

# International Journal of Management Cases

## Management and Finance Issue

Attracting R&D foreign direct investment through an evolutionary model of place marketing. The case of Ireland

Development of the Management Compensation in German HDAX Companies from 2003 to 2012

A Critical Corporate Social Responsibility (CSR) Timeline: how should it be understood now?

Successful learning is change

Regulation of electronic payment services

Performance Measurement in Non-Profit Organisations – Exploring the Commonalities between Impact, Outcome and Performance Measurement in Open Youth Work Providers

Forecasting Gold Spot Prices by Gold ETF's Using Multiple Linear Regression Model: an Indian Context

Influencing Factors for Managing Foreign Subsidiaries of Multinational Companies of the German Mittelstand

Volume 16 Issue 4

**EDITORS****Editor in Chief****Dr. Tomasz Wisniewski**

The University of Szczecin Poland

[t.wisniewski@univ.szczecin.pl](mailto:t.wisniewski@univ.szczecin.pl)**Europe****Professor Darko Tipuric**

Graduate School of Economics, University of

Zagreb [dtipuric@efzg.hr](mailto:dtipuric@efzg.hr)**The Rest of the World****Dr. Gianpaolo Vignali**

University of Manchester

[gianpaolo.vignali@manchester.ac.uk](mailto:gianpaolo.vignali@manchester.ac.uk)**EDITORIAL BOARD****Professor Claudio Vignali**

University of Vitez, BH

[c.vignali@leedsmet.ac.uk](mailto:c.vignali@leedsmet.ac.uk)**Dr. Mirko Palic**

Graduate School of Economics, University of

Zagreb [mpalic@efzg.hr](mailto:mpalic@efzg.hr)**Dr. Leo Dana**

University of Canterbury, New Zealand

[leo.dana@cantebury.ac.nz](mailto:leo.dana@cantebury.ac.nz)**Professor Barry J. Davies**

Professor of Marketing, University of

Gloucestershire, UK [bdavies@glos.ac.uk](mailto:bdavies@glos.ac.uk).**Professor Alberto Mattiacci**

Professor of Retailing and Marketing, The University of

Sienna, Italy [mattiacci@bunisi.it](mailto:mattiacci@bunisi.it)**Dr. Hans-Rüdiger Kaufmann**

University of Nicosia, Cyprus

[kaufmann.r@unic.ac.cy](mailto:kaufmann.r@unic.ac.cy)**Professor Dr. Jürgen Polke**

Virtual University of Munich, Germany

[jurgen.polke@fhv.at](mailto:jurgen.polke@fhv.at)**Professor Carlo A. Pratesi**

Professor of Retailing Marketing, University of

Urbino, Italy [capbox@tin.it](mailto:capbox@tin.it)**Professor Brenda Sternquist**

Professor, International Retail Management,

Michigan State University, USA

[steinqui@msu.edu](mailto:steinqui@msu.edu)**Dr Ulrich Scholz**

Fontys Fachhochschule, Netherlands

[u.scholz@fontys.nl](mailto:u.scholz@fontys.nl)**Professor Vitor Ambrosio**

University of Estoril, Portugal

[vitor.ambrosio@esthe.pt](mailto:vitor.ambrosio@esthe.pt)**Professor Bernd Britzelmaier**

Pforzeim University, Germany

[bernd.britzelmaier@hs-pfrozeim.de](mailto:bernd.britzelmaier@hs-pfrozeim.de)**Professor Ihn Hee Chung**

Kumoh Institute of Technology, South Korea

[ihnhee@kumoh.ac.kr](mailto:ihnhee@kumoh.ac.kr)**Professor Gianpaolo Basile**

University of Salerno, Italia

[gibasile@unisa.it](mailto:gibasile@unisa.it)**Professor Carmen Rodriguez Santos**

Universidad de Leon, Espania

[carmen.santos@unileon.es](mailto:carmen.santos@unileon.es)**Dr. Razaq Raj**

Leeds Metropolitan University, UK

[r.raj@leedsmet.ac.uk](mailto:r.raj@leedsmet.ac.uk)[www.ijmc.org](http://www.ijmc.org)[www.circleinternational.co.uk](http://www.circleinternational.co.uk)**ISSN 1741-6264**

International Journal of Management Cases is published by:

Access Press UK,  
1 Hillside Gardens ,  
Darwen,  
Lancashire,  
BB3 2NJ  
UK

Copyright © Access Press UK

# Contents

Attracting R&D foreign direct investment through an evolutionary model of place marketing. The case of Ireland 4  
*Enrico Bonetti & Barbara Masiello*

Development of the Management Compensation in German HDAX Companies from 2003 to 2012 18  
*Bernd Britzelmaier, Franziska Frank, Melanie Landwehr & Sandra Reimer*

A Critical Corporate Social Responsibility (CSR) Timeline: how should it be understood now? 46  
*Lucy Hack, Alexandra J Kenyon & Emma H Wood*

Successful learning is change 56  
*Antje Duden*

Regulation of electronic payment services 65  
*Otakar Schlossberger*

Performance Measurement in Non-Profit Organisations – Exploring the Commonalities between Impact, Outcome and Performance Measurement in Open Youth Work Providers 76  
*Corinna Anja Hatzfeld*

Forecasting Gold Spot Prices by Gold ETF's Using Multiple Linear Regression Model: an Indian Context 93  
*Kirti Arekar & Rinku Jain*

Influencing Factors for Managing Foreign Subsidiaries of Multinational Companies of the German Mittelstand 101  
*Bernd Bernecker*

## Attracting R&D foreign direct investment through an evolutionary model of place marketing. The case of Ireland

**Enrico Bonetti**

University of Naples II, Italy

**Barbara Masiello**

University of Naples II, Italy

### Abstract

Recently, most of the national and local governments are increasingly competing to attract in their territories foreign direct investments (FDIs) in R&D, wishing to get the multiple benefits associated to them. Indeed, the expanding internationalization of business R&D and high-tech activity opens important opportunities and challenges for the policy agenda. In such a scenario, this paper analyses the successful case of Ireland, which has gained notoriety on an international level by implementing an intended and effective marketing strategy finalized at intercepting the international cross-boarder flows of high-tech and R&D investments. The results of our case study's analysis allow us to propose a two-stages model of place marketing for policy makers, who aim at positively influencing both the attractiveness of the location for inward investments and the benefits accruing to the local economy. According to our model, in each of the two stages, policy makers should set different objectives (first, attraction and then, embeddedness), target at different market segments and use a different set of operational tools.

This work presents both theoretical and practical implications. From a theoretical point of view, it represents a first attempt to analyse systematically the topic of the attraction of R&D FDIs in terms of marketing options available to policy makers. By taking the policy maker's perspective, this work contributes to extant literature by shedding light on a side of the topic almost overlooked by previous studies.

As to the practical implications, the results of this work give policy makers suggestions for choosing the marketing policy that is more appropriate to pursue the attraction, and subsequently, the embeddedness of R&D FDIs in their territories.

**Key words:** FDI, R&D, Marketing strategies, Marketing tools, policy maker, Ireland

### Introduction

Literature has widely recognized that knowledge and innovation represent a primary foundation of competitive advantage both for companies and for territories (Archibugi, Iammarino, 1999; Cantwell, Piscitello, 2000; Audretsch, 2000; Cantwell et al., 2004; Edler, Wolfgang, 2008). In particular, as it has been observed, foreign direct investments (FDIs) are increasingly seen as an important source for achieving greater and faster economic growth and technology development (UNCTAD, 2005; European Union, 2011). It is therefore not surprising that policy makers, on the one hand, are progressively focusing their attention on internal innovative activities promotion, and on the other hand, they are trying to intercept and to attract international flows of foreign direct investments (FDIs) in R&D. Both theoretical and empirical literature shows in fact that inward FDIs act as an aid

for speedy industrial and economical development, besides strengthening in-house technological and innovation capabilities.

However, although literature is rich in studies concerning the reasons that can lead a company to internationalise its R&D activities, only few works adopted, in a systematic way, the policy maker perspective (CREST, 2007; OECD, 2007, 2008; Guimon, 2009). Underway tendencies are both opportunities to catch and threats to face in the global competition; for this reason, it is more and more important to understand what strategic and marketing tools a policy maker can use, coherently with the aims he wants to reach (Zanatta et al., 2006, 2008; Ito, Wakasugi, 2007; Guimon, 2009, 2011; Wellhausen, 2013).

As a matter of fact, while the internationalisation of innovation and R&D is not entirely new, the current phase has three distinguishing characteristics: it is gathering pace, it is spreading to more countries, including developing countries, and it goes beyond adapting technology to local conditions (OECD, 2008; Cantwell, 1989, 2005; Wellhausen, 2013). Following the fragmentation of the value chain and the resulting internationalisation of manufacturing, MNEs now increasingly establish R&D facilities at many locations worldwide, while corporate R&D activities are still carried out predominately in the home country. MNEs are changing how they innovate and building globally distributed R&D (and innovation) networks: instead of simply adapting technology to local conditions, firms now source knowledge from worldwide centres of knowledge (Cantwell, 2005; Hedge, Hicks, 2008).

Obviously, these changes can be considered as an opportunity for policy makers aiming to make a country, a region, or a city, an attractive place for settling research activities and carrying out innovative processes, particularly for high tech firms. From this perspective, it is critical to be able to develop specific marketing activities, aimed to attract R&D FDIs, which can contribute to start up growth processes in host territories.

This paper aims to make an examination of the marketing tools that policy makers can put into action to attract R&D FDIs and to exploit their effects to sustain territory's growth, by analysing the successful case of Ireland.

Indeed, in recent years Ireland has linked its economic growth to a clear and meaningful policy for the development of innovation, attracting an amount of FDI, which is disproportionate in comparison to the size of its economy. In 2007 - despite a decline<sup>1</sup>, largely due to the high cost of labour and energy, as well as the entry of new countries into the EU and the fierce competition from developing countries such as India - FDI accounted for less than 73% of Irish GDP, amounting to a total of 22.4 billion euro. In addition, although investments in R&D represent about 1,20% of GDP (and, therefore, are below the European average, that is 2%), a significant portion of them (about 70%) comes from companies belonging to groups of foreign ownership (OECD, 2008). Moreover, recently the *Economist Intelligence Unit* ranked Ireland eleventh out of 82 countries, in the ranking of the most favourable places for managing entrepreneurial activities (Business Environment Rankings 2008-2012).

For these reasons and for the fact that Ireland is a small country that could not rely on a historical track of excellence in high technology, the Irish experience has gained notoriety on an international level and its R&D FDI attraction policy is considered by scholars a

---

<sup>1</sup> In 2007, green-field FDIs fell by 22%, while in 2006 they had declined by 25%.

successful case, which is cited by many as a benchmark to emulate (Krugman, 1997; OECD, 2008).

In such a scenario, this paper, relying on a deep analysis of the Irish case, proposes a theoretical model that policy makers can follow in order to successfully intercept R&D FDIs and root them in their territories.

This paper will proceed as follow: first, we introduce the case of Ireland, by analysing in depth targets and value proposition of the marketing strategy adopted to intercept international flows of high-tech and R&D FDIs. Then, we interpret such experience in the light of the previous literature about the attraction of FDIs, in order to assess the motivation behind the Irish strategy and the benefits associated with it. Afterwards, we examine marketing tools implemented by Irish policy makers and the results obtained. Hence, on the basis of our Irish case analysis and interpretation, we present a two-stage model for policy makers that plan to attract and embed high-tech foreign investments in their territories. Finally, conclusions and implications are discussed.

### **Place marketing strategy to attract R&D FDIs: The case of Ireland**

As anticipated, the national policies to attract R&D-intensive FDIs into Ireland have obtained very good results, especially when considering the country dimensions. Ireland is ranked globally as the fifteenth best place in the world to do business (World Bank, 2013). According to European Innovation Scoreboard 2008, Ireland is among the so-called "Innovation Follower", with a performance that has been increasing fastest within this group and a score (0,533) above the EU average (0,475).

FDIs play a crucial role in explaining such results, since they significantly concur to the national GDP (73% in 2007). In 2008, investments by foreign firms increased (+14%) as well as the R&D and innovation projects (+22%; IDA, 2008). Among the world-leading firms that have chosen Ireland for their investment there are Glaxo Smith Kline, Pfizer, Johnson&Johnson and Boston Scientific (Life Sciences), Microsoft, IBM, Google e Intel (ICT), and Fidelity Investments, Citi and Blizzard Entertainment (value-added services).

The effects produced by FDIs on the Ireland economic system are extremely relevant. Indeed, foreign firms employ around 136,000 workers, export for more than €90 billion per year, contributed for €16 billion in direct expenditure to the Irish economy and in 2007 paid an estimated €3 billion in corporation tax (47% of the total amount; IDA, 2008).

Moreover, FDIs gave an impulse to the improvement of local infrastructure, regulatory environment and workforce's quality, with benefits for the entire economy. FDIs have also promoted the development of know-how and new technologies that helped Ireland in reaching a global dimension (IDA, 2008).

So, which are the strategic directions followed by policy makers to achieve such results? And which are the marketing tools implemented? In the next section an analysis of targeting strategies, as well as of value proposition adopted and marketing tools implemented is provided, in order to gain insights for suggesting a more generalized place marketing model for policy makers, which aim at attracting R&D FDIs.

#### *The Irish targets and the value proposition offered*

The explicit choice in terms of segmentation and targeting is one of the distinctive traits of the Irish policy. Indeed, from the very beginning the FDI attraction strategy has been characterized by a clear industry-based segmentation. In particular, Irish strategy has never been aimed towards those firms operating in traditional leading industries of the country (manufacturing and agriculture), while it was directed to high-tech companies that could have changed the nation's strategic positioning in the global scenario, laying the groundwork for the creation of new competencies in the following fields: pharmaceutical, biotechnology and biomedical engineering, ICT, financial and international services, digital media and engineering. The result has been an amazing growth of the foreign investments in R&D, carried out mainly through green-field investments rather than through acquisitions of local companies.

However, in recent years, the country is gradually moving towards a targeting which is driven by technology platforms more than industry distinctions, as illustrated by the words of Eamonn Sheehy, project manager of IDA Ireland (Industrial Development Authority), that is the national agency for industrial development and investment attraction: *"We realized that targeting can no longer be simply on an industry basis, due to the strong on going convergence among industries, such as ICT, pharmaceutical, life sciences and medical devices. Therefore, we are now working to identify areas of convergence, or technology platforms, where we can globally compete"*(Guimon, 2009).

Finally, albeit with some difficulties, in an attempt to improve the quality of FDI attracted in the country, the agency is developing new screening systems to evaluate the quality of the proposals for investment in R&D and to define the level of support to be provided. Indeed, rating systems have been based traditionally on the number of new jobs created or on the level of the planned investments, while currently IDA is even trying to incorporate more intangible aspects that would allow it to get a more accurate and forward-looking judgment. However, this is not an easy path, as explained by Sean Dorgan, former CEO of IDA (he held the position from 1999 to 2008): *"The targeting of R&D FDI is a very complex challenge because there are no reliable indicators and although we introduced new ones in our measurement systems, they are not easy to translate into political speeches and newspaper headlines as it always happens for new jobs created"* (Guimon, 2009).

As it has been observed, together with the Netherlands, Ireland is among the "best performers" in attracting those FDI defined by literature as "strategic asset-seeking" (or "asset-augmenting"; Dunning, Narula, 1995), only behind Scandinavian countries, Switzerland, Germany and United Kingdom (European Commission, 2006).

Indeed, according to literature, two main forms of R&D internationalisation can be recognized that are based on the firms' different motivations behind the choice of setting high-tech and R&D activities abroad:

- "asset-exploiting internationalisation";
- "strategic asset-seeking internationalisation".

"R&D asset-exploiting internationalisation" is a consequence of production globalization and pursues the aim of adapting company's products and processes to the peculiar needs of foreign markets. As a matter of fact, aiming to better exploit available intangible resources (knowledge, own technologies, brands, licences, and so on) out of domestic market, companies can decide to settle their R&D activities directly abroad. In this way, R&D FDIs allow company to get closer to final markets and to be more effective in

adapting products and processes to local needs, than it could be by conducting R&D activities in home country. In other words, such firms seek above all proximity to their clients (especially if they represent lead users) and the best conditions to adapt their products to local markets (Dunning, Narula, 1995; Kuemmerle, 1999; Hedge, Hicks, 2008). “R&D strategic asset-seeking internationalisation”, instead, is mainly oriented to gain access both to knowledge resources and to cost advantages, present in foreign territories. Global competition intensification forced firms to run even faster innovation processes, exploiting a knowledge base that is even more multidisciplinary and often geographically diffused. In this perspective, the decision to settle R&D activities abroad satisfies the need to open new “technological windows”, in order to gain access to knowledge resources and innovation trends, which differently would be precluded. Therefore, R&D FDIs are mainly exploited to create new knowledge and innovation instead of spreading them. Often firms choose a given foreign country, not only because it can offer cognitive resources, but also because there they can get cost benefits, not available in the domestic market, finally improving innovation processes efficiency and reducing related risks. Thus, in strategic asset-seeking internationalisation, factors leading the choice to settle R&D investments abroad are mainly supply-driven, such as the opportunity to find qualified human resources, technology cutting edge research centres, favourable intellectual propriety regulations, advanced services supporting innovation processes, and so on (Dunning, Narula, 1995; Kuemmerle, 1999; Meyer-Kramer, Reger, 1999; Hedge, Hicks, 2008).

Irish government has mainly target at R&D strategic asset-seeking internationalisation and many of the most important high-tech companies in the world have chosen Ireland as a strategic hub for their European networks, thanks to the winning value proposition that the country is able to offer.

Such value proposition is primarily based on a clear and explicit political will, directed towards the attraction of high-tech companies as a priority in national decisions, which, over the last forty years, has reshaped the profile of the country.

Moreover, Ireland offers a favourable environment for the development of innovation, which is characterized by ([www.idaireland.com](http://www.idaireland.com)):

- a condition of political and legislative stability;
- a strategic location for the access to EMEA countries (Europe, Middle East and Africa);
- strategic clusters of leading global companies in the field of pharmaceutical, biotechnology and biomedicine, ICT, international and financial services, digital media and engineering;
- a well-established reputation as a hub for the improvement of business processes.

Another central aspect of the Irish value proposition is the quality of human resources and the attention paid to the development of human capital. The education system of the country ranks among the higher positions on several IMD World Competitiveness Yearbook 2008 parameters, compared to the most advanced economies in the world (Table 1).



