance protocols in Australia were designed according to the universal best practice corporate governance measures, there is very limited research on governance practices of universities, especially in the Australian context to investigate the application of corporate governance indicators to measure the best practice corporate governance in the university sector. The purpose of this research is to fill this gap in the literature by using the universal best practice corporate governance indicators to evaluate the corporate governance mechanisms in the university sector giving special reference to Australian universities.

The Conceptual Framework

The conceptual framework (Figure 1) was derived from the governance mechanisms described in the governance literature (Aldridge 2004; Khanchel 2007). Applications of institutional theory to investigate governance have been advocated in the governance literature (Aldridge 2004; Greenwood & Hinings 1996; Kondra & Hinings 1998). According to Weir and McKnight (2002), institutional corporate governance consists of external governance mechanisms and internal governance mechanisms. External governance mechanisms are those influences, such as government policy, exerted from outside a university. According to the corporate governance literature (Khanchel 2007, Bhagat and Black 2002), structural composition and the processes of the board characterize a firm's internal governance structure.

Figure 1 Conceptual Framework



The National Governance Protocols considered the structural composition of universities as an important measure of the governance mechanisms of universities (Protocol 3, 4, 5 and 6). The size (numbers of members in the board) (Yermack 1996) and the extent of independence of the board (Khanchel 2007) were used to analyse the structural composition in the previous studies. In this respect, the greater the structural separation of oversight committees from the management of particular activities such as appointment and remuneration of senior staff, the more robust the governance should be. Particular prominence was given to audit committees that are charged with monitoring strategic objectives, the overall financial performance, reporting requirements and their compliance with 'best practice' corporate governance standards. Board meetings (Shivdasani and Zenner 2004) and transparency in reporting were used as measures for board process as of Khanchel (2007) and used the above measures as indicators in analysing the corporate governance of universities. The board of directors of the universities referred to as the council of the university and the board and the council has used interchangeably in the forthcoming paragraphs of this paper.

The corporate governance framework used in this study was similar to the framework used in previous studies conducted by Kyereboah-Coleman and Biekpe (2005), Chen, Elder and Hsieh (2005) and Weir, Laing and McKnight (2002) in the corporate sector. Governance framework of this study consists of internal corporate governance variables and external corporate governance variables. The research questions addressed in this paper was: *do Australian Universities apply the best practice corporate governance measures?*

Methodology

Data for the study were collected from the annual reports of thirty seven publically funded universities, and web pages of universities. Bachelors College was excluded from the study due to its special nature.

The criteria for the evaluation in this study were drawn from the Protocols. The data were compiled in a comparative data base and analysed using SPSS. In the current study about governance performance of universities consists of external and internal corporate governance variables.

The external corporate governance mechanism variable, the influence of the regulatory authority, was measured by using the universities' compliance with 2003 National Governance Protocols. The internal corporate governance mechanism variables were board size, board independence, role of standing committees, and board processes indicated by transparency in reporting and board meetings. Internal corporate governance mechanisms such as council size were measured by counting the number of appointed, elected and ex-officio

members in a council (Chaganti, Mahajan & Sharma 2007; Eisenberg, Sundgren & Wells 1998), council independence was calculated as the percentage of external members to the total number of members in the council (Bhagat & Black 2002) and a council committee index (Appendix 1) was constructed by using the board committee index measures used in the existing literature (Callen, Klein & Tinkelman 2003; Khanchel 2007; Klein, April 1998). A board committee index was calculated for each university. The variables used to construct this index were audit committees, remuneration committees and nomination committees. Similarly, existence of an audit committee, a chair who was external or not, a majority of external members or not and number of meetings held during the year were considered for audit committees. Existence of a nomination committee, CEO not a member of the committee and existence of a remuneration committee, and CEO not a member of the committee, were considered for remuneration committees (Appendix1). Board meetings held during the year 2007 was used, assuming that a maximum number of meetings for the year should be twelve. The depth and the extent of the information disclosure in the annual reports were used to calculate the transparency index (Appendix 2).