**Table 1: The quality of Irish human resources according to some indicators IMD World Competitiveness Yearbook, 2008.**

Capacity of the education system to meet the needs of a competitive economy of new challenges (score of the country)	Flexibility and adaptability of the population having completed university education (score of the country)	Percentage of workforce employed per hour, in U.S. dollars	Workforce productivity (GDP per person)
Ireland = 6,88	Ireland = 7,80	Ireland = 41,00	Ireland = 47,40
Netherland = 6,26	USA = 7,34	Belgium = 41, 00	USA = 46,02
France = 5,94	Netherland = 6,73	Spain = 40,00	Netherland = 41,51
Germany = 5,61	Portugal = 6,20	USA = 39, 00	Germany = 39,87
USA = 5,62	United Kingdom = 6,12	France = 39, 00	United Kingdom = 37,68

Source: [www.idaireland.com](http://www.idaireland.com).

In addition, the success of Ireland in attracting R&D FDIs has been also driven by a strong cooperation among the actors of the local system of innovation (Lundvall, 1992; Etzkowitz, Leydesdorff, 1995): national and regional governments, entrepreneurs, Universities and public research organizations (such as Conway, NBIRT), regulators, and various agencies for innovation, development and investments' attraction (a.o., IDA Ireland, SFI, Enterprise Ireland, Forfàs, Shannon Development, and so on).

A key role has been played by IDA Ireland, a State-sponsored agency established in 1949 within the *Department of Industry & Commerce*. In 1994, the agency has become an autonomous organization focused on the attraction and development of FDI, and in particular of those investments that are “of high value, requiring high skill levels and a sophisticated business environment”, such as R&D activities, European Headquarters, High End Manufacturing, Global Services ([www.idaireland.com](http://www.idaireland.com)).

IDA Ireland is one of the few European inward investment promotion agencies, which has a real control and a wide power to directly negotiate the offered incentives (Loewendahl, 2001), and this strongly impact over the value proposition of the country.

IDA acts as a key-player, a “meta-organizer” that works together with other public and private organizations in order to encourage FDIs and economic growth. Almost one third of new R&D investment in 2008 involved IDA collaboration with Irish academic and research institutes, many of which were supported by SFI. IDA also acts as a “One-Stop Agency”, which integrates and develops the different components of the value proposition, which coherently communicates the “final offer” to potential investors, and which helps to connect various actors of the local system of innovation to the target, by managing different place marketing tools, as it will be described later on.

In light of the Irish selected targets – and of the change of the targeting strategy over time – as well as of the value proposition offered to them, it is possible to recognize in the Irish experience an evolutionary approach to the attraction of the R&D FDI.

The focus of the strategy has always been oriented at targeting the strategic-asset seeking FDIs. However, at the beginning the main aim of the place marketing strategy seemed to be mainly “to attract” such investments into the country, while during the last years the Irish policy makers seem to pursue more actively the objective of “embedding” the R&D FDI into the local economy. It is not a case, as observed before, that the country is gradually moving towards a targeting which is driven by technology platforms rather than by industry sectors. The former, indeed, can more easily create convergence areas able to generate knowledge spill-overs and positive externalities, whose benefits are cross-boarding and produce higher and more stable benefits for the local economy.

Such evolution, also emerges by the government's program on innovation policies “Strategy for Science, Technology, and Innovation” (2006-2013), which has introduced new objectives and tools to increase the attraction and the embeddedness of both public and private R&D FDIs, in the coming years, as well as to improve their quality<sup>2</sup>. The new programme “Horizon 2020-IDA Ireland Strategy” also reinforces such approach.

To sum up, we can distinguish two different steps of the place marketing strategy: a) an attraction stage, and b) an embeddedness stage.

In the following section the place marketing tools adopted by Ireland will be discussed, with reference to each of the two identified phases.

### *Place marketing tools*

The strategy adopted by Ireland was strengthened by its ability to change the place marketing tool, according to the changes of the aims. Essentially, Ireland implemented a combination of hard and soft tools, but this combination was made of different tools, depending on whether the aims were those related to attraction in the strict sense or to embeddedness.

Specifically in relation to the first of the two phases, which make up Ireland place marketing strategy, there is a combination of hard and soft tools that constitute a marketing mix whose main role is to create conditions to compete in R&D attraction.

Within the hard tools, one of the most relevant is represented by private and public research infrastructure. In particular Ireland was divided into eight areas, distinguished by industry, (North West, North East, Midlands, East, West, Mid West, South East, South West) in each of them there are research centres and/or universities (such as Trinity College Dublin, National University of Ireland, Athlone Institute of Technology, Cork Institute of Technology), science parks (such as the Cork Business and Technology Park, Athlone Business and Technology Park, Tullamore Business and Technology Park) some of which fall under the IDA network (such as, for example, the Blanchardstown Business & Technology Park or College Business & Technology Park), as well as offices and support services. In particular, in the Dublin area are concentrated many ICT research institutes and firms. In Cork, in the south, pharmaceutical and electronics industry prevail. The area of Galway, in the west, focuses on the biomedical industry, while around Shannon airport mainly multinational companies producing software have settled.

---

<sup>2</sup> The objectives of the program include the following: (i) number of foreign affiliates with a minimum size of R&D (over € 100,000) equal to 520 by 2010; (ii) number of foreign affiliates that carry on significant levels of R&D (over 2 million Euros) equal to 150 by 2010; (iii) expenditure on R&D of foreign firms at least equal to 1.675 billion euro by 2013 (DETE, 2006).

An additional hard tool can be considered the attention towards talents' attraction and conservation; more in detail, Irish government has considered one of its priorities the increase of the capacity to develop and to attract highly qualified resources from abroad; it also committed to double the number of PhD graduates by 2013.

Fiscal and financial incentives are a further set of hard tools. Specifically, Irish Government created a national agency to distribute R&D funds, named Science Foundation Ireland (SFI). SFI invests both in public and private research oriented towards the production of new knowledge, technologies and towards the creation of new firms, mainly in biotechnology, ICT and renewable energy. Moreover, IDA also has a large independence to negotiate financial incentives directly with potential foreign investors. While most of the other countries prefer to separate this function because of accounting reasons, IDA is instead one of the few IPA in the world which can directly control the incentives and so, from time to time, propose an offer which is tailored on to the needs of a specific customer, even before the latter's decision to invest in Ireland. In addition, Ireland made agreements with more than fifty countries to eliminate (or minimize) the problem of double taxation.

Among soft tools it is possible to mention pre-settlement customized value-added services, such as information and statistics about possible locations, financial incentives, meeting with institutions, service providers, potential partners, etc.

To the set of soft tools can also be brought back those numerous communication and relational marketing actions, which represent one of the main fields of activity of IDA. Similarly to what happens in the first phase of place marketing strategy adopted by Ireland, the second phase as well is characterized by the combination of hard and soft tools; but in this case their use turns out to be more oriented to promote and support knowledge spillovers.

Hard tools consist essentially in the implementation of a clear and efficient intellectual property regime. In 2006, Irish government published some guidelines for the management of intellectual property rights issues, which may arise from the joint venture activities and IDA took care of distributing them to MNE based in the country.

On the other hand, the soft tools firstly include policies to develop a collaborative environment; among these, a significant role is played by Centres for Science, Engineering and Technology (CSETs), that are public-private consortia funded with specific programs promoted by Irish Government. The CSETs are managed by SFI, but IDA plays a central role in encouraging the participation of foreign companies based in the country, assisting them to establish relationships with research centres, universities or other domestic organizations. This is a tool aimed particularly at promoting the creation of a collaborative environment among the actors of the local system, through the development of joint research projects between firms and research institutions.

The basket of soft tools also includes policies to increase absorptive capacity of local firms, which are reflected in the participation of IDA in international fairs (mainly focused on technology transfer and research) all over the world; the funding of seminars and workshops primarily aimed at encouraging matching between local and non local actors operating in the target industries; the organization of missions and presentations directly to potential investors.

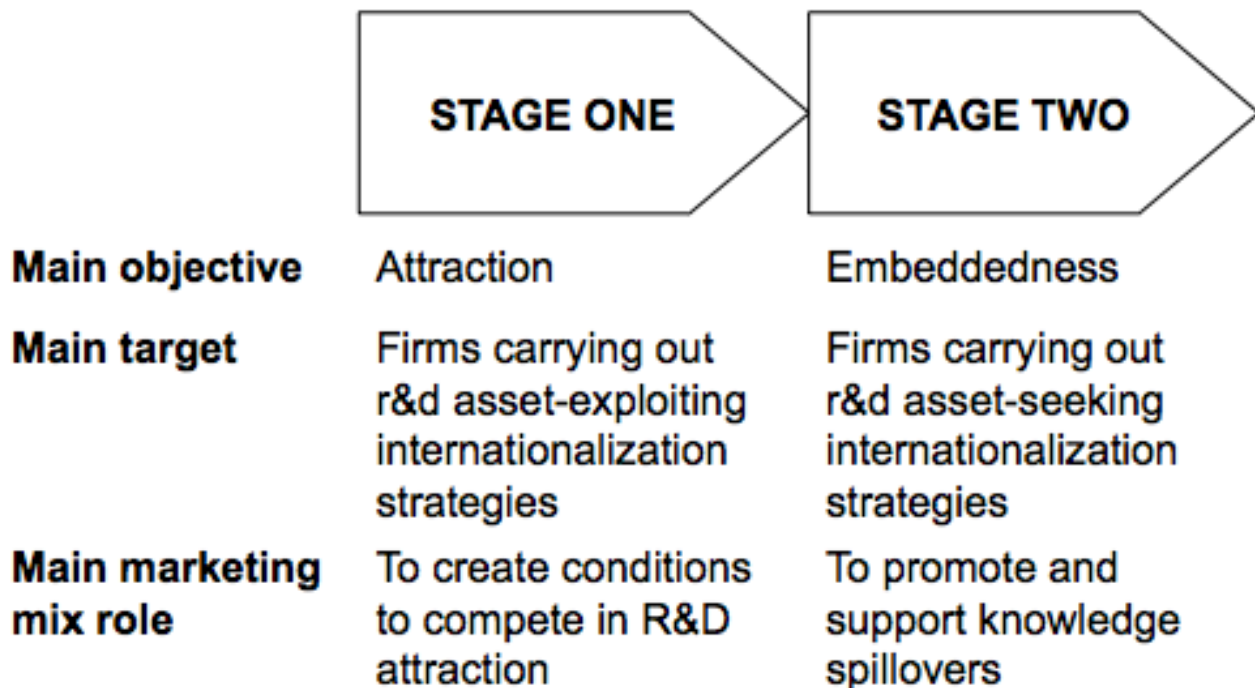
Finally, a relevant role is that of post-settlement customized value-added services, such as the assignment, by IDA to each foreign firm that invests in the country, of a specific project manager who follows and supports its development path.

### An interpretative marketing model for policy makers to attract R&D FDIs

The analysis of the place marketing strategy implemented by Ireland showed that its policy makers referred to the different reasons behind the firms' internationalisation of innovation in order to define a marketing strategy useful to intercept and attract the global flows of R&D FDIs.

Trying to draw a lesson of wider scope by the analysis of the "Irish case" and to bring it on a more abstract and generalized dimension, we propose a two-stages process, where, in each stage, the policy maker sets different objectives (attraction *versus* embeddedness), targets at different market segments and uses a different set of operational tools.

**Figure 1: An Interpretive Marketing Model**



As shown in fig. 1, in the first stage the main objective of the policy maker is related to firms' attraction, without making any distinction in terms of industry or technology; they mainly set medium-short term objectives, such as: to increase employment and investments in the territory, to exploit elsewhere created knowledge, to obtain visibility, to improve image, and so on. Then, in this stage, main market target for the policy maker is represented by firms pursuing asset-exploiting benefits, such as: proximity to local clients, better efficiency and effectiveness in adapting products and processes to local market specific needs, or support to local production and sales functions (Criscuolo, 2005; Hedge and Hicks; 2008). Therefore, marketing tools are aimed at promoting firms agglomeration, at facilitating access to final markets as well as at creating "hygienic quality" conditions,

that is to endow the territory with a mix of those factors – such as infrastructures, intermediaries and meta-organizers, quality human resources or fiscal incentives – that are needed to effectively compete in the attraction of R&D FDIs (Serapio, Dalton, 1999; Jones-Evans et al., 1999; OECD, 2003; Howells, 2006; Almeida et al., 2008; Hu, 2007).

On the contrary, in the second stage policy makers' final aim is no longer merely to attract and retain R&D resources from the outside, but rather to combine them with the local innovation system, in order to generate long-term benefit for the innovative capacity of the territory, promoting the creation of new knowledge and triggering local development processes. Main targets, in this stage, are firms carrying out R&D asset-seeking internationalisation strategies. Consequently, marketing mix tools have to be aimed to allow the territory to take advantage of inward FDI by embedding spill-overs in long term (Lutz, 2001; Smedlung, 2006; Lazaric et al., 2008). Policy makers have then to implement tools to encourage firms to capture economic benefits from global innovation activities; in other words place marketing tools in this stage are aimed at promoting the relational and cognitive proximity between actors. In particular, more emphasis should be put on strengthen domestic absorption capacity. In this case, target firms are those one mainly pursuing "strategic asset-seeking" benefits, such as, for instance, the access to a collaborative and dynamic environment that favour the exchange of tacit knowledge, or to an efficient intellectual property regime (Criscuolo, 2005; Hedge and Hicks, 2008).

## Conclusions and implications

The internationalisation of business R&D and technological activity is a recent phenomenon, with increasing cross-border flows of R&D and significant shares of domestic R&D performed by affiliates of foreign firms. These developments open important opportunities and challenges for territories. In particular, along with strategies intended to sustain endogenous innovation processes, most of the governments are competing to attract R&D FDIs, wishing to get benefits associated to them. Both theoretical and empirical literature shows in fact that inward FDIs act as an aid for speedy industrial and economical development, besides strengthening in-house technological and innovation capabilities. However, although several studies have analysed reasons that can lead a company to internationalise R&D activities, literature still lacks a framework to get an in depth comprehension of the phenomena from the policy makers' perspective (Criscuolo, 2005; CREST, 2007; Guimon, 2009). Therefore, notwithstanding the importance that this issue holds in the modern territories' competitive dynamics, a systematic analysis of marketing tools and strategies that policy makers can adopt in order to attract R&D FDIs, and to exploit benefits accruing to the local economy, is still required. This paper tries to contribute to fill this gap; in particular, it starts from the analysis of one of the most renowned international best practices and, relying on literature on this topic, proposes a model useful to define a marketing strategy aiming to promote a territorial development based on the R&D FDIs' attraction and embeddedness in the local systems of innovation.

More in detail, we analysed the characteristics and tools of the investment attraction strategy adopted by Irish government and then, after interpreting it through a review the existing literature by adopting the policy makers' perspective, we proposed a two-steps model.

In each stage of our model, different policy makers' objectives are related to different target firms and different set of operational tools. In the first stage (Attraction Phase) the

main objective is R&D FDI's attraction and the favoured targets are those firms that carry out R&D asset-exploiting internalisation paths. Consequently, marketing tools are directed to create "hygienic quality" conditions, that is to endow the territory with a mix of those factors that are needed to effectively compete in the attraction of R&D FDI's.

In the second stage (Embeddedness Stage), the policy maker sets objectives aiming at embed foreign firms in local innovation system, in order to generate long-term benefits for the innovative capacity of the territory. Main targets, in this stage, are firms carrying out R&D asset-seeking internalisation strategies and marketing mix tools have to be aimed to allow the territory to take advantage of inward FDI by embedding spillovers in long term.

The effectiveness of a process structured as described is very well demonstrated by the excellent results obtained by Ireland in R&D FDI's attraction. In the next future – as it is expressed in the Programme "Horizon 2020-IDA Ireland Strategy" – Ireland will continue investing in the local innovation system and in the policies for attracting R&D and high-tech FDI's, in order to maintain, or better to improve, its position in the global competition, also defending from emerging markets such as India and China

Of course, it cannot be ignored that policy makers' potential tools to attract and to embed R&D FDI's also depend on several external circumstances, as well as on the actual and potential endowment of resources of a territory, which policy action can only partially shape through deliberate strategies.

However, this work represents an attempt to analyse systematically the problem in terms of marketing options available to policy makers, supporting their choice of the marketing tools that are more appropriate in order to pursue a specific objective.

In doing so, this work approach the issue of the attraction and embeddedness of R&D FDI's, by taking the point of view of the policy maker, a perspective almost ignored by previous studies.

Future research will have to explore more in detail these issues, by verifying, for instance, differences for developed and developing countries. Moreover, it has been recently pointed out that – in order to turn the process of internationalisation of R&D into a win-win situation both for the home country and the world – policy will need to strengthen its focus on fostering inward and outward spill-overs and on strengthening the relevance of international collaboration by focusing on thematic priorities in fields of global importance (OECD, 2008). Future research should therefore be addressed to explore this further step, defining the more appropriate policy makers' marketing strategies and toolbox.

## References

ARCHIBUGI, D. & IAMMARINO, S. (1999) The policy implications of the globalisation of innovation. *Research Policy*. 28 (3). pp 317-336.

ALMEIDA, A., SANTOS, C. & SILVA, M.R. (2008) Bridging Science to Economy: the Role of Science and Technologic Parks in Innovation Strategies in 'Follower' Regions. *Working Paper*, EconPaper Repec.

AUDRETSCH, D. (2000) Knowledge, Globalization and Regions: An Economist's Perspective, in DUNNING, J. (ed.) *Regions, Globalization and the Knowledge-Based Economy* (pp 63-81). New York: Oxford University Press.

- CANTWELL, J., DUNNING, J. & JANNE, O. (2004) Towards a Technology-Seeking Explanation of U.S. Direct Investment in the United Kingdom. *Journal of International Management*. 10 (1). pp 5-20.
- CANTWELL, J. (1989) *Technological Innovation and Multinational Corporations*. Oxford: Basil Blackwell.
- CANTWELL, J. (2005) The Globalisation of Technology: What Remains of the Product Cycle Model?. *Cambridge Journal of Economics*,.19 (1). pp 155-174
- CANTWELL, J. & PISCITELLO, L. (2000) Accumulating technological competence: its changing impact on corporate diversification and internationalization. *Industrial and Corporate Change*. 9 (1), pp 21-51.
- CREST (2007) *Internationalisation of R&D – Facing the Challenge of Globalisation: Approaches to a Proactive International Policy in S&T*. Brussels.
- CRISCUOLO, P. (2005) *Internationalisation of Corporate R&D: A Survey of the Literature*. Mimeo.
- DUNNING, J. & NARULA, R. (1995) The R&D Activities of Foreign Firms in the US. *International Studies of Management and Organisation*. 25.
- EDLER, J. & WOLFGANG, P. (2008) International Industrial R&D-Policy Challenges: Introduction to the Special Issue. *The Journal of Technology Transfer*. 33 (4). Pp 331-336.
- EUROPEAN UNION (2011) *Innovation Union Competitiveness Report 2011*. European Commission.
- ETZKOWITZ, H. & LEYDESDORFF, L. (2000) The Dynamics of Innovation: from National Systems and 'Mode 2' to a Triple Helix of University-Industry-Government Relations. *Research Policy*. 29 (2). pp 109-123.
- EUROPEAN COMMISSION (2006), *Regional Innovation Scoreboard 2006*. Brussel.
- FLORIDA, R. (2002) *The Rise of the Creative Class*. New York: Basic Books.
- GUIMON, J. (2009) Government strategies to attract R&D-intensive FDI. *The Journal of Technology Transfer*. 34 (4). pp 364-379.
- HEDGE, D. & HICKS, D. (2008) The Maturation of Global Corporate R&D: Evidence from the Activity of U.S. Foreign Subsidiaries. *Research Policy*. 27 (3). pp 390-406.
- HOWELLS, J. (2006) Intermediation and the Role of Intermediaries in Innovation. *Research Policy*. 35 (5), pp 715-728.
- HU, A.L. (2007) Technology Parks and Regional Economic Growth in China. *Research Policy*. 36 (1). pp 76-87.

JONES-EVANS, D., KLOFSTEN, M., ANDERSSON, E. & PANDYA, D. (1999) Creating a Bridge between University and Industry in Small European Countries: the Role of the Industrial Liaison Office. *R&D Management*. 29 (1), pp 47-56.

KRUGMAN, P. (1997) Good News for Ireland: A Geographical Perspective, in GRAY, A. (ed) *International Perspective on the Irish Economy*, Dublin: Indecon.

KUEMMERLE, W. (1999) Foreign Direct Investment in Industrial Research in the Pharmaceutical and Electronics Industries - Results from a Survey of Multinational Firms. *Research Policy*. 28.

IDA (2008) *Annual Report 2008*. Ireland: IDA Ireland Press Office.

ITO, B. & WAKASUGI R. (2007) What Factors Determine the Mode of Overseas R&D by Multinationals? Empirical evidence. *Research Policy*. 36 (8). pp 1275-1287.

LAZARIC, N., LONGHI, C. & THOMAS, C. (2008) Gatekeepers of Knowledge versus Platforms of Knowledge: from Potential to Realized Absorptive Capacity. *Regional Studies*. 42 (6). pp 837-852.

LÜTZ, S. (2001) Learning through Intermediaries: the Case of Inter-Firm Research Collaborations, in EBERS (ed.) *The Formation of Inter-organizational Networks*. (pp 220-237). Oxford: Oxford University Press.

MEYER-KRAMER, F. & REGER, G. (1999) New Perspectives on the Innovation Strategies of Multinational Enterprises: Lessons for Technology Policy in Europe. *Research Policy*. 28 (7). pp 751-776.

OECD (2003) *Tax Incentives for Research and Development: Trends and Issues*. Paris: Organization for Economic Cooperation and Development.

OECD (2007) *Science, Technology and Industry Scoreboard 2007*. Paris: Organization for Economic Cooperation and Development.

OECD (2008) *The Internationalisation of Business R&D: Evidence, Impacts and Implications*. Paris: Organization for Economic Cooperation and Development.

SERAPIO, M. & DALTON D (1999) Globalization of Industrial R&D: An Examination of Foreign Direct Investments in R&D in the United States. *Research Policy*. 28. pp 303-316.

SMEDLUNG, A (2006) The Roles of Intermediaries in a Regional Knowledge System, *Journal of Intellectual Capital*. 7 (2), pp 204-220.

UNCTAD (2005) *World Investment Report 2005: Transnational Corporations and the Internationalization of R&D*. Unctad.

ZANATTA, M., COSTA, I. & FILIPPOV, S. (2006) Foreign Direct Investment: Key Issues for Promotion Agencies. *United Nations University Policy Brief*. 10. pp 1-8.

ZANATTA, M., STRACHMAN, E., CARVALHO, F., VARRICHIO, P.C., CAMILLO, E. &



BARRA, M. (2008) *National Policies to Attract FDI in R&D. An Assessment of Brazil and Selected Countries*. United Nations University Research Paper. 2008/69.

WELLHAUSEN, R.L. (2013) Innovation in Tow: R&D FDI and investment incentives. *Business and Politics*. 15 (4). pp 467-491.

WORLD BANK (2013) *Doing Business 2013 Report*. Washington DC: The World Bank and The International Finance Corporation.

## Development of the Management Compensation in German HDAX Companies from 2003 to 2012

**Bernd Britzelmaier**

Pforzheim University, Germany

**Franziska Frank**

Pforzheim University, Germany

**Melanie Landwehr**

Pforzheim University, Germany

**Sandra Reimer**

Pforzheim University, Germany

### Introduction

“To gold they tend, / On gold depend, / All things!” The German writer *Johan Wolfgang von Goethe* (2000, l. 2,802 et seqq.) already knew this when he addressed wealth in his masterpiece “Faust” more than 100 years ago. Since then there have been no major changes on this statement. Even gold is no longer used as means of payment these days, a business is just going well today when there is a balance between performance of employees and fair equivalent. And this is exactly the point in which the opinions of the society are divided. Bad conditions in the labor market as well as great concessions of employees on the one hand are confronted with constantly rising management compensations on the other hand. This is why over the past years management compensation of Germany’s largest listed stock corporations has become more and more the focus of attention and criticism in public debates (Freiburg, 2006, p. 1 et seqq.).

Once the results of the past financial year and thus the compensation reports are announced, heated debates about the annual income of Martin Winterkorn (Volkswagen AG), Dr. Dieter Zetsche (Daimler AG) or Jim H. Snabe and Bill McDermott (SAP AG) are opened. These managers rank among the top earners of German corporations. But in general, even their colleagues in other large companies do rarely earn less than one million euros per year. Furthermore, there were several corporate scandals over the past years that have intensified the public debates even more. As an example the high severance payment of Wendelin Wiedeking can be mentioned. Although the former chairman of Porsche AG threatened the existence of the car manufacturer with the proposed acquisition by Volkswagen AG, he still received 50 million euros annual income when he was dismissed in 2009 (Fockenbrock, 2013, p. 52 et seq.).

The public debates about management compensations are not disregarded by politics and legislature. Instead, they even make the incentives of compensation systems partially responsible for the financial and economic crisis in 2008 and 2009. Before the crisis, business actions and managerial decisions were rather short-term oriented and therefore lead to the negative effect on the overall economy. The German government has reacted with the establishment of several laws and recommendations for more transparency and a more sustainable as well as long-term orientation regarding compensation structure and corporate governance. But it is still controversial if all these legal regulations and voluntary measures affect the development of management compensation in German corporations (Hexel, 2012, p. 142 et seqq.). Therefore the present paper deals with the analysis of the

development of management compensation in German HDAX companies from 2003 to 2012. Thereby focus is laid on the overall development of management compensation as well as its relation to key performance indicators. Furthermore, the influence of the financial and economic crisis in 2008 and 2009 on management compensation is analyzed. Finally, reasons for the development of management compensation in German HDAX companies are given.

## **Literature Review**

### **Definition of HDAX**

The HDAX is a German stock market index that consists of all member companies of the German stock index (DAX), the Mid-Cap-DAX (MDAX) and the TecDAX (Jung, 2006, p. 758). The DAX represents the German leading index and comprises the 30 largest and highest volume shares at the Frankfurt Stock Exchange (Bortenlänger / Kirstein, 2011, p. 58). Companies ranked immediately below the DAX are listed in the MDAX. It includes 50 shares from all sectors excluding technology (Deutsche Börse Group, 2013a, n.p.). The performance of the 30 largest companies of the technology sector is tracked by the TecDAX (Deutsche Börse Group, 2013b, n.p.). Taken as a whole, the HDAX represents a cross-sector index that includes 110 companies meeting the Prime Standard. It is the successor to the DAX 100 index. The performance of the companies is measured in terms of order book volume and market capitalization (Jung, 2006, p. 758).

### **Definition of Management**

Management can be defined as an institution or as a function. The former refers to all executive positions in an organization which are able to decide, control and direct. Within the corporate hierarchy, there are three levels of management as an institution: top-management (e.g. board of directors), middle-management (e.g. head of department or plant manager) and lower-management (e.g. team leader or foreman). Management as a function on the other hand focuses on management tasks. These tasks particularly include the steering, planning, coordinating and controlling of an organization (Schierenbeck, 2003, p. 95; Middendorf, 2005, p. 16). Therefore the management is responsible for the strategic decisions that influence fundamentally the strategic direction of the corporate development. The most important objective is to protect the long-term success of a company (Hungenberg, 2011, p. 4). In the context of the present paper, management is defined as an institution. For the analysis of the development of management compensation, the top management is considered and within this one above all the chairman of the executive board.

### **Definition and Types of Compensation**

In general, compensation is defined as the monetary equivalent paid to an employee by the employer in return for the work performed (Fohlmeister-Tiede, 2000, p. 18). The compensation received by a manager is typically a mixture of salary, short-term and long-term incentives as well as other benefits (Gutmann / Klose, 2005, p. 6). In the following the different types of compensation are explained in:

#### **Salary**

Salary represents the basic compensation. It is a fixed amount of money which depends on several factors like industry, company size or length of service with a company (Maurer, 2011, p. 11). Furthermore, the risk appetite of the manager influences the size of salary, too. The more risk-averse a manager is, the higher is the fixed portion of compensation negotiated. In general, salary is not performance-related and thus has no incentive effect for the management. It rather functions to fulfill the participation requirements of the manager and to ensure an adequate standard of living. But it can also be used as calculation base for the performance-related types of compensation. Consequently, it indirectly affects the total amount of a manager's compensation package (Lazar, 2007, p. 37 et seqq.).

### **Short-term Incentives**

Short-term incentives belong to the variable types of compensation and are also known as bonuses or annual incentives. A yearly agreement on operative performance targets provides the basis for the short-term incentives. The better the targets achieved, the higher the bonus for the management. Performance targets are often related to corporate success and represent an incentive effect for the management (Brühl, 2009, p. 454). Achieving objectives requires the ability of managers to influence and measure their own performance (Stock-Homburg, 2010, p. 425). The payment combination of salary plus short-term incentives is referred to as total cash compensation (Kramarsch, 2000, p. 9).

### **Long-term Incentives**

As well as the short-term incentives, long term incentives represent variable types of compensation. The difference between both is in the incentive effect which bases not just on one, but on several years when it comes to long-term incentives. Usually, the time horizon extends over two to five years (Freiburg, 2006, p. 41). With long-term incentives, managers shall participate in a company's long-term and sustainable success and be challenged to act in a more strategic and future-oriented way. Increasing the corporate value is the main objective of this compensation type (Becker / Kramarsch, 2006, pp. 25). The sum of total cash compensation plus long-term incentives is called total direct compensation (Kramarsch, 2000, p. 9).

Long-term incentives can be distinguished between share-based and indicator-based compensation. Share-based compensations referring to stocks, share options or convertible bonds are just applicable by listed stock corporations. All other companies depend on indicator-based compensations like phantom plans or other cash-based plans (Becker / Kramarsch, 2006, pp. 44 et seqq.). The following graph (Table 1) gives an overview of all kinds of long-term incentives.

### **Other Benefits**

Other benefits are also known as fringe benefits or perquisites and represent all cash or non-cash benefits provided in addition to the normal salaries. Examples for other benefits are company cars, housing, group insurance or specialized benefits. In addition to that, social security benefits like pension plans become more and more attractive. The purpose of other benefits is to increase quality of life and to improve motivation and retention of the management. Especially in case of status symbols, there is a strong incentive effect for the managers. Most of the benefits are tax-free or at least tax-advantaged (Freiburg, 2006, p. 43 et seqq.).

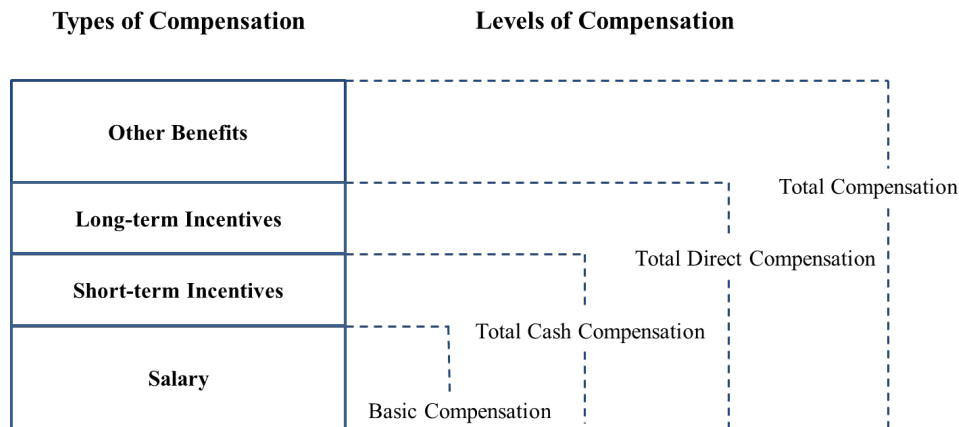
**Table 1: Long-term Incentives**

Share-based Compensation		Indicator-based Compensation	
Real Equity Compensation	Virtual Equity Compensation	Phantom Plans	Other Cash-based Plans
<ul style="list-style-type: none"> <li>- Shares                             <ul style="list-style-type: none"> <li>• Employee Shares</li> <li>• Restricted Stocks</li> <li>• Performance Shares</li> </ul> </li> <li>- Share Options</li> <li>- Convertible Bonds</li> </ul>		<ul style="list-style-type: none"> <li>- Phantom Stocks</li> <li>- Phantom Options</li> </ul>	<ul style="list-style-type: none"> <li>- Long-term Cash Compensation</li> <li>- Deferred Compensation</li> <li>- Bonus Bank</li> </ul>
Equity	Cash	Cash	Cash
Usually applied by listed companies		Usually applied by listed and non-listed companies	

(own illustration based on Becker / Kramarsch, 2006, p. 44)

By adding up salary, short-term and long-term incentives as well as other benefits, the compensation package is complete and it is referred to as total compensation. The following graph shows all types of compensation introduced before as well as the corresponding levels of compensation:

**Figure 1: Types and Levels of Compensation**



(own illustration based on Kramarsch, 2000, p. 9)

**Legal Regulations and Recommendations regarding Management Compensation in Germany**

The following legal regulations and recommendations refer to the level, structure, determination and transparency of management compensation in German corporations. First, each legal regulation or recommendation is explicitly explained. Finally, the dates of introduction or rather the dates of amendment are shown as an overview in a timeline.

## German Corporate Governance Codex (DCGK)

In general, the DCGK represents a legal and factual regulatory framework for managing, supervising and controlling a company (Werder, 2008, p. 1). The objective of the codex is to make the corporate governance system more transparent and therefore increase the confidence of stakeholders. Since its establishment in 2002, the DCGK is mandatory for all listed stock corporations in Germany, even though its application is also recommended for all non-listed companies (DCGK, 2002, p. 1). If necessary, there is an annual amendment by the governmental commission (Welge / Eulerich, 2012, p. 57). According to Art. 161 AktG, all listed stock corporations need to publish a declaration of conformity once a year. Thereby, both the board of directors and the supervisory board are required to declare whether the DCGK recommendations are complied. In case of non-compliance, reasons are required (DCGK, 2012, p. 2). The DCGK is divided into seven sections (Welge / Eulerich, 2012, pp. 55 et seq.). Regarding management compensation, codexes 4.2.2 to 4.2.5 are relevant. Therein, appropriateness, structure, possibilities of limitation and disclosure requirements of management compensation are specified. The most important contents are presented in the following.

According to codex 4.2.2, the supervisory board is responsible for the assessment of adequate management compensation. The level of compensation depends on the performance of each manager, the current economic situation of the company as well as a cross-sectorial comparison (DCGK, 2002, p. 6; DCGK, 2012, p. 6).

Codex 4.2.3 refers to the structure of management compensation. Accordingly, it shall consist of fix and variable components. The latter are usually performance-related and therefore relate to negative performance developments, too. Furthermore, management compensation shall include one-time, yearly as well as long-term incentive effects (DCGK, 2002, p. 6; DCGK, 2009, p. 8). As amended in 2003, the supervisory board is able to limit the management compensation. For example, the limit can be independent on windfall profits which are not generated by corporate performance (DCGK, 2003, pp. 6 et seq.; Strieder, 2005, p. 96). The codex version of 2007 has introduced a cap on severance payment. In case of an early termination of the position as a management board member, severance payment should not be higher than a two year's income (DCGK, 2007, p. 7). In addition to that, since the codex amendment of 2012 has been established, severance payment can even be completely avoided if the manager is responsible for the resignation by oneself (DCGK, 2012, p. 6).

Disclosure requirements as well as the way of disclosure are regulated in codex 4.2.4 and 4.2.5. The compensation report is part of the notes of the financial statement or the management report (DCGK, 2012, p. 8). It is required to state the compensation of each manager in individualized form. Exclusively the general meeting of shareholders can veto against the individual disclosure with a three-quarters majority (DCGK, 2006, p. 7).

In practice, the DCGK is of high relevance and becomes more and more important because of the ongoing public debates regarding management compensation. Some of the codex recommendations have already resulted in separate German laws which are introduced in the following.

## **Act on the Disclosure of Management Board Compensation (VorstOG)**

Since the implementation of some DCGK recommendations were unsatisfactory, German legislature passed the VorstOG in 2005. Since the financial year 2006, it is legally binding for all listed and non-listed stock corporations in Germany (VorstOG, 2005, p. 2,267 et seq.). Material amendments of the law refer to the German Commercial Code (HGB). In particular, these include the notes or rather the consolidated notes according to Art. 285 Sent. 1 Marginal No. 9a) HGB, Art. 286 (4 / 5) HGB and Art. 314 (1) Marginal No. 6a) HGB as well as the management report or rather the group management report according to Art. 289 (2) Marginal No. 5 HGB and Art. 315 (2) Marginal No. 4 HGB.

The VorstOG states that the disclosure of all relevant information referring to the compensation of each member of the management board is to be made in the notes of the financial statement or the management report. The total compensation is published by name of each member unless the general meeting decides otherwise with a three-quarters majority. Components of the management compensation are salaries, profit sharing, subscription rights, other share-based compensations, expense allowances, insurance premiums, provisions and other benefits. All components are to be divided into fix and variable compensation types (VorstOG, 2005, p. 2,267 et seq.).

## **Act on the Appropriateness of Management Board Compensation (VorstAG)**

Beside the VorstOG, since the financial year 2010 there is another German law which regulates management compensation. The VorstAG affects the German Commercial Code (HGB) as well as the German Stock Corporation Act (AktG) (VorstAG, 2009, n.p.). Objective of the law is to structure management compensation more sustainable and long-term oriented. Furthermore, the supervisory board is given more responsibilities (Koch / Stadtmann, 2011, p. 215). The most important contents of the VorstAG are detailed in the following.