Results

The following presents the results of the analyses of the measures of internal and external governance mechanisms.

Table. 3 Descriptive Statistics for Governance Mechanism Variables

	N	Minimum	Maximum	Mean	Std. Deviation
Comply with protocols (<i>regulatory index</i>)	37	.92	1.00	.9395	.03480
Board size	37	12.00	22.00	19.2432	2.76290
Board independence	37	.50	.70	.6000	.05185
Board committees	37	.18	.76	.5424	.14090
Board meetings	37	4.00	12.00	6.8378	1.48162
Transparency in reporting	37	.25	1.00	.6038	.18067
Valid N (listwise)	37				

Source 2009 research

Descriptive Statistics for External Governance Mechanism

A measure of Compliance with the National Governance Protocols for Higher Education has been used in the current study as the proxy for the influence of the regulatory authority.

Regulatory Index (Influence of the regulatory Authority)

Universities' compliance with National Governance Protocols was used as the regulatory index of the study. The minimum value for compliance with the protocols was 92 percent and the maximum was 100 percent. The standard deviation was only 3 percent and the mean value of compliance with protocols was a high 94 percent. Compliance with the 2003 National Governance protocols represented the role of the influence of regulatory authority or the regulatory index in the study. Descriptive statistics showed that the mean value of the compliance with the protocols was 94 % at the time of study and this agrees with the findings of the Australian Government Higher Education Report (2005) which confirmed that all the Australian universities have made some effort to comply with 2003 National Governance Protocols by year 2005. Some universities could not address the risk criteria as outlined in the protocols and this brought down the mean value to 94%.

Descriptive Statistics for Internal Governance Mechanisms

There were five indices used in the construction of the index of internal governance mechanisms. They were board size, board independence, board committees, board meetings and transparency in reporting. Descriptive statistics for the internal governance mechanism variables presented in Table 3 are followed by the summary in detail.

Board Size

Descriptive statistics for board size of Australian universities varied from a maximum of 22 council members to a minimum 12 council members. The mean value was 19 members in the council or the governing body of the university. According to the research findings of the study, 8 out of 37 universities had 22 council members and the minimum, 12 council members, were at the Central Queensland University. This confirmed the adaptation of the suggested board size of the Higher Education Protocols (2003). The higher average of 19 members suggested that universities prefer to have larger governing bodies.

Board Independence

Board independence showed the extent of the appointment of external members in the university councils. Descriptive statistics showed that the minimum value for board independence index was 50 percent at James Cook University and the maximum value, 70 percent, was at Edith Cowen University. The mean value for board independence was 60 percent. This confirmed the protocol (2003) requirement that there should be a majority of external members in the university governing body.

Board Committee Index

The Board committee index in the current study referred to the process of appointing standing committees to the university council. This variable examined the existence, process and the independence of audit, remuneration and the nomination committees as standing committees in the university governing body (appendix 1). In analysing the process of the audit, remuneration and nomination committees, the number of meetings held and the influence of the Vice Chancellor as the Chief Executive Officer of the University on those committees were also addressed. The maximum value for the board committee index was reported as 76 percent and the minimum value was 18 percent. The mean for the standing committee index of Australian universities was 54 percent. Further investigations of the research revealed that every university has an audit committee and the chair of the committee was an external member. This explained that all 37 universities had independent audit committees. The research results further disclosed only 12 out of 37 universities had remuneration committees and 20 out of 37 universities had nomination committees as of 2007 and other universities were in the process of establishing, remuneration committees and nomination committees.

Board Meetings

The board meeting index was used as the measure of board process. The number of Council meetings held during the year was used as the measure of board meetings for the present study. The descriptive statistics varied from a maximum of 12 meetings at the University of Melbourne and the minimum 4 meetings held during the year at the Australian Catholic University. The mean value for board meetings showed as 6.8 which could be considered as seven meetings per year. Shivadasani and Zenner (2004) suggested that, boards should increase the frequency of meetings if the situation requires high supervision.