Art. 107 (3) Marginal No. 3 AktG states that the total compensation of the management is assessed by all members of the supervisory board together. With the so called "Advisory Vote", the management board can just vote for the compensation structure and not for the level of compensation (Art. 120 (4) AktG). The vote is not legally binding, but in case of a vote against the defined management structure, the supervisory board needs to substantiate its conclusion and if necessary discuss it again (Koch / Stadtmann, 2011, p. 215 et seq.).

According to Art. 87 (1) AktG, the VorstAG requires an appropriate compensation level. Appropriateness of the management compensation refers to the individual performance of each manager, the current economic situation of the company, conventionality and sustainability of the management compensation as well as long-term orientation of the calculation base. Referring to the conventionality of the management compensation, there are horizontal and vertical benchmarks. On the one hand, horizontal benchmarks refer to the usual market compensation. For comparison reasons, countries, sectors and company sizes need to be considered. On the other hand, vertical benchmarks relate to the normal compensation level within the company. Therefore, the management compensation is compared with the salary of employees on lower hierarchy levels. Regarding appropriate management compensation, it is also to be mentioned that sustainability refers to continued existence of the company, a healthy growth, positive earnings and the consideration of stakeholder interests. Moreover, for the long-term calculation base usually

a time horizon of two to five years is applied (Welge / Eulerich, 2012, p. 39; KPMG, 2009, n.p.).

Another amendment of the VorstAG concerns Art 87 (2) AktG. This states that the supervisory board has the right to intervene into existing contracts of management board members to reduce their compensation. Such a reduction is just possible in case of a deterioration of the economic situation (KPMG, 2009, n.p.). According to Art. 116 (3) AktG, a consideration is to be paid in case of an inappropriate assessment of the management compensation by the supervisory board. For reducing such a damage claim, the supervisory board can take out a so called "Directors and Officers Insurance". This is stated in Art. 93 (2) AktG. However, there is a deductible of ten percent of the damage which is limited to 1.5 times the annual salary (Koch / Stadtmann, 2011, p. 215).

### **German Accounting Standard No. 17 (DRS 17)**

The German Accounting Standards Committee is an independent institution whose tasks are to develop generally accepted accounting principles, to provide advice to legislature on accounting regulations, to represent the Federal Republic of Germany in international accounting and financial reporting bodies as well as to develop interpretations of the national and international accounting standards. Because of the ongoing discrepancies and regulatory gaps regarding VorstOG and VorstAG, DRS 17 was established in 2005 and followed by an update in 2010 to specify both management compensation laws and to ensure a uniform application of them (DRSC, 2010, pp. 3 et seqq.; Halstrick / Hainz, 2010, p. 668). The most important specifications or recommendations of DRS 17 are described in the following.

DRS 17 mainly concerns Art. 314 (1) Marginal No. 6 HGB and Art. 315 (2) Marginal No. 4 HGB. Therefore it applies to all listed and non-listed stock corporations in Germany which are required to prepare a consolidated financial statement (DRSC, 2010, pp. 6 et seq.). In the interest of transparency, DRS 17 recommends a disclosure of the information about management compensation in a separate compensation report in the context of the group management report. Regarding a clear presentation, the individualized details on management compensation should be shown in a table. Once a certain type of presentation is selected, it should be used continually. For reasons of comparability, figures of the previous year should be reported, too (DRSC, 2010, Marginal No. 10-13).

According to DRS 17, the total management compensation includes earnings for management activities in the parent company as well as in the subsidiary (DRSC, 2010, Marginal No. 14-19). The standard follows the principle of definitive increase in net worth. According to this, management compensation is just shown if a certain management activity is actually provided (Hastrick / Hainz, 2010, p. 668). However, earnings for activities as an employed person or for advisory work are not implied. Moreover, pensions are not considered as compensation, but need to be listed separately (DRSC, 2010, Marginal No. 14-19). Payments to board members that terminate their position during the business year are disclosed as part of the total compensation. In such a case, the earnings need to be deferred to the date of resignation (DRSC, 2010, Marginal No. 36).

### **Recommendations of the European Commission (EC)**

On European level, focus was already placed at an early stage on the development of adequate regulations regarding management compensation. In 2004, the European



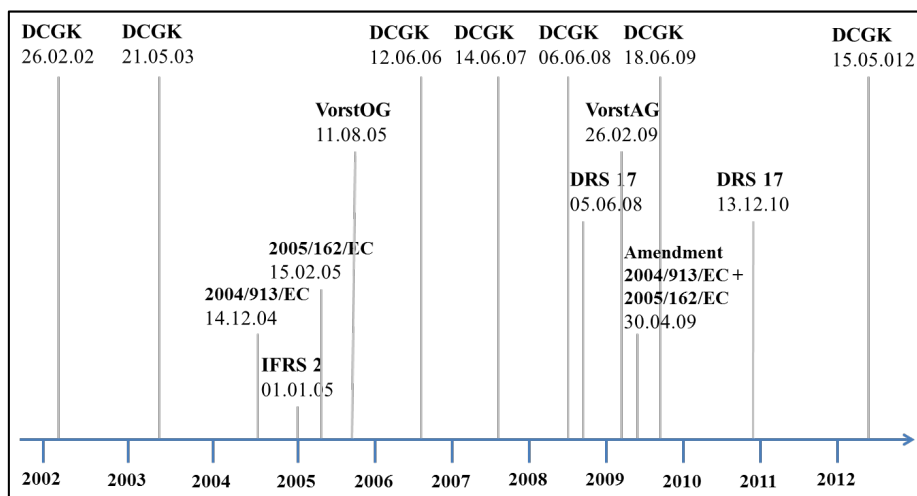
Commission established the recommendation 2004/913/EC “Regime for the remuneration of directors of listed companies”. Its objective is to ensure the transparency of management compensation of listed stock corporations in EU member states (European Commission, 2004, pp. 56 et seq.). Another recommendation followed in 2005. It is called 2005/162/EC and refers to the role of non-executive or supervisory directors of listed companies and on the committees of the supervisory board. The recommendation emphasizes the importance of independence within supervisory or administrative bodies of a company (European Commission, 2005, pp. 55 et seq.).

The financial crisis of 2008 and 2009 revealed more and more complex compensation structures and an orientation on short-term performance in the EU member states. This led to an increasing willingness of managers to take risk. The European Commission saw this development as a reason to update the recommendations on management compensation. In 2009, an amendment of 2004/913/EC and 2005/162/EC was established. Main objective of these amendments is to be more sustainable as well as long-term oriented when it comes to compensation structure and corporate governance (European Commission, 2009, p. 2). The recommendations by the European Commission are fully implemented by VorstAG in Germany (IDW, 2009, n.p.).

### International Financial Reporting Standards (IFRS)

IFRS provides just a few regulations on management compensation. Since the establishment of IFRS 2 in 2005, disclosures have been required regarding share-based compensations (IFRS 2.44-2.51). These regulations are commented by DRS 17 and therefore represent information to be disclosed in the consolidated financial statements of listed and non-listed stock corporations in Germany (DRSC, 2010, Marginal No. 74). The following graph represents a timeline in which all legal regulations and recommendations regarding management compensation in Germany are shown. They are listed according to their date of introduction or rather their date of amendment:

**Figure 2: Timeline of Legal Regulations and Recommendations regarding Management Compensation**



(own illustration based on Welge / Eulerich, 2012, p. 24)

## Data and Methodology

Beside a profound literature review and in order to obtain an insight view on the development of management compensation in German HDAX companies from 2003 to 2012, an analysis of the relevant annual reports is to be carried out. An annual report provides information about the company's activities and financial performance to shareholders and other interested people. According to VorstOG, details about management compensation can be found in the notes of the financial statement or the management report (VorstOG, 2005, p. 2,267 et seq.). Most of the companies even follow the recommendations of DRS 17 and disclose a separate compensation report (DRSC, 2010, Marginal No. 10-13).

Objects of analysis are all companies listed in HDAX from 2003 to 2012. Just companies that are listed consistently during the ten-year period can be considered. Since HDAX comprises 110 member companies of DAX, MDAX and TecDAX, a company exchanging between the three indices is still entered into the analysis. But in case of an interruption of listing, the company is excluded. Furthermore, it is required for the analysis that all accounts are in euro. Considering all of the above, there are 58 out of 110 companies meeting the requirements. The data basis consisting of 58 HDAX companies is listed in the following table. As of December 31, 2012, it shows that 29 companies refer to DAX, 23 companies to MDAX and six companies to TecDAX:

As analyzing period, the business years from 2003 to 2012 are used. Some of the HDAX companies have a business year that deviates from the calendar year. Because of this the analyzing period is extended from September 30, 2002 to February 28, 2013. A deviating business year belongs to the calendar year in which most of the months correspond.

## Descriptions

### Key Performance Indicators

Once data and methodology is determined, data collection can start. For analyzing the development of the management compensation in German HDAX companies from 2003 to 2012, the annual reports of the 58 selected HDAX companies are used. Beside some key compensation figures, there are some additional key performance indicators that are gathered to analyze the compensation development. These involve in particular earnings before interest and tax (EBIT), turnover and personnel indicators like personnel expenditures and number of employees. Each indicator is explained in more detail in the following:

### Key Compensation Figures

Referring to management compensation, the key compensation figures of all members of the management board in total as well as of the chief executive officers (CEO) are gathered. Members of the management board are all managers with an executive position within a certain business year. Compensation of former management board members who has terminated their executive position, but still retains an entitlement to benefits is not considered in the analysis. In case of a termination within an analyzed business year, the compensation is taken into account up to the date of resignation. In addition to that, severance payments in the year of resignation as well as other special payments are considered as one-time payments. The relevant data of total compensation can almost

completely collected in the annual reports of the 58 selected HDAX companies from 2003 to 2012. A recommendation for the disclosure of total management compensation data has already been given by DCGK in 2002. Because of the required declaration of conformity, data is available throughout the ten-year period under review (DCGK, 2012, p. 2). Since business year 2006, the declaration is even legally binding for all stock corporations because of the VorstOG (VorstOG, 2005, p. 2,267 et seq.).

**Table 2: Listed HDAX Companies as of December 31, 2012**



(own illustration)

Beside the total compensation, the annual payments to the CEO as the highest ranking member of the management board are gathered in the annual reports of the 58 selected HDAX companies from 2003 to 2012. Consequently, an analysis of single board members can be made. In comparison to the rest of the board, the CEO most often receives the highest annual income within a company. Regarding severance or rather one-time payments, the same conditions as mentioned above are relevant. In case of the termination of a CEO within an analyzed business year, the compensation of the predecessor is gathered until the date of resignation and the compensation of the successor is used from the date of joining on. SAP AG and Deutsche Bank AG appoint more than one CEO in certain business years. For reasons of comparability, the average annual income of the CEOs within one company is taken into account in the analysis. In general, the data of CEO compensation is more fragmentary than the data of total

management compensation. It is to be stated that just 14 of the 58 selected HDAX companies disclose their CEO payments throughout the ten-year period under review. However, the completeness increases over the years. There are three companies which do not publish even once the relevant data for the analysis. The three companies are Hugo Boss AG, Kronen AG and Südzucker AG. Furthermore, Puma AG just discloses data regarding CEO compensation in an irregular way. The incompleteness in CEO compensation refers to the lacking regulations. An individual disclosure of the CEO compensation has already been recommended by DCGK in 2002 (DCGK, 2012, p. 2), but just since business year 2006 it is legally binding by VorstOG (VorstOG, 2005, p. 2,267 et seq.). Moreover, companies can veto the individual disclosure of CEO data by a three-quarters majority of the general meeting of shareholders (DCGK, 2006, p. 7; VorstOG, 2005, p. 2,267 et seq.).

For the analysis of the present paper, the management compensation is divided into the four compensation types salary, short-term incentives, long-term incentives and other benefits. Long-term components are further differentiated into share-based and indicator-based compensation. Pensions vary widely in terms of structure and conditions within the 58 selected HDAX companies. A direct comparison is thus not possible. Therefore pensions are not considered as compensation type and remain disregarded in the present analysis.

### **Earnings before Interest and Tax (EBIT)**

In many companies, EBIT represents a target or measurement parameter regarding corporate success. Furthermore, it shows the operative earning power and therefore constitutes a central control parameter. Since EBIT is adjusted by volatile tax rates, interest expenses and other extraordinary factors, a direct comparison between companies is possible. Even the majority of the 58 selected HDAX companies is located in Germany, EADS N.V. has its headquarters in the Netherlands. EBIT is free of regional effects and therefore also an international comparison can be made (Koeder / Schmorleiz, 2004, p. 204).

Some annual reports do not show EBIT, but EBITDA, EBITA or earnings before tax. In such cases, the relevant key performance indicator is calculated manually. It is also to be mentioned that banks have another structure of their accounts. There is no EBIT or an alternative key performance indicator available. Therefore, EBIT of banks is not considered in the analysis of the present paper.

### **Turnover**

Turnover represents the sum of all products sold multiplied by their particular sales price. It shows the pure income of a company within a certain period. Beside order intake, turnover is often used as internal economic indicator of a company. Depending on the amount of turnover within a certain period, an increase or a decline of the business activities can be concluded (Coenenberg / Haller / Schultze, 1009, p. 1,050).

As already mentioned for EBIT, banks do not report turnover or an alternative key performance indicator in their annual reports. Therefore, turnover of banks is not considered in the present analysis. In addition to that, insurance companies do not publish turnover either. But instead, there is a gross premium available that can be used in the analysis as an equivalent for turnover numbers.

## Personnel Indicators

As personnel indicators, personnel expenditures and average number of employees are gathered. Both personnel indicators are required by law to be disclosed in the notes of the financial statement according to Art. 314 (1) Marginal No. 4 HGB. For this reason, most of the 58 selected HDAX companies publish the personnel indicators in their annual reports. Whereas the average number of employees can be gathered completely, the personnel expenditure of Aixtron SE in 2003 and EADS N.V. in 2012 are not provided.

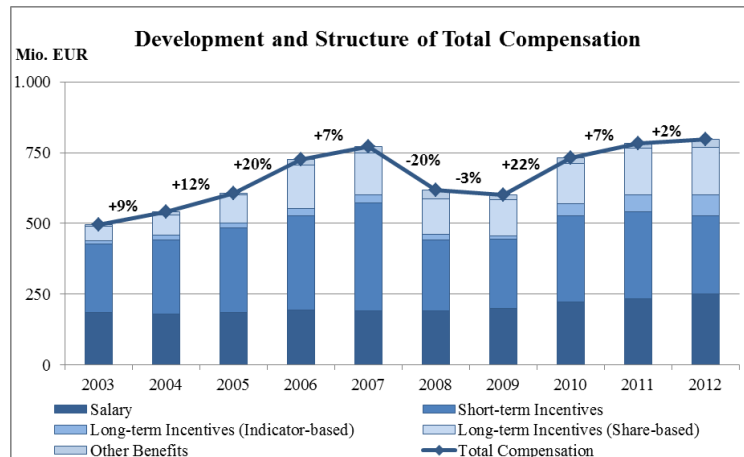
Personnel expenditures on the one hand include wages and salaries, social contributions and expenditures for pensions as well as related employee benefits. The number of employees on the other hand involves regular staff, trainees and members of the management board. It can be gathered as value at the balance sheet date or as average value. For the present analysis, the average number of employees is used because the disclosure requirement ensures continuous availability throughout the ten-year period. Furthermore, the average number of employees can be measured in headcounts or in full-time equivalents. The present analysis refers to headcounts since most of the annual reports provide this figure. In case of missing information regarding the means of measurement, it is assumed that the employee number is measured in headcounts. This inaccuracy is unavoidably entered into the present analysis.

## Research Design

Once all relevant data is gathered out of the annual reports of the 58 selected HDAX companies, the development of the management compensation from 2003 to 2012 can be analyzed. First, the overall development is considered. Afterwards, there is an analysis of the management compensation in relation to some relevant key performance indicators. In doing so, focus is laid on EBIT, turnover and personnel expenditures. Furthermore, the influence of the financial and economic crisis in 2008 and 2009 on management compensation is emphasized within each analytical part. In the following, the analyses of management compensation and the relevant key performance indicators are explained in detail:

### **Overall Development of Management Compensation in German HDAX Companies from 2003 to 2012**

In terms of the overall development of management compensation in German HDAX companies, it is analyzed how the total management compensation has developed over the period from 2003 to 2012. Moreover, the development of the compensation structure is examined over the ten-year period. The following graph shows the absolute and relative development of total management compensation as well as its segmentation into different types of compensation:

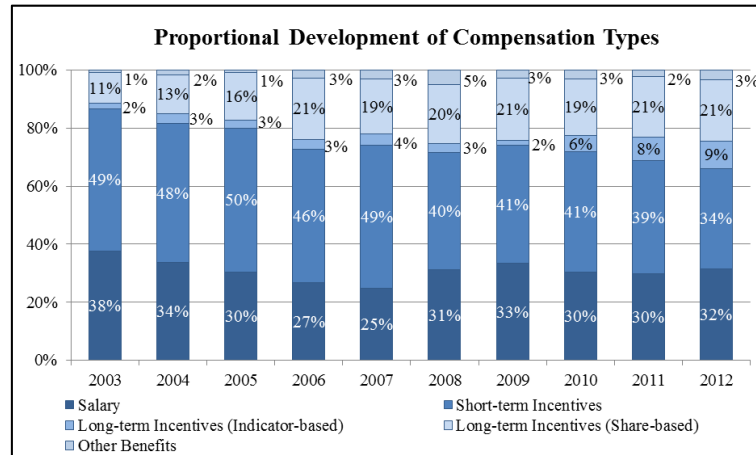
**Figure 3: Development and Structure of Total Compensation**

(own illustration)

According to the graph, there is a continuous growth in total management compensation from 2003 to 2007. Within this period, the curve shape is rather progressive and the average growth rate makes up 12 %. In 2008, there is a significant collapse of management compensation because of the financial and economic crisis. The cuts in management compensation of the 58 selected HDAX companies continue in 2009. After end of crisis, the growth of management compensation starts again, but it is not as strong as in the years before crisis. There is an average growth rate of 10 % from 2010 to 2013 which weakens from year to year. The curve shape is rather progressive.

With a total management compensation of 772.8 million euros, 2007 represents the business year with the highest pre-crisis level of compensation. During economic and financial crisis in 2008 and 2009, total management compensation shrinks to around 600 million euros. This amounts the same level as in 2005. Within a very short time after end of crisis, the compensation level of 2007 is caught up again. In 2011 and 2012, managers of German HDAX companies earn 784.2 million euros or rather 796.8 million euros. Despite a flattening growth of management compensation, the pre-crisis level is exceeded. In comparison, the year with the lowest management compensation is 2003. In this year, the managers receive just 494.5 million euros in total.

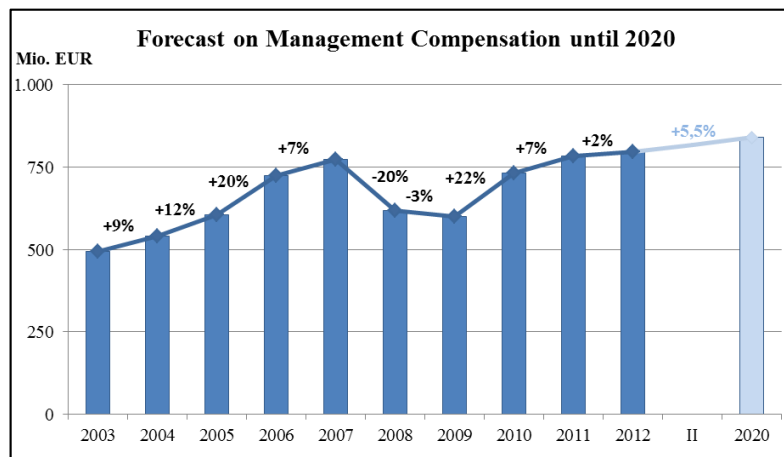
The following graph focuses not on the total management compensation level, but on its structure within the analyzing period from 2003 to 2012. The total management compensation of a year makes up 100 % and is partially divided into salary, short-term incentives, long term incentives based on shares as well as on indicators and other benefits:

**Figure 4: Proportional Development of Compensation Types**

(own illustration)

At the beginning of the analyzing period, salary represents with 38 % a pretty high proportion of total management compensation. Over the years, this proportion shrinks. During the crisis years 2008 and 2009, salary exceeds a proportion of 30 % again. This refers to the fact that the overall management compensation was reduced in these years and managers especially waived variable components of compensation what leads to a higher percentage of salary. It is notable that short-term incentives are around 50 % until 2007. But during crisis, its percentage shrinks to 40 % and since then it has not increased to pre-crisis level again. Instead, long-term incentives have become more and more relevant since crisis. Whereas long-term incentives based on shares have already increased continuously in pre-crisis years to around 20 %, also long-term incentives based on indicators have shown a growth in post-crisis years. The decrease of short-term incentives and the increase in long-term incentives are because of the establishment of VorstAG in 2010. According to the law, management compensation shall be structured more sustainable and long-term oriented (Welge / Eulerich, 2012, p. 38 et seq.). Therefore more and more long-term components are introduced into total management compensation. But despite the increasing proportion of long-term incentives, short-term incentives are still dominant when it comes to the total amount of management compensation. Thus, VorstAG shows just a limited ability to assert its regulations on management compensation in German HDAX companies. As a last point, the graph shows a continuous development of other benefits. Their proportion of total management compensation is rather low over the ten-year period.

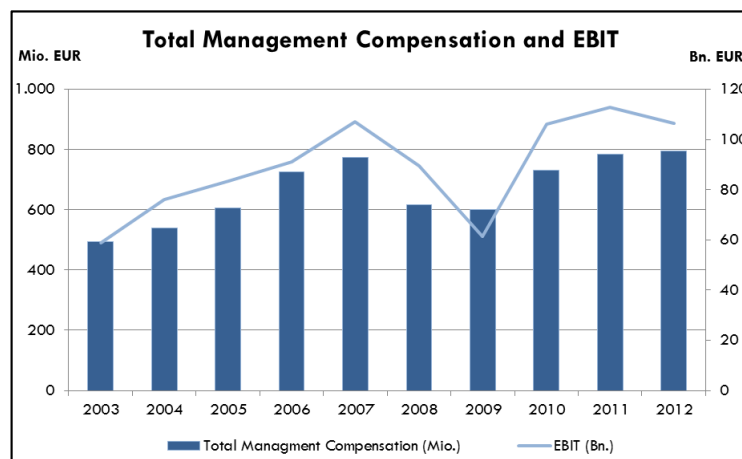
After analyzing the overall development of total management compensation in German HDAX companies from 2003 to 2012, there is a forecast to be made on the future compensation developments up to the year 2020. For doing so, a linear projection based on the existing historical data is conducted. It can be assumed that the level of management compensation will further increase over the next years. The average compensation growth rate amounts between 2003 and 2012 6.2 %. For the following nine years, this means an average growth rate of 5.5 %. Therefore, the total management compensation of the 58 selected HDAX companies will be 839.9 million euros in 2020. In the following graph, the forecast on management compensation is shown:

**Figure 5: Forecast on Management Compensation until 2020**

(own illustration)

### Development of Total Management Compensation in Relation to EBIT in German HDAX Companies from 2003 to 2012

Many companies show a parallelism between the development of total management compensation and EBIT. The total correlation of the 58 selected HDAX companies is shown in the following graph:

**Figure 6: EBIT and Total Management Compensation**

(own illustration)

Because of the existing correlation between both indicators, the next analysis focuses on the development of management compensation in relation to EBIT. For this purpose, a percentage value is calculated for each HDAX company. Since the amount of total management compensation is already considered in the calculation of EBIT, the key performance indicator needs to be adjusted. Otherwise total management compensation would enter into the percentage value twice. With the following formula, the percentage value is calculated:



**Equation 1: Total Management Compensation in Relation to EBIT**

$$\frac{\text{Total Management Compensation}}{\text{Adjusted EBIT}} \text{ in \%}$$

(own illustration)

The percentage value states how much of the operative results the shareholders of a particular HDAX company are willing to pay for their managers per year. The following table shows the percentage value of each selected HDAX company from 2003 to 2012 as well as its average per year. It needs to be taken into account that the two banks are not entered into the present analysis because of the missing key performance indicator in their annual reports. In addition to that, negative operative results are not considered because that would mean a lack of comparability.

Over the ten-year period, a German manager earns on average 2.2 % of the operative result. The highest average percentage value shows the business year 2007 (3.9 %). This high figure can be mainly attributed to companies like Aixtron SE, Merck KGaA, EADS N.V., Infineon Technologies AG and Kontron AG. The percentage values of these companies are all higher than ten percent. In contrast, business year 2008 shows the lowest average percentage value (0.3 %). In this year, no HDAX company pays management compensation on a double-digit level.

Regarding management compensation of single HDAX companies, there is a range between a minimum of 0.1 % and a maximum of 25.0 %. The highest relation between total management compensation and EBIT is represented by Aixtron AG in 2006. But the company pays also management compensation on a double-digit level in 2004 (15.7 %) and 2007 (13.6 %). However, it stands out that in other business years there is no calculation possible because of a negative EBIT. In comparison to other German HDAX companies, managers of Aixtron AG are paid more than average. Therefore the appropriateness of the compensation level is to be questioned. Worth mentioning is also the paid management compensation of Rheinmetall AG in 2009. In the crisis year, the total management compensation represents 22.2 % of EBIT. Considering the economic situation of Rheinmetall AG and a collapse of EBIT from 200 million euros to 15 million euros in 2009, the appropriateness of the compensation level is to be questioned, too. In any case, a cut in management compensation could be justified.

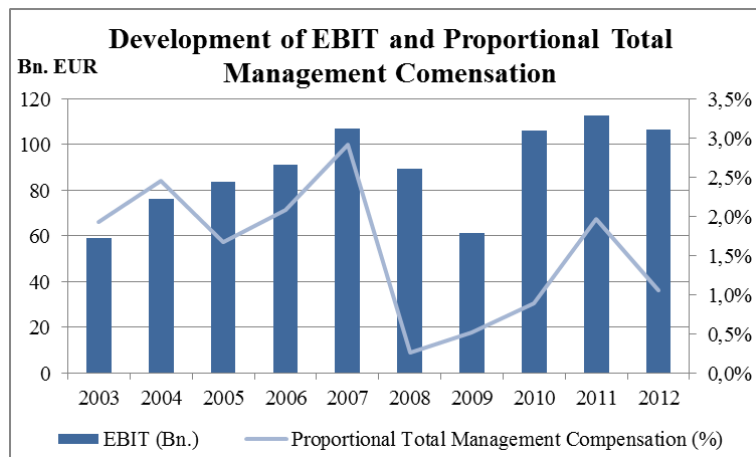
**Table 3: Total Management Compensation in Relation to EBIT**

(own illustration)

Reasons for the high compensation levels can be found in the company sizes. Both Aixtron AG and Rheinmetall AG are rather small companies within the 58 selected HDAX companies. The level of management compensation is not in proportion to EBIT. Therefore it can be stated that the smaller a company, the higher is the proportion of the operative result the shareholders are willing to pay for their managers (Götz / Friese, 2012, p. 420). To support the above statement, a large company is to be analyzed next. In terms of absolute key compensation indicators, managers of Volkswagen AG are among the top earners in Germany. But by considering relative compensation indicators, a different statement can be made. According to the table above, the percentage value of Volkswagen AG is below average over the entire analyzing period. The car manufacturer represents no outlier when it comes to total management compensation in relation to EBIT. In this case, smaller companies like Aixtron AG or Rheinmetall AG are more noticeable. Perhaps, an orientation on relative key compensation indicators may relax the ongoing public debates.

Beside the consideration of single HDAX companies, an overall view of the development of total management compensation in relation to EBIT is given next. The following graph shows the development of EBIT in comparison to the percentage value of the present analysis:

**Figure 7: Development of EBIT and Proportional Total Management Compensation**



(own illustration)

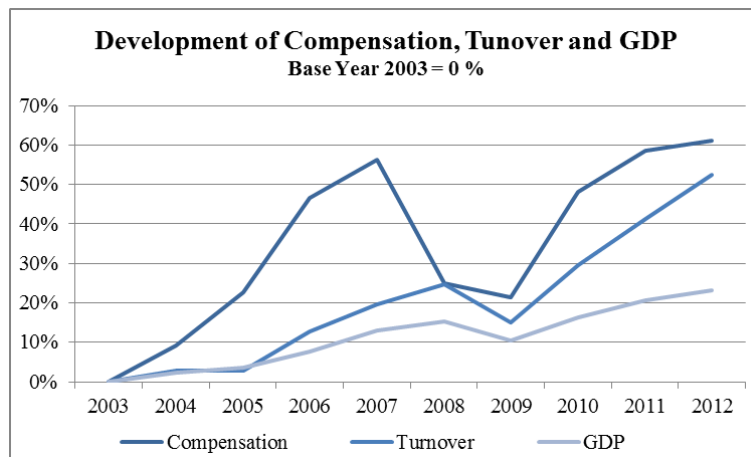
According to the graph, the compensation proportion of EBIT differs from the development of absolute EBIT figures. There is no proportional correlation. For example, there is a cut in proportional total management compensation even though EBIT continually grows in 2005. In addition to that, whereas EBIT declines slightly in 2008 and continue to shrink in 2009, there is a significant collapse of the compensation proportion in 2008, but already a moderate recovery in 2009. After crisis, EBIT increases to pre-crisis level again. But managers of German HDAX companies do not earn the same proportional total management compensation as before crisis.

### **Development of Total Management Compensation in Comparison to Turnover of German HDAX Companies from 2003 to 2012**

Turnover is chosen as one of the relevant key performance indicators because of its use as an internal economic indicator of a company. An increase in turnover implies growing demand and a decline in turnover indicates a difficult economic situation for the company (Coenberg / Haller / Schultze, 2009, p. 1,050). Beside the internal economic situation, also the overall economic situation is to be analyzed. For such an external comparison, the gross domestic product (GDP) is usually used. GDP is a measurement of the economic performance of a country. A change in GDP indicates economic growth or rather regression (Destatis, 2013a, n.p.). The GDP data for the present analysis refers to current prices (Destatis, 2013b, n.p.).

Eventually, the development of the internal as well as external economic indicators is compared with the development of the total management compensation of the 58 selected HDAX companies from 2003 to 2012. For the analysis, 2003 represents the base year. In this year, no change is shown in the three figures analyzed. The following graph shows the development of management compensation and turnover of the 58 selected HDAX companies as well as the development of the GDP from 2002 to 2012:

**Figure 8: Development of Compensation, Tunover and GDP**



(own illustration)

According to the graph, at the beginning of the analyzing period turnover and GDP develop in the same way. However, since 2005 the economic trend of the 58 selected HDAX companies has been stronger than of the overall economy. All in all, turnover and GDP perform in parallel over the ten-year period. Both turnover and GDP are at their lowest in 2009. Although 2008 is already known as crisis year, companies as well as the overall economy still perform well because of a high level of orders companies can live on. Therefore, 2008 even shows a peak just before the collapse in 2009 because of the financial and economic crisis. In post-crisis year, turnover rises significantly whereas GDP just increases moderately.

The development of the total management compensation exceeds the development of turnover and GDP over the entire analyzing period. There is an exorbitant increase until 2007. In contrast to the economic indicators, total management compensation indicates the crisis already in 2008. This is because of the early reaction of some members of the management board or supervisory board of some of the 58 selected HDAX companies when it comes to cuts in management compensation because of the difficult economic situation. For example, Deutsche Bank AG waived all performance-related types of compensation in 2008 (Deutsche Bank AG Annual Report, 2008, p. 53). Like turnover and GDP, total management compensation is at its lowest in 2009. However, total management compensation is never below the economic indicators. Whereas in 2007 the CEO of a German HDAX company earns on average 4 million euros, in 2008 the earnings shrink to 3 million euros. In spite of cuts in total management compensation because of the crisis, German CEOs still receive a decent annual income. In post-crisis years, total management compensation rises much stronger than turnover and GDP. The compensation level of the peak year 2007 is already reached again in 2011. However, a flattening of the compensation curve has been visible since 2011.

### **Development of CEO Compensation in Relation to Personnel Expenditures of German HDAX Companies from 2006 to 2012**

Since the establishment of the VorstAG in 2010, conventionality of the management compensation is to be considered with regard to horizontal and vertical benchmarks. Whereas horizontal benchmarks refer to the usual market compensation, vertical benchmarks relate to the normal compensation level within a company (Welge / Eulerich, 2012, p. 39; KPMG, 2009, n.p.). The following analysis focuses on the vertical benchmark. In doing so, the CEO compensation is compared with the average personnel expenditures

per employee within a particular HDAX company. Thereby a coefficient is determined like in the following formula. The coefficient states how much a CEO earns more than an average qualified employee in a particular HDAX company:

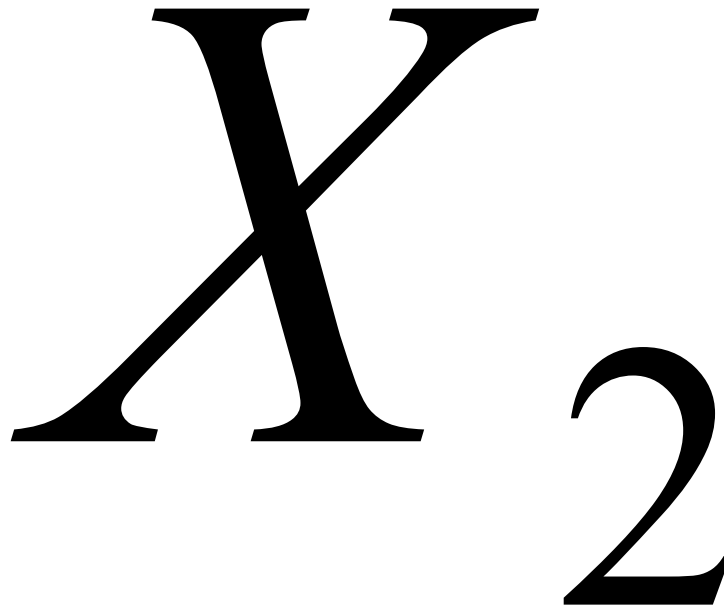
### Equation 2: CEO Compensation in Relation to Personnel Expenditures

$$\frac{\text{CEO Compensation}}{\text{Average Personnel Expenditure}} \text{ as Coefficient}$$

(own illustration)

For the first time, the disclosure of individual CEO compensation has been legally binding with the establishment of the VorstOG in 2006 (VorstOG, 2005, p. 2,267 et seq.). Before, data is provided just sporadically. Therefore the analysis of CEO compensation and average personnel expenditures in German HDAX companies starts in 2006. The following table shows the coefficient of each selected HDAX company from 2006 to 2012 as well as the average per company and per year:

Over the seven-year period, the CEO compensation in German HDAX companies is on average 56 to 78 times higher than the earnings of an average qualified employee. The highest coefficient shows the business year 2007 (78) and the lowest the business year 2009 (56). For an adequate overall statement of the development of CEO compensation in relation to average personnel expenditures, there are not enough data available and the analyzing period needs to be extended. There is an increase in the coefficient from 2006 to 2007. But if this increase has already been continuously before is not visible. Only during crisis in 2008 and 2009 the coefficient falls below 70. In post-crisis years, it exceeds 70 marginally and stays on this level.

**Table 4: CEO Compensation in Relation to Personnel Expenditures**

(own illustration)

The coefficient shows a wide range within the 58 selected HDAX companies. The highest coefficient comes from Puma SE in 2006 (573) and the lowest from Aixtron SE in 2012 (5). The high CEO compensation level of Puma SE depends on the payment of some long-term incentives out of special compensation programs (Puma SE Annual Report, 2007, p. 51). Beside Puma SE, Volkswagen AG shows a remarkable average coefficient (201) over the seven-year period, too. In 2008, the high coefficient of Volkswagen AG refers to the exercise of all existing stock options. From that point on the compensation structure of the car manufacturer's management has been changed. The long-term incentives are no longer share-based, but indicator-based and strategic oriented (Volkswagen AG Annual Report, 2008, p. 103). Before the change in compensation structure, the coefficient lays below 70. After the change, it increases to far above 100. In 2011, the CEO of Volkswagen AG even earns 332 times more than one of its average qualified employees. There are also other companies whose average coefficient is over 100. As an example, Adidas AG, Daimler AG, Deutsche Post AG, Fresenius Medical Care AG und Co.KGaA, Linde AG, Metro AG, Siemens AG and TUI AG can be named.

It is also to be mentioned that the coefficient of Commerzbank AG is just 8 in 2008 and the following years. In other business years the CEO of Commerzbank AG earns 20 times more than an average qualified employee. The low coefficient refers to the difficult economic situation of the bank during the crisis in 2008 and 2009. It received financial help by a special fund for financial market stabilization. As long as using this fund, Commerzbank AG was not allowed to pay more than 500 thousand euros to their

members of the management board. The bank made use of the fund from 2009 to 2011 (Commerzbank AG Annual Report, 2011, pp. 43 et seqq.). Also Deutsche Bank AG, the second bank within the 58 selected HDAX companies, shows voluntary cuts on management compensation during crisis. Members of the management board waved all performance-related types of compensation in 2008 (Deutsche Bank AG Annual Report, 2008, p. 53). By comparing both banks, the coefficient of Commerzbank AG is much lower than the one of Deutsche Bank AG. Just in 2012, both banks approximate.