Transparency in Reporting

Transparency in reporting was measured by using a transparency index. The transparency index was constructed to measure the depth and the extent of information disclosure in the annual reports of the universities in addition to fulfilling the mandatory requirements in reporting for government agencies. The

annual reports of universities are considered as one of the main instruments that could be reliably used by the external users of information in making informed decisions regarding universities. The minimum value for transparency in reporting was 25% and the maximum value was 100% for the University of Melbourne in the index. The mean value of the transparency index was 60% where the standard deviation was 18%. Statistics showed that on average universities exhibited 60 percent transparency in reporting in their general purpose reports (Annual reports) in addition to fulfilling mandatory disclosure requirements.

DISCUSSION AND CONCLUSION

Analysis of the Governance structures and process of Australian universities were performed for the year 2007 by using descriptive analysis. All the universities comply with the National Governance Protocol requirement of maximum board (council) size, with a majority of external members. Board committee indices suggest that universities adopted universal best practice, but not every university has nomination and remuneration committees. Though the number of meetings held during the year 2007 was varied among universities the average of seven meetings per year suggests the councils make an effort to regularly screen and monitor the performance of the universities.

The reforms in higher education governance in recent years were driven by internal and external pressures. Some remarkable changes that took place in the governance systems of universities were that every university has established as an autonomous independent entity by its enabling legislation and the withdrawal of the commonwealth and the state government from certain control and management functions, devolution of responsibility to university councils, and adoption of funding models which gives more autonomy and freedom to universities. In other words universities are encouraged to develop new sources of income, which lead to development of new forms of accountability through performance and outcome based funding for universities.

The results of the empirical study revealed that governance structures of the Australian universities are independent and applying universal best practice governance, hence it is appropriate to apply the corporate governance indicators to evaluate the governance mechanisms of universities in the Australian context. Effective governance structures play a very important role in attracting most needed funds, and building stakeholder confidence and reputation and to being competitive in the demand driven Australian university sector.

This study contributed to the existing literature by analyzing the application of universal corporate governance indicators to measure the governance in the university sector. It revealed that Australian universities as independent corporate bodies incorporated under their own individual Acts, apply the universal best practice corporate governance measures to evaluate the performance of the governance mechanism of universities.

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Appendix 1

COUNCIL COMMITTEES

Name of the University	Yes	No
Existence of the audit committee	1	0
Chair external	1	0
Majority of external members	1	0
6 < audit committee meetings	1	0
Existence of the nomination committee	1	0
CEO not the chair	1	0
CEO not a member	1	0
Existence of the remuneration committee	1	0
CEO not a member	1	0
CEO not the chair	1	0
Total	10	

Appendix 2

TRANSPARENCY IN REPORTING

Does the annual report show the following?

Item	Yes	No
COUNCIL STRUCTURE		
Council size	1	0
Council appointment process clear	1	0
Expertise and skills of council members	1	0
Council members are evaluated at regular intervals	1	0
Roles and responsibilities of council members	1	0
Duties of members and breeches	1	0
Training program for existing members	1	0
Training for new members	1	0
COUNCIL PROCESS		
Meetings and attendance of meetings	1	0
COUNCIL COMMITTEES	1	0
List of council committees	1	0
Council committee meetings and attendance	1	0
COMPLIANCE		
List of compliances and disclosure	1	0
Disclosure of significant event	1	0
Strategic plan	1	0
Mission	1	0
Strategic goals	1	0
Information of other business entities	1	0
Risk statement	1	0
Joint venture Risk analysis	1	0
KPIs (1 for each year, max up to five)		
Student load statistics	5	
Staff load statistics	5	
Research grants	5	
Research and publications	5	
Graduate destination (full-time employment etc.)	5	
Graduate outcome (overall satisfaction etc.)	5	
Average enter score/student demand	5	
Financial performance	5	
Financial position	5	
Total	65	