According to the analysis, there is a wide range of coefficients regarding CEO compensation in relation to average personnel expenditures within the 58 selected HDAX companies. This is because the personnel expenditures of a company usually depends on the number as well as the qualification level of its employees (Götz / Friese, 2010, p. 419). Since the 58 selected HDAX companies differ widely in those two factors, a comparison within the companies is difficult. Even a comparison within a certain industry or a certain indices is just partially applicable. Whereas the two banks can be compared well regarding their CEO compensation, for example a comparison between Aixtron SE and Siemens AG, which both belong to the technology sector, is not possible. A company like Aixtron SE with 723 employees cannot be contrasted with a concern like Siemens AG with more than 400 thousand employees. All in all, the appropriateness of CEO compensation in terms of conventionality within a horizontal benchmark is hardly to be analyzed because of the strong distinctions between the 58 selected HDAX companies.

### Reasons for the Development of Management Compensation in German HDAX Companies

The present analysis on the development of management compensation in German HDAX companies from 2003 to 2012 reveals a general increase in the annual income of German managers. Therefore it can be assumed that there is just a minor impact of legal regulations and voluntary measures on the development of management compensation in German corporations. Now the question is to be answered why the annual income of German managers has been increased over the analyzing period and will probably continue to rise in future.

There are several possible reasons for the increase in management compensation in German HDAX companies. The reasons are shown in an overview in in the following graph and explained in more detail afterwards:

**Figure 9: Reasons for the Development of Management Compensation**



(own illustration based on Koch / Raible / Stadtmann, 2012, pp. 110 et seqq.; Maug / Albrecht, 2011, pp. 861 et seqq.)

Although most laws on management compensation intend to limit its level, there are also legal regulation that accelerated the increase of management compensation in past. For example, share options were not allowed to be used as components of management compensation for a long time. In 1998, the German Corporate Sector and Supervision Transparency Act (KonTraG) were introduced to simplify the compensation structure of German stock corporations. Since then, share options can be used to provide incentives for German managers. As a result, together with the proportion of share-based compensation, the total level of management compensation has been increased (Koch / Raible / Stadtmann, 2012, pp. 110 et seqq.).

Globalization can also be named as one of the reasons for the increasing level of management compensation. Within the global market, economic interdependencies as well as the economy as a whole becomes more and more comprehensive and complex. Therefore managers need to act in a more challenging surrounding. The upgrade of management activities leads to the demand for a higher reward by managers (Koch / Raible / Stadtmann, 2012, p. 111).

But not just the field of management activities is influenced by globalization, many companies get the opportunity to expand their businesses in the global market and therefore to increase their company sizes. Larger companies usually appoint more than one member in the management board (Koch / Raible / Stadtmann, 2012, p. 111). Furthermore, more focus is laid on abilities and talents. This is because a highly qualified manager is connected with the success of an organization. For top managers, international competition can be observed on the labor market. This is also known as "War on Talents". Therefore large companies usually offer high compensations to acquire and retain top managers (Maug / Albrecht, 2011, pp. 861 et seqq.).

Another reason for the increasing level of management compensation are the numerous mergers and acquisitions between German and US companies. As an example, the corporate merger of Daimler AG and Chrysler Group LLC can be named. Consequently, compensation structure as well as the level of compensation is adapted to the new corporate standards. Since the annual income of managers is higher in the US than in Germany, a corporate merger implies an adaption of the German compensation level to the higher US standard (Koch / Raible / Stadtmann, 2012, p. 111).

Finally, institutional investors affect the level of management compensation, too. By investing, they gain a lot of influence on the management and corporate governance of a corporation. Existing managers are often replaced. The new managers usually receive high compensation offers. Therefore the compensation level in Germany has been increased (Koch / Raible / Stadtmann, 2012, p. 111).

## **Conclusion**

The present paper analyzes the development of management compensation in German HDAX companies from 2003 to 2012. Thereby, focus is laid on the three research questions as described earlier. In summary, they can be answered in the following way:



By analyzing the development of the total management compensation, a general increase can be identified. However, there is a sharp decline in the years 2008 and 2009 because of the financial and economic crisis. In comparison with turnover and GDP, the cuts in management compensation of German HDAX companies are not as significant. The establishment of laws on management compensation can be seen in structural changes. For example, since the establishment of VorstAG in 2010, the percentage of long-term incentives has been increased. After crisis, the level of management compensation quickly and strongly increased to pre-crisis level. But there has been a flattening of the compensation curve for the last years of the analyzing period.

German CEOs often earn a multiple of the annual income of an average qualified employee. This reveals the comparison between CEO compensation and the average personnel expenditures of the 58 selected HDAX companies. Most public debates bases on these pay differences. However, the analysis of the relation of total management compensation and EBIT changes the situation. According to the percentage value, small companies pay usually higher proportions of the profit to their managers than large companies.

All in all, the question is still open if German corporations will react on the ongoing public debates and adapt the structure as well as the level of management compensation in near future. Reasons for a further increase in a manager's annual income are given in the present paper. Among others, share-based compensation, globalization, mergers and acquisitions and institutional investors accelerate the growth in management compensation. For stemming a further increase, there are several limitation possibilities regularly discussed in public. Such possibilities can be caps on compensation or pensions, more voting rights for shareholders or higher taxation of management compensation, to name only a few of them (Hexel, 2012, pp. 142 et seqq.).

Despite of all limitation possibilities, it is up to German politics and legislature to limit the level of management compensation. The next step could be made by the governmental commission. It could publish a recommendation on the limitation of management compensation in German corporations in the DCGK. Without governmental support, the level of management compensation will probably excessively grow further in the following years.

## References

- Becker, F.G. & Kramarsch, M.H., 2006. *Leistungs- und erfolgsorientierte Vergütung für Führungskräfte*. Göttingen: Hogrefe Verlag.
- Bortenlänger, C. & Kirstein, U., 2011. *Börse für Dummies*. Weinheim: Wiley-VCH Verlag.
- Brühl, R., 2009. *Controlling: Grundlagen des Erfolgscontrollings*. München: Oldenbourg Verlag.
- Coenenberg, A.G., Haller, A. & Schultze, W., 2009. *Jahresabschluss und Jahresabschlussanalyse. Betriebswirtschaftliche, handelsrechtliche, steuerrechtliche und internationale Grundsätze – HGB, IFRS, US-GAAP*. 21<sup>st</sup> ed. Stuttgart: Schäffer-Poeschel Verlag.
- Deutsche Börse Group, 2013a. *Börsenlexikon: MDAX*. [Online] Frankfurt am Main: Deutsche Börse AG (2013). Available at: <http://deutsche-boerse.com/dbg/dispatch/de/kir/>

[dbg\\_nav/about\\_us/30\\_Services/40\\_Know\\_how/10\\_Stock\\_Exchange\\_A\\_Z?glossaryWord=PI\\_glos\\_MDAX](http://dbg_nav/about_us/30_Services/40_Know_how/10_Stock_Exchange_A_Z?glossaryWord=PI_glos_MDAX) [Accessed 31 May 2013].

Deutsche Börse Group, 2013b. *Börsenlexikon: TecDAX*. [Online] Frankfurt am Main: Deutsche Börse AG (2013). Available at: [http://deutsche-boerse.com/dbg/dispatch/de/kir/dbg\\_nav/about\\_us/30\\_Services/40\\_Know\\_how/10\\_Stock\\_Exchange\\_A\\_Z?glossaryWord=pi\\_glos\\_TecDAX](http://deutsche-boerse.com/dbg/dispatch/de/kir/dbg_nav/about_us/30_Services/40_Know_how/10_Stock_Exchange_A_Z?glossaryWord=pi_glos_TecDAX) [Accessed 31 May 2013].

DRSC, 2010. *Deutscher Rechnungslegungs Standard Nr. 17. Berichterstattung über die Vergütung der Organmitglieder (geändert 2010)*. [Online] Berlin: Deutsches Rechnungslegungs Standards Committee e.V. (2013). Available at: [http://www.drsc.de/docs/press\\_releases/2010/drs17\\_geaend2010\\_nearfinal.pdf](http://www.drsc.de/docs/press_releases/2010/drs17_geaend2010_nearfinal.pdf) [Accessed 10 May 2013].

European Commission, 2004. Empfehlung der Kommission vom 14. Dezember 2004 zur Einführung einer angemessenen Regelung für die Vergütung von Mitgliedern der Unternehmensleitung börsennotierter Gesellschaften. *Amtsblatt der Europäischen Union*, 29 December 2004, pp. 56-59. Available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:385:0055:0059:DE:PDF> [Accessed 18 May 2013].

European Commission, 2005. Empfehlung der Kommission vom 15. Februar 2005 zu den Aufgaben von nicht geschäftsführenden Direktoren/Aufsichtsratsmitgliedern börsennotierter Gesellschaften sowie zu den Ausschüssen des Verwaltungs-/Aufsichtsrats. *Amtsblatt der Europäischen Union*, 25 February 2005, pp. 51–63. Available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:052:0051:0063:DE:PDF> [Accessed 18 May 2013].

European Commission, 2009. Empfehlung der Kommission zur Ergänzung der Empfehlungen 2004/913/EG und 2005/162/EG zur Regelung der Vergütung von Mitgliedern der Unternehmensleitung börsennotierter Gesellschaften. Available at: [http://ec.europa.eu/internal\\_market/company/docs/directors-remun/directorspay\\_290409\\_de.pdf](http://ec.europa.eu/internal_market/company/docs/directors-remun/directorspay_290409_de.pdf) [Accessed 18 May 2013].

Fockenbrock, D., 2013. Reich werden. *Handelsblatt*, 22-24 March 2013, pp. 52 et seq.

Fohlmeister-Tiede, B., 2000. *Leistungsabhängige Vergütung im Innendienst von Erstversicherungsunternehmen*. Karlsruhe: Verlag Versicherungswirtschaft.

Freiburg, S., 2006. *Managergehälter und Lohngerechtigkeit. Hintergründe, Strukturen, Ethik*. Saarbrücken: VDM Verlag Dr. Müller.

Goethe von, J.W., 2000. *Faust. Der Tragödie erster Teil*. Original version 1878. Stuttgart: Verlag Reclam.

Götz, A. & Friese, N., 2012. Vorstandsvergütung im DAX und MDAX – Fortsetzung der empirischen Analyse 2011 nach Einführung des Vorstandsvergütungsangemessenheitsgesetzes. *Corporate Finance biz*. August 2012, pp. 414-424.

Gutmann, J. & Klose, I., 2005. *Vergütung: Wie Sie Mitarbeiter leistungsgerecht bezahlen*. Freiburg: Haufe-Lexware Verlag.

Halstrick, M. & Hainz, G., 2010. Neuregelung des Deutschen Rechnungslegung Standards DRS 17. *Arbeit und Arbeitsrecht*. November 2010, pp. 668-670.

Hexel, D., 2012. Drei Jahre VorstAG – Bilanz und Perspektive der Vorstandsvergütung. *Der Aufsichtsrat*. October 2012, pp. 142-144.

Hungenberg, H., 2011. *Strategisches Management in Unternehmen: Ziele - Prozesse - Verfahren*. Wiesbaden: Gabler Verlag.

IDW, 2009. *Bundesregierung: VorstAG entspricht EU-Vorgaben. Meldung vom 31.07.2009*. [Online] Düsseldorf: IDW Verlag GmbH (2013). Available at: <http://www.idw.de/idw/portal/d592298> [Accessed 23 May 2013].

Jung, H., 2006. *Allgemeine Betriebswirtschaftslehre*. München: Oldenbourg Verlag.

Koch, R. / Raible, K.F. & Stadtmann, G., 2012. Vorstandsvergütung in Deutschland. Hält der Höhenflug an oder ist eine Trendwende in Sicht? *Zeitschrift Führung und Organisation*. 81 (2), pp. 110-117.

Koch, R. & Stadtmann, G., 2011. Das Gesetz zur Angemessenheit der Vorstandsvergütung. *Zeitschrift für Wirtschaftspolitik*. 60 (2), pp. 212-239.

Koeder, K.W. & Schmorleiz, W., 2004. *Jahresabschluss. Eine visualisierte Einführung*. 6<sup>th</sup> ed. Stuttgart: Verlag Lucius & Lucius.

KPMG, 2009. *Auf einen Blick: Die neue Vorstandsvergütung*. [Online] Frankfurt am Main: KPMG AG (2013). Available at: [http://www.kpmg.de/docs/20090701\\_Die\\_neue\\_Vorstandsverguetung.pdf](http://www.kpmg.de/docs/20090701_Die_neue_Vorstandsverguetung.pdf) [Accessed 10 May 2013].

Kramarsch, M.H., 2000. *Aktienbasierte Managementvergütung*. Stuttgart: Schäffer-Poeschel Verlag.

Lazar, C., 2007. *Managementvergütung, Corporate Governance und Unternehmensperformance: Eine Modelltheoretische und Empirische Untersuchung*. Heidelberg: Springer Verlag.

Maug, E./ Albrecht, B., 2011. Struktur und Höhe der Vorstandsvergütung: Fakten und Mythen. *Schmalenbachs Zeitschrift für betriebswirtschaftliche Forschung*. December 2011, pp. 858-881.

Maurer, C., 2011. *Top-Managementvergütung in DAX 30-Unternehmen: Eine empirische Analyse unter besonderer Würdigung der Anforderungen des Deutschen Corporate Governance Kodex*. München: GRIN Verlag.

Middendorf, C., 2005. *Klinisches Risikomanagement*. Münster: LIT Verlag.

DCGK, 2002. *Der Deutsche Corporate Governance Kodex in der Fassung vom 26. Februar 2002*. [Online] Frankfurt am Main: Regierungskommission Deutscher Corporate Governance Kodex (2013). Available at: [http://www.corporate-governance-code.de/ger/download/DCG\\_K\\_D20020223.pdf](http://www.corporate-governance-code.de/ger/download/DCG_K_D20020223.pdf) [Accessed 7 May 2013].

DCGK, 2003. *Der Deutsche Corporate Governance Kodex in der Fassung vom 21. Mai 2003*. [Online] Frankfurt am Main: Regierungskommission Deutscher Corporate Governance Kodex (2013). Available at: [http://www.corporate-governance-code.de/ger/download/DCG\\_K\\_D200305.pdf](http://www.corporate-governance-code.de/ger/download/DCG_K_D200305.pdf) [Accessed 7 May 2013].

DCGK, 2006. *Der Deutsche Corporate Governance Kodex in der Fassung vom 12. Juni 2006*. [Online] Frankfurt am Main: Regierungskommission Deutscher Corporate Governance Kodex (2013). Available at: [http://www.corporate-governance-code.de/ger/download/D\\_CorGov\\_Endfassung\\_Juni\\_2006.pdf](http://www.corporate-governance-code.de/ger/download/D_CorGov_Endfassung_Juni_2006.pdf) [Accessed 7 May 2013].

DCGK, 2007. *Der Deutsche Corporate Governance Kodex in der Fassung vom 14. Juni 2007*. [Online] Frankfurt am Main: Regierungskommission Deutscher Corporate Governance Kodex (2013). Available at: [http://www.corporate-governance-code.de/ger/download/D\\_Kodex\\_2007\\_final.pdf](http://www.corporate-governance-code.de/ger/download/D_Kodex_2007_final.pdf) [Accessed 7 May 2013].

DCGK, 2009. *Der Deutsche Corporate Governance Kodex in der Fassung vom 18. Juni 2009*. [Online] Frankfurt am Main: Regierungskommission Deutscher Corporate Governance Kodex (2013). Available at: [http://www.corporate-governance-code.de/ger/download/kodex\\_2009/D\\_CorGov\\_Endfassung\\_Juni\\_2009.pdf](http://www.corporate-governance-code.de/ger/download/kodex_2009/D_CorGov_Endfassung_Juni_2009.pdf) [Accessed 7 May 2013].

DCGK, 2012. *Der Deutsche Corporate Governance Kodex in der Fassung vom 15. Mai 2012*. [Online] Frankfurt am Main: Regierungskommission Deutscher Corporate Governance Kodex (2013). Available at: [http://www.corporate-governance-code.de/ger/download/kodex\\_2012/D\\_CorGov\\_Endfassung\\_Mai\\_2012.pdf](http://www.corporate-governance-code.de/ger/download/kodex_2012/D_CorGov_Endfassung_Mai_2012.pdf) [Accessed 7 May 2013].

Schierenbeck, H., 2003. *Grundzüge der Betriebswirtschaftslehre*. München: Oldenbourg Verlag.

Destatis, 2013a. *Bruttoinlandsprodukt (BIP)*. [Online] Wiesbaden: Statistisches Bundesamt (2013). Available at: <https://www.destatis.de/DE/Meta/AbisZ/BIP.html> [Accessed 11 June 2013].

Destatis, 2013b. *Volkswirtschaftliche Gesamtrechnung. Bruttoinlandsprodukt in jeweiligen Preisen und preisbereinigt*. [Online] Wiesbaden: Statistisches Bundesamt (2013). Available at: <https://www.destatis.de/DE/ZahlenFakten/Indikatoren/Konjunkturindikatoren/VolkswirtschaftlicheGesamtrechnungen/vgr111.html> [Accessed 11 June 2013].

Stock-Homburg, R., 2010. *Personalmanagement: Theorien- Konzepte - Instrumente*. Heidelberg: Springer Verlag.

Strieder, T., 2005. *DCGK. Deutscher Corporate Governance Kodex Praxiskommentar*. Berlin: Erich Schmidt Verlag.

VorstAG, 2009. *Gesetzesbeschluss des Deutschen Bundestages. Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG) vom 19.06.2009*. [Online] Berlin: Deutscher Bundestag (2013). Available at: <http://dip21.bundestag.de/dip21/brd/2009/0592-09.pdf> [Accessed 10 May 2013].

VorstOG, 2005. *Gesetz über die Offenlegung der Vorstandsvergütungen (Vorstandsvergütungs-Offenlegungsgesetz – VorstOG) vom 3. August 2005. Bundesgesetzblatt*. 10 August 2005, pp. 2.267 et seqq. Available at: [http://www.bmj.de/SharedDocs/Downloads/DE/pdfs/Gesetz\\_ueber](http://www.bmj.de/SharedDocs/Downloads/DE/pdfs/Gesetz_ueber)

[die\\_Offenlegung\\_der\\_Vorstandsverguetungen.pdf?\\_\\_blob=publicationFile](#) [Accessed 10 May 2013].

Welge, M.K. & Eulerich, M., 2012. *Corporate-Governance-Management. Theorie und Praxis der guten Unternehmensführung*. Wiesbaden: Gabler Verlag.

Werder von, A., 2008. *Führungsorganisation. Grundlagen der Corporate Governance, Spitzen- und Leitungsorganisation*. 2<sup>nd</sup> ed. Wiesbaden: Gabler Verlag.

The annual reports of the 58 selected HDAX companies from 2003 to 2012 are not listed in the references above. They are provided on the official homepage of each company and can be looked up there.

## A Critical Corporate Social Responsibility (CSR) Timeline: how should it be understood now?

**Lucy Hack**

Leeds Metropolitan University, UK

**Alexandra J Kenyon**

Leeds Metropolitan University, UK

**Emma H Wood**

Leeds Metropolitan University, UK

### Abstract

CSR continues to gain high regard by scholars and stakeholders despite the fact it has no fixed definition. Indeed CSR definitions and/or purpose alter daily according to business aims, industry practices and to 'fit' the purpose of academia. The purpose of this research paper, therefore, is to critique the definitions of CSR from the 1950's to the present day, to ascertain the changing dynamics, emphasis and words used to embrace such a powerful notion.

Bowen (1950) recognised CSR as lines of philanthropic action, which abide by the values of society. However, Frederick (1960) and Davis (1960) later dismissed this wholly philanthropic approach. Running alongside the 'admirers' of CSR, Friedman (1970) argued that CSR is vague and foolish, as society overestimates the suggested competitive advantage unless responsible business directly relates to profit. As a solution, later authors such as Carroll (1999) see CSR as a competitive tool, which evidences responsible actions, with potential to tackle issues unrelated to their products. The 1980's and 90's saw a plethora of changing definitions as the purpose of CSR continued to ignite interest in governments, NGOs and businesses who began to see a move from responsible actions; towards competitive, individualised responsible actions.

It was concluded that the definition of CSR began as a fairly intangible, ambiguous concept. As businesses have increased in size and economic autonomy, attempts to be comprehensive in CSR efforts have increased. This paper concludes that CSR has become a multi-quantifiable tool to represent responsible business activities, with direct links to annual accounting reports and performance indicators. To date, the definition of CSR appears to reflect individual businesses rather than all corporations, and their relationship with stakeholders and society.

**Key Words:** Corporate social responsibility, definition, history.

### Introduction

According to Okoye (2009, pg.613) corporate social responsibilities (CSR) are an attractive area of research with noteworthy *'implications for academia, industry and society.'* Despite the attractiveness of this topic and an abundance of academic discussion on it; there still remains a significant lack of consensus regarding the correct or universal definition of CSR (Font et al, 2012). The term is not a new concept (Taneja, Taneja and Gupta, 2011) and it has continually evolved over time to fit the purpose of the work of different academics (Bebbington, 2001), and remain in line with that which corporations determine as their *'role'* within society (Argandona and Hoivik, 2009, pg.222).

Interestingly, businesses are regularly made aware of their social responsibilities, as they are pressurised to meet the social and environmental expectations of stakeholders and/or society (Salama, Dixon and Habbash, 2012). In fact, governments are regularly engaging in discourse and working with organisations to bring CSR onto political and business agendas (Albareda et al 2008). It seems, therefore, as Hopkins (2003, pg.10) proposes that a comprehensive understanding of CSR must consider all ‘*stakeholders*,’ which includes everyone and everything impacted by individual businesses; the people and the environment. Past attempts at achieving an all-encompassing definition have turned into hesitant and vague statements (Dahlsrud, 2008), and businesses have attempted to individualise their own definition of CSR to match their agenda, both of which are criticised for adhering to certain CSR definitions without a fully understanding its relevance (Okoye, 2009), or worse making false or inaccurate claims (Reich, 2008). For Holcomb, Upchurch and Okumus (2007, pg.462) the common ground amongst these debates is that corporations recognise they should integrate socially responsible activities into their business strategy; but it is not yet clear on what they should do. Therefore, individual businesses relate to CSR in different ways, and this prevents ‘*productive engagements*’ (Okoye, 2009; Dahlsrud, 2008, pg.1). To try to overcome this, this paper provides a critique of the definitions of CSR from the 1950’s to present, to establish the changing aspects, recognise the work of authors more sceptical of CSR and provide a précis of definitions that represent CSR in the 21<sup>st</sup> Century.

### The 1950s and 60s

The notions of sustainability and social responsibility date back over a century for example, business people such as ‘Sir Titus Salt’ providing social benefits for their workforce in Saltaire, West Yorkshire (Smith, 2003). However, academic literature concerning the responsibilities of corporations largely came to the fore during the 1950’s, with authors such as Bowen (1953) boldly claiming that as corporations grow and more importantly ‘go global,’ so does their use and impact on the planet’s resources (Blindheim and Langhelle, 2010). This is mirrored by Spencer (1958) who over 50 years ago recognised that changes in technology and increase in the size of businesses have altered the managerial role, and that their biggest challenge is not making profit, but to create ‘*social action*.’ Therefore, during the 50s and 60s philanthropy, or ‘*community service and employee welfare*’ were the terms used to categorise CSR activities; all aiming to serve the interests of citizens and play upon recognition through ‘*enlightened self-interest*’ as Banerjee (2007, pg.7) reflected. Often viewed as duties, these ‘*obligations*’ were deemed ‘*desirable in terms of the objectives and values of society*’ (Bowen 1953, pg.6), and attempts to define CSR began thus; giving society and businesses the impression that CSR was compulsory, and foolish to avoid (Banerjee, 2007; Bowen, 1953).

Later the 1960’s definitions, however, partially dismissed philanthropy and took a more open and simplistic approach; seeing CSR as actions which go ‘*beyond the firm’s direct economic or technical interest*’ (Davis, 1960, pg.70). This moves on from Bowen’s (1953) earlier assertions as authors such as Davis (1960) and Frederick (1960) recognised CSR as a broader issue and one which could be seen as a range of actions essentially added onto business activities, for:

*‘...broad social ends and not simply for the narrowly circumscribed interests of private persons and firms.’*

(Frederick, 1960, pg.60)

Despite this openness, responsibility was still regarded a managerial role and CSR actions could be judged based on their distance from *'direct economic or technical interest'* (Davis, 1960, pg.60). However, Davis and Blomstrom (1966) claimed that the general public per se, as well as business managers should become a *social actor* as everyone should be socially responsible and aware of how their actions impact upon society as a whole (Davis and Blomstrom, 1960).

### The 1970s: Combining Business and CSR

The debate regarding roles and responsibilities evolved during the 1960's and 70's; debating whether CSR should still be understood as the actions of the single businessman (Davis, 1960). Bowen somewhat dismissed areas of his original individualistic approach to CSR; stating that the efforts of one person or businessman cannot be felt, as a business of any size cannot depend on the charitable, voluntary actions of one team member; indeed it must be the responsibility of all employees/members (Carroll, 1999; Blindheim and Langhelle, 2010). For Friedman (1970) CSR was not laxly applied to individuals to champion, rather it was merely a suggestion for businesses to engage in if they wished. This 'take it or leave it' argument suggests that it is unjust to assume all corporations will take CSR on board (Friedman, 1970; Atkins, 2006).

Nevertheless during this period CSR was described as a businesses' responsibility towards its stakeholders; namely employees, customers, community, and the environment, and in time would become an organisation's competitive advantage. Friedman (1970) stated categorically that the *'competitive advantage claim'* of CSR is overestimated. Furthermore, he argued that the overall aim of business is to generate profit for shareholders and not partake in activities which divert attention away from doing so (Friedman, 1970). This statement is still drawn upon today as recent authors such as Asaf, Josiassen and Cvelbar (2012) confirm that companies need to know if engaging in CSR is worthwhile for the development of their business.

Friedman's (1970) alternative stance outlines that CSR can only be conceived if considered within the realms of profit; keeping business:

*'...within the rules of the game... in open and free competition without deception or fraud.'*  
(Friedman, 1970, pg.63)

This approach suggests businesses should not engage in time consuming, costly and benevolent CSR efforts; viewing businesses as inappropriate *'vehicles for social benevolence'* (Reich, 2008, pg.9). According to Schwartz and Saiia (2012, pg.6) Friedman's *'neo-classical economic view of CSR'* is narrow-minded, but areas of his work have been misinterpreted. The majority interpret Friedman's (1970) criticism to mean that the only social responsibility a business holds is to maximise profit for its stakeholders, and bending the rules is permissible (Schwartz and Saiia, 2012). Recent authors such as Atkins (2006) maintain this understanding of CSR, stating that telling corporations to sell goods for and to engage in social means, rather than for stakeholder profit is negligent, foolish and flawed; questioning CSR's existence within the business realm. In reality, Friedman (1970) is keen to dismiss *'deception and fraud'* as acceptable elements of CSR: *'...suggesting that firms have an obligation to act in a trustworthy (i.e. honest) manner...'* (Schwartz and Saiia, 2012, pg.7)



Friedman's (1970) critique and the multiple debates and attempts to define CSR show that the term is whatever you make of it, and *'means something, but not always the same thing, to everybody'* (Votaw, 1973, pg.11; Moneva, Archel and Correa, 2006). As a result, some describe CSR as their legal requirement as a business, whereas others view CSR as their *'social responsibility'*; defining it as ethically sound actions desired by members of society. 1970's definitions therefore appear hesitant and vague; evidencing a lack of an *'unbiased definition,'* meaning businesses will understand CSR differently and prevent the term from moving forward (Dahlsrud, 2008, pg.1).

To ensure business and social responsibility remained intertwined, Sethi (1975) claimed that the essence of CSR is how a business delivers profit to stakeholders, and that it must be consistent with ethical standards, law and social expectations. This helps define CSR as corporate actions which bring business activities in-line with the *'prevailing social norms'* and *'values'* (Sethi, 1975, pg.62). This explanation has often been described as lacklustre and overused (Fitch, 1976). Arguably, the majority of CSR literature focusses on failure and the uninspiring efforts of organisations, but in reality it should be understood as the *'serious attempt to solve social problems,'* regardless of who or what is to blame for the issues at hand (Fitch, 1976, pg.38). This description does however complicate the definition of CSR even further, because if there is no immediate or long-term financial benefit to the business, wider social problems must be considered in different ways (Holmes, 1976). CSR can, therefore also be described as a process where social problems are identified, and corporations anticipate what *'constitutes a desired state of affairs'* and devise policies that will achieve those outcomes (Fitch, 1976, pg.39). Clearly, during the 1970's CSR was hotly debated and in these discussions gained prominence in the academic and business consciousness, and began to 'find its feet' on the national and international stage.

### **The 1980s and 90s: Identifying Social Issues**

Moving on to the 1980s and 90s, the responsibilities attributed to businesses changed and became the concept of *'power'* (Jones, 1980, pg.59). Businesses had the supremacy in making decisions and negotiations with the causes they deemed socially responsible for their corporation, which consequently did provide improvement in the *'social control of business'* and *'improved corporate governance'* (Jones, 1980, pg.59). However, Votaw (1972) saw that businesses were manipulating the public view of what CSR actually is, thus diluting the ground made during the 1960s and 1970s in providing definition and meaning. For Jones (1980, pg.59-60) businesses were seen to be influential in solving social problems, but it is important to remember that whilst their *'stake may go beyond mere ownership,'* their CSR obligation needed to mirror societal interests, not just those of stakeholder/investors.

Wartick and Cochran (1985, pg.760) went on to say that *'corporations cannot be moral agents,'* thus questioning the power given to businesses in deciding what social issues need addressing. Fundamentally, profit maximisation (reflecting back to Friedman 1970) is the overall aim of a business, thus it is:

*'...to the extent that managers use corporate resources to promote socially responsible activities, they are "stealing" from owners' dividends, from customers' wealth, or from employees' wages.'*

(Wartick and Cochran, 1985, pg.760)

For successful application of CSR, businesses needed to be dealing with the same concept and have the same understanding of it (Okoye, 2009). To help this situation, Drucker (1984); a prominent business spokesman at the time, stated that a definition of CSR does not need to be complicated, as it is merely about seeing social issues as business opportunities; thus suggesting CSR be there to:

*'...to tame the dragon that is to turn a social problem into an economic opportunity and economic benefit, into productive capacity, into human competence, into well-paid jobs, and into wealth.'*

(Drucker, 1984, pg.62)

The 1990s onwards saw an influx of authors attempting to create such opportunities by combining business and society, which according to Wood (1991, pg.695) they are *'interwoven rather than distinct entities.'* Cannon (1992, pg.33) for example, recognised that CSR is where businesses contribute to society and communities in *'efficient, profitable and socially responsible'* ways. The opportunity, therefore, to maintain a competitive advantage from individualised CSR efforts, therefore still prevails (Holcomb, Upchurch and Okumus, 2007). Individualising the CSR efforts of a business can be defined by highlighting two processes:

*'An all-encompassing notion, [corporate] social responsibility refers to both the way a company conducts its internal operations, including the way it treats its workforce, and its impact on the world around it.'*

(Reder, 1994, pg.5)

This definition sparked the beginning of a number of comprehensive descriptions of CSR, where businesses were encouraged to focus on what is important to them individually, whilst reinforcing the claim that some areas of CSR are dependent on time and place (Reder, 1994; Blindheim and Langhelle, 2010). Similarly, Carroll (1999) described CSR through a three circle model; the inner circle highlighted functions economics, the intermediate functions are those demonstrating sensitivity to changing social values, and the outer circle as the emerging and extra social responsibilities. There are definite legal and economic areas which form the baseline, and any extra ethical, philanthropic activities are considered to be about 'going the extra mile.'

Like Reder's (1994) definition, Carroll's 'Three Circles' Approach is adaptable, logical and universally applicable but is not immune from criticism. The emerging social responsibilities can also be likened to what Holcomb, Upchurch and Okumus (2007) describe as 'cherry picking' activities. Thus any businesses choose to adopt self-regulated CSR, meaning they are able to evaluate their own performance and what areas they need to focus on. This is suggested to be a way of 'cherry picking' CSR activities, whilst actually doing as little as possible, thus calling for a much more critical and strict way of defining CSR; avoiding self-regulated approaches going unnoticed and being overlooked (Font et al, 2012), as well as pinpointing those considered social actors (Hopkins, 2003).

### **The 21<sup>st</sup> Century: Establishing Priorities**

The CSR journey arrives now at the 21<sup>st</sup> century where the term *'stakeholder'* was introduced and used more and more to describe those impacted by individual businesses; note stakeholders includes both people and the environment (Hopkins, 2003, pg.10).

Clearer, steadfast definitions emerged and CSR became an entity and an ethical and responsible route for business, thus CSR is a way of creating:

*'...higher and higher standards of living, whilst preserving the profitability of the corporation, for peoples both within and outside the corporation.'*  
(Hopkins, 2003, pg.10)

Indeed the *'supercapitalist'* 21<sup>st</sup> century society we live in today means it is even more difficult for businesses to be wholly socially responsible, without compromising the preservation of profit (Reich, 2005, pg.5; Hopkins, 2003). For Glavas and Piderit (2009, pg. 53) the current often resolute definitions of CSR give too much space for businesses to make false claims and be *'put up on a pedestal'* as *'socially responsible,'* whilst Karnani (2010) states that positive examples of companies successfully implementing CSR are few and far between. Argandona and Hoivik (2009, pg.222) outline that the undecided *'role'* of the corporation within society, may be to blame for the confusion surrounding the CSR definition. Social welfare will automatically improve when businesses do well; this is an inevitable consequence of success upon the economy, but this does not necessarily mean they have played a vital role in social and community development (Karnani, 2008). It is also suggested that understandings of CSR are flawed, as businesses cannot achieve selfless acts (Karnani, 2008), thus in reality it does not physically exist and is *'no more than an aspiration for best practice or morally acceptable behaviour'* (Boeger, Murray and Villiers, 2008, pg.86).

To understand what it means to be socially responsible, Crowther and Aras (2008, pg.117) outline the typical qualities expected by a *'perfect person,'* but it is likely that customers cannot do the same for a perfect, ethical business because *'such a person does not exist.'* In response, authors are currently trying to *'cover all bases'* by providing comprehensive approaches to understanding CSR (Okoye, 2009; Taneja, Taneja and Gupta, 2011). These approaches focus on maximising the impact of CSR actions, and chase a different understanding of CSR which is more pertinent to individual businesses and their association with society *or stakeholders'* (Okoye, 2009, pg.624).

### **Conclusion: where do we go now?**

With so many disputes over CSR, an agreed definition of the term becomes farfetched as it has different significance for different corporations, and viewing CSR contribution as an automatic loss of profit, makes CSR:

*'...as meaningful as cotton candy... the more you try to bite into it the faster it dissolves.'*  
(Reich, 2008, pg.6)

CSR may well bring a certain level of competitive advantage when implemented (Asaf, Josiassen and Cvelbar, 2012), but if the term is meaningless or intangible, incorporating it into the aims of a corporation is irresponsible and the business itself cannot be taken seriously (Jones, Hillier and Comfort, 2013). There appears to be great difficulty in preparing a justified set of CSR definitions that give businesses a foundation from which to act upon. It is also clear that CSR will not disappear from the business agenda anytime soon, and its definition is likely to evolve, just as it has over the past 60 years, in line with the social and political developments of corporations (Taneja, Taneja and Gupta, 2011).

Technically, CSR is not a traditional management tool, thus it can be viewed as a moral duty rather than a business tactic (Zwetsloot, 2003); reinforcing the need for clear guidance and a deeper understanding of social responsibility (Boeger, Murray and Villiers, 2008). Such guidance could be a framework that breaks CSR down into manageable chunks and processes:

*'CSR must be defined to contain a number of minimum requirements and to entail a system of corporate accountability through regulatory intervention and enforcement of obligations.'*

(Boeger, Murray and Villiers, 2008, pg.86)

Singling out specific CSR processes may well help businesses prioritise their CSR contributions, and continue with on-going research and development to support change. Definitions of CSR have altered significantly since the 1950's to the present day. These changes have gone from purely social, philanthropic methods, to comprehensive approaches incorporating social, environmental and legal responsibilities. Business managers were first identified as those accountable for CSR, but this gradually evolved towards a whole business approach requiring team ethics, and a shared understanding of the social and environmental impact of individual businesses. These changes are mirrored in the work of Bowen (1953), Holmes (1976), Reder (1994) and more recently Hopkins (2003).

Despite little universal knowledge of essential CSR actions expected by businesses, as the power of corporations expands over time, those businesses choosing to not use their authority in a socially responsible manner may well lose that luxury, opportunity and positive reputation (Davis, 1973). A singular CSR definition is not close to being found (Font et al, 2012) but individuals, groups and corporations all have responsibilities, social or not. A happy medium needs to be found where baseline social responsibilities are agreed upon, and the terms *'continuous and enduring,'* are applied to the commitment of each business towards them (Argandona and Hoivik, 2009, pg.224).

## References

Albareda, L., Lozano, J. M., Tencati, A., Midttun, A., & Perrini, F. (2008). The changing role of governments in corporate social responsibility: drivers and responses. *Business Ethics: A European Review*, 17(4), pp. 347-363.

Argandona, A. Hoivik, H.V.W. (2009) Corporate social responsibility: One size does not fit all. Collecting evidence from Europe. *Journal of Business Ethics*. 89(3), pp.221-234

Asaf, A.G. Josiassen, A. Cvelbar, L.K. (2012) Does Triple Bottom Line Reporting Improve Hotel Performance? *International Journal of Hospitality Management*. 31, pp.596-600

Atkins, B. (2006) Is corporate social responsibility responsible? FORBES. [Blog] 28<sup>th</sup> November. Available at: <[www.forbes.com/2006/11/16/leadership-philanthropy-charity-lead-citizen-cx\\_ba\\_1128directorship.html](http://www.forbes.com/2006/11/16/leadership-philanthropy-charity-lead-citizen-cx_ba_1128directorship.html)> [Accessed 10<sup>th</sup> January 2014]

Banerjee, S.B. (2007) *Corporate Social Responsibility: The Good, the Bad and the Ugly*. Cheltenham, Edward Elgar Publishing Limited

- Bebbington, J. (2001) Sustainable development: a review of the international development, business and accounting literature. *Accounting Forum*. 25(2), pp.128-157
- Blindheim, B-T. Langhelle, O. (2010) A Reinterpretation of the Principles of CSR: A Pragmatic Approach. *Corporate Social Responsibility and Environmental Management*. 17, pp.107-117
- Boeger, N. Murray, R. Villiers, C. (2008) *Perspectives on Corporate Social Responsibility: Corporations, Globalisation and the Law*. Cheltenham, Edward Elgar Publishing Limited
- Bowen, H.R. (1953) *Social Responsibilities of the Businessman*. New York, Harper and Row
- Cannon, T. (1992, pg.33) *Corporate Responsibility*. London, Pitman Publishing
- Davis, K. (1960) Can Business Afford to Ignore Corporate Social Responsibilities. *California Management Review*. 2, pp.70-76
- Carroll, A.B. (1999) Corporate social responsibility: evolution of a definitional construct. *Business and Society*. 3, pp. 268-295
- Crowther, D. Aras, G. (2008) Governance and Responsibility: An investigation into the relationship between corporate governance and corporate sustainability. *Management Decision*. 46(3), pp.433-448
- Davis, K. Blomstrom, R.L. (1966) *Business and its environment*. New York, McGraw-Hill
- Dahlsrud, A. (2008) How corporate social responsibility is defined: an analysis of 37 definitions. *Corporate Social Responsibility and Environmental Management*. 15(1), pp. 1-13
- Drucker, P.F. (1984) Converting social problems into business opportunities: The new meaning of corporate social responsibility. *California Management Review*. 26(2), 53-63
- Fitch, H.G. (1976) Achieving corporate social responsibility. *Academy of Management Review*. 1(1), pp.38-46
- Font, X. Walmsley, A. Cogotti, S. McCombes, L. Hausler, N. (2012) Corporate social responsibility: The disclosure-performance gap. *Tourism Management*. 33(6), pp. 1544-1553
- Frederick, W.C. (1960) The growing concern over business responsibility. *California Management Review*. 2, pp.54-61
- Friedman, M. (1970) The Social Responsibility of Business is to Increase its Profits. *New York Times Magazine*. September 13, 1970
- Glavas, A. Piderit, S.K. (2009) How Does Doing Good Matter?: Effects of Corporate Citizenship on Employees. *Journal of Corporate Citizenship*. 36, pp.51-70

- Holcomb, J.L. Upchurch, R.S. Okumus, F. (2007) Corporate social responsibility: what are the top hotels reporting? *International Journal of Contemporary Hospitality Management*. 19(6-7), pp.461-475
- Holmes, S.L. (1976) Executive perceptions of corporate social responsibility. *Business Horizons*. 19, pp.34-40
- Hopkins, M. (2003) *The Planetary Begin- CSR Matters*. London, Earthscan
- Jones, T.M. (1980) Corporate social responsibility revisited, redefined. *California Management Review*. 22(22), pp.59-67
- Jones, P. Hiller, D. Comfort, D. (2013) The Leading Spirits and Beer Companies and Corporate Social Responsibility. *Corporate Governance: The International Journal of Effective Board Performance*. 13(3), pp.249-260
- Karnani, A. (2010) The case against corporate social responsibility. *Wall Street Journal*. 23, pp.1-5
- Moneva, J.M. Archel, P. Correa, C. (2006) GRI and the camouflaging of corporate unsustainability. *Accounting Forum*. 30(2), pp.121-137
- Okoye, A. (2009) Theorising Corporate Social Responsibility as an Essentially Contested Concept: Is a Definition Necessary? *Journal of Business Ethics*. 89, pp.613-627
- Reder, A. (1994) *In Pursuit of Principle and Profit: Business Success through Social Responsibility*. New York, Putnam
- Reich, R. (2008) The case against corporate social responsibility. Goldman School of Public Policy Working Paper No.GSPP08-033
- Salama, A. Dixon, R. Habbash, M. (2012) An Examination of Environmental Disclosures in UK Corporate Annual Reports. *Journal of Accounting, Business & Management*. 19(1), pp. 19-42
- Schwartz, M.S. Saiia, D. (2012) Should Firms Go Beyond Profits? Milton Friedman versus Broad CSR1. *Business and Society Review*. 117(1), pp.1-31
- Sethi, S. (1975) Dimensions of Corporate Social Performance: An Analytical Framework. *California Management Review*. 17(3), pp.58-64
- Smith, N.C. (2003) Corporate social responsibility: not whether, but how. Center for Marketing Working Paper. 3(701), pp.1-35
- Spencer, D.L. (1958) Dare we renege? The social responsibility of business in the world scene. *Business Horizons*. 1(4), pp.38-47
- Taneja, S.S. Taneja, P.K. Gupta, R.K. (2011) Researches in Corporate Social Responsibility: A Review of Shifting Focus, Paradigms, and Methodologies. *Journal of Business Ethics*. 101, pp.343-364

Wood, D.J. (1991) Corporate Social Performance Revisited. *Academy of Management Review*. 16, pp.691-718

Votaw, D. (1973) Genius Becomes Rare. In: Votaw, D. Sethi, S.P. (ed) *The Corporate Dilemma: Traditional Values Versus Contemporary Problems*. New Jersey, Prentice Hall

Wartick, S.L. Cochran, P.L. (1985) The evolution of the corporate social performance model. *Academy of Management Review*. 10(4), pp.758-769

Zwetsloot, G.I.J.M. (2003) From Management Systems to Corporate Social Responsibility. *Journal of Business Ethics*. 44(2-3), pp.201-208

## Successful learning is change

Antje Duden

Leeds Metropolitan University, UK

### Abstract

Trust in an organization's members and leadership is the basis of a lived learning culture. This paper summarizes in part the findings of a case study in a small to medium-sized organization in South Germany in relation to current theory. To understand this phenomenon, we need to look beyond the primary literature of experts such as Schein's three culture levels, Argyris and Schön's double-loop learning or Senge's fifth discipline of systemic learning. Cultural rituals and opportunities surrounding face to face communication are becoming more important in today's digital existence. This culminates in trust and engaged members and leaders. Results of a content analysis with qualitative problem-centred interviews and an analysis of quantitative secondary data provide input concerning positive learning effects in an organization. With a feeling of cultural security and a good mix of communication, different operational principles are accepted and as a result the majority of organizational members perform better.

**Key Words:** Organization culture, communication, leadership and management

### Introduction

In theories many possibilities to manage learning and changing processes are described. However, not very many that result learning in a culture of trust. In practice implementing trust is difficult. And the basics of a learning culture have to evolve within the enterprise and this needs trust in all directions. An evolving learning culture includes all individuals in the entire organization; the management and the employees and workers (Senge 2006; Schein 2010). For this understanding, the view is on the humans in an organization. The value and the view of humans are essential and not the perspective that humans are a resource, like a machine (König & Volmer 2008). This view is a systemic approach and a radical break from the top-down approach. The magic word "communication" provides this. This is further discussed in the work of the German sociologist and system theorist Niklas Luhmann<sup>3</sup> (Pinnow 2011). The result is an organization culture with excellent communication between the members of an organization all through the hierarchy and levels. Cause the kind of communication and the confidential partnership between members of the management, employee and the customers is the basis for successful learning all over an organisation (Covey 2009; Sprenger 2012).

*"Feedback is the breakfast of champions"* says Ken Blanchard, a management expert (Jumpertz 2014, p. 38). He means personal feedback in a situational setting and environment is the most important building block of partnerships in an organization (Jumpertz 2014). With this background and the knowledge of the mixed members of an organization in the future, with the generation of baby boomer (1946-1964), the generation x (1965-1978) and the generation y (1979-1999) working together successfully is possible (Culen et al. 2013). This results in a confident feeling in all participants and changing processes are now possible and realisable. Due to the participants knowing the different

---

<sup>3</sup> Niklas Luhmann (December 8, 1927 - November 6, 1998) was a German sociologist and the prominent publisher of the system theory (1984). In this, communication is one of the important topics.



views and requirements in their organization, the work becomes more enjoyable resulting in motivated and integrated members in an organization (Senge 2006).

This paper presents some findings of a single case study in a small to medium-sized organization in South Germany in relation to current theory. The second part describes learning culture and the models of Senge and Argyris & Schön with an overview towards the cohesion between culture, leadership, communication and trust. The third part describes the paradigm and the methodology used (Lamnek 2005; Witzel 2000). The fourth part summarizes some results of this approach and subsequent interpretations – a basis of learning in an organization.

### **Learning, organization culture and different views**

Senge's "fifth discipline" mentions important points for effective learning in organizations: personal mastery, personal perception "mental model", shared vision and team learning. The sum of which creates system thinking. Personal mastery is achieved and created in an environment that encourages personal and organizational goals to be developed and realised in partnerships. Build a sense of group commitment by developing shared images of the future is the shared vision of the whole staff. Team learning processes that foster spoken and collective thinking, increases a group's capacity to reliably develop group intelligence and cohesion, such as the principle of Aristotle: "*The whole is greater than the sum of its parts*". The members of the organization develop the ability to see the "*big picture*" and understand how changes in one area affect the whole system (Senge et al. 1997; Senge 2001).

Below is a typical model of individual and organizational learning, as described by Argyris & Schön. It is referred to as single- and double-loop learning or reframing learning<sup>4</sup>. The development of these models leads to the deutero-learning model and means the learning through feedback. The important point is the ability to reflect. Coupled with the self-reference of the systemic theory of Luhmann one can reflect his/her behaviour and choose differences between his/her own and the environment in different contexts (Baraldi et al. 1997; Luhmann 1973). Only with the possibility to reflect on situations and human behaviour in social systems, can feedback be a functioning process in an organization; it's more than a critical view in a mirror. This is the beginning of learning and changing.

Learning is more than a process between action and result, correction is also possible and essential. Likewise correction is possible between corporate values and aims and actions to achieve the stated goals. The values of an organization can be mentioned and are visible, but values of members of an organization are deeply rooted and are not always visible like the third culture level according Schein (2010)<sup>5</sup>. The third and most profound level covers the most elementary and deeply entrenched attitudes and convictions which, even if they are detected from an outside point of view are difficult to decode and can allow various interpretations and speculations (Schein 2000).

---

<sup>4</sup> "Single-loop learning occurs when matches are created, or when mismatches are corrected by changing actions. Double-loop learning occurs when mismatches are corrected by first examining and altering the governing variables and then the actions." (Argyris 1999, p. 68).

<sup>5</sup> The topmost level consists of artefacts; obvious and observable facts such as clothing, architecture and interior design within a "corporate identity". The second level contains values and standards, regulations for collective behaviour, as seen in organizational guidelines (Schein 2000).

For a learning culture it is essential that values appear, it is necessary and required. Only with a good feeling and in culture of trust can members indicate and be transparent according to their values. This is the basis for feedback culture where learning through reflective and constructive ways towards solutions is possible. The last step of Argyris & Schön is to review the results, actions and corporate aims and to reflect upon possibilities for correction. There is a fundamental need in all learning cultures for members to question and analyse information and to receive acknowledgement. Through monitoring and an evaluation of the continual development process being put in place; proactive thinking and survival is ensured (Argyris & Schön 1999; Argyris & Schön 2008; Maturana & Varela 2009; Probst 1998; Probst et al. 2006).

### **Trust as a result of communication and behaviour**

Pinnow mentioned leaders have to respect people and treat them seriously. He based his conclusion on Sprenger. *“Every manager must then decide for himself or herself whether they choose “the straight approach of making demands, negotiating and arriving at agreements, or continue to play games of psychological seduction. You must choose between the spirit of fostering self-esteem and the specter of motivating from without.” (Sprenger 2003, p. 259; see also Pinnow 2011, p. 90).* Trust in this context, is more than a message, regardless of form or the product’s themselves; it is observable behaviour, which makes leaders *“vulnerable and human”* (Pinnow 2011, p. 90). *“Without trust no authentic/true communication..., without communication not trust.”* (Hubig & Siemoneit 2007, pp. 178 and 179). It is a requirement and at the same times a product of interaction. Trust creates successful interaction. Trust start within ourselves, it helps us to think positively and be tolerant in our interactions with others (Hubig & Siemoneit 2007).

A learning organization needs trust to be able to reflect on human behaviour in working situations. *“A relationship starts with trust. If you do not trust your employees, the employees will not trust you. More importantly: if you not trust your employees, then you do not have any”* (Sprenger 2004, p. 165). Trust from others and placing trust in others ensures success. To reach this you have to make commitments and empower all members of an organization. If all employees and managers are “on board”, a conceptual thinking process will begin which include; creativity and innovation, problem solving, strategic thinking, goal setting, effective interdepartmental communication, achievement milestones and other positive secondary effects (Senge 2001). It is important to have trust in your personnel and their competencies (Argyris 1999; Sackmann 2004; Saunders 2011).

In organizational structures that have planned and periodical meetings, dialogs can appear, in which partners have a visible and transparent value position. This needs time together and then communication will be successful (Gloger 2013).

### **Systemic view and management**

The systemic theory is based on the biology of cognition, in which Maturana & Varela (1980) states the primary function of every living organism is to survive. These organisms are individual living systems, separated by the environment.<sup>6</sup> This means behaviour is guided by the internal constitution and not by external events. This is the only relevant fact

---

<sup>6</sup> This autopoietic *“emphasizes life’s maintenance of its own identity, its informational closure, its cybernetic self-relatedness, and its ability to make more of itself. Autopoietic refers to self-producing, self-maintaining, self-repairing, and self-relational aspects”* (Britannica Encyclopedia n. d.).

in the systemic view. Every form of communication is an impulse in the system, such as small talk in the elevator or an informal gathering at the coffee machine where a project might be discussed, feedback opportunities or informal chats with experts. Despite modern technology, face to face interactions is still the most effective and popular form of communication. These offer the greatest opportunities for change and growth (Pichler 2011).

There is a vast amount of literature on new management styles with titles such as *Six Sigma, Re-Engineering, Developing your Company or Leadership*, etc.... on the market. All include the idea of facilitating learning in organizations and human resource development. In this view, humans are resources like machines (Taylor 2000). Behind this thinking feedback is mentioned as the most important step and the most complex way. Soft skills are mentioned, but this means a hard discipline (Jancsary & Wilms 2009). This includes the ability to be objective about one's own behaviour, communication and feeling and thus be authentic and resolute in one's actions (Beerel 2009; Drucker 2000; Gelink 2011).

To sum up, systemic leadership of an organization gives the basics of communication with possibilities of feedback in a feedback culture. This has a great influence of the learning possibilities in an organization and thus its success. "*The basic ... leadership is a system. ... It is always focussed on the people and the culture of the organization*" (Pinnow 2011, p. 121). During the research work in a case study in a SME in South Germany about successful learning, the most mentioned words in the context of learning in problem centred interviews were "manager", "communication" and "trust".

### **Paradigm and methodology**

"*A paradigm may be viewed as a set of basic beliefs that deals with ultimate or first principles. It represents a worldview that defines for its holder, the nature of the "world", the individual's place in it, ... ; a paradigm establish an ultimate truth.*" (Lincoln & Guba 1989, p. 200). The point of view is according to Deetz (1996) and representing this study as interpretative with a premodern and traditional consensus. The whole research work is a process of understanding, is similar to the hermeneutic helix according to Danner (1979, p. 53; see also Mayring 2002, p. 30).

After initial high-level talks with representatives of the management and a presentation by the author, introducing the study, problem-oriented interviews were performed (Lamnek 2005; Witzel 2000). The face to face interviews were exploratory and loosely structured (Saunders et al. 2007). Results made different points of views visible and helped in understanding the behavior of the members of the organization. Interpretations closed on patterns of behavior and helped to see the "big picture" and the possibilities of learning (Senge 2006; Deetz 1996). With secondary data, I could find out if hypotheses, which were built during the research process, are valid or not. The methods used for both the data collection and the analysis are at the same time inductive and deductive in nature. From the view point of human constructivism "science is driven by questions not methods" (Denzin & Lincoln 2000). The important step is the interpretation of the findings. The possibility for generalization of the results is constricted, because the interpretation is only valid in this specific context. The author attempts to make conclusions based on the interpretation of the interviews and the secondary data. (Mayring 2008; Gläser & Laudel 2009)

## Findings and summary

Feedback is only possible if the participants are aware of their identity and their self-image is not shaken. This presupposes a constructive procedure, a cautious approach and empathy according to Goleman et al. (2002). This makes a feedback culture within the organization possible:

1. Leaders and managers should act as role models; that means they have to be authentic, visible and believable.
2. Information about decisions must be transparent for all the employees, not only for the relevant members; this create a feeling of reliability. One important point in this context is the validity of the information; only real-time information is “good” information.
3. Different possibilities of communication, e.g. small talk in the elevator, in a walk to a meeting, feedback opportunities, informal chats with experts or discussions between employers and employees in planned intervals.
4. For the members of an organization it is very important they have access to learning and individual development and they are involved in its planning. The personal development is a result of feedback in a discussion between employers and employees.
5. For new development phases in products or adapted processes it is important to accept failures. Failure and blame are closely connected. Here the type of mistake is important. It is necessary to deal openly and constructively with mistakes using a solution oriented approach (Edmondson 2011, p. 30).
6. In the context of learning the word “trust” was often mentioned. Trust is the result of all above points and will be visible in a culture of feedback. In this culture, appreciation comes to the fore and critiques concerning behaviour is possible, perhaps on interpersonal levels<sup>7</sup>. This procedure applies in both directions and needs trust between the participants, the managers and the staff.

These points assume a leadership and management in which “*emotional intelligence competencies ... inspire and motivate people ...cultivate resonant leadership throughout teams and organizations...*” (Goleman et al. 2002b, p. IV). Only then is learning unconsciously omnipresent and possible and leave the members of an organization feeling confident. “*A robust company is not a collection of leftover “human resources”. It is a community of engaged human beings.*” (Online Mintzberg 2009). Trust in an organization’s members and leadership is the basis of a lived learning culture and assured innovation and success of an organization.

## References

Argyris, C., 1999. *On Organizational Learning 2.*, Ed., Cornwall: Wiley-Blackwell.

---

<sup>7</sup> Every communication has a relationship and content. In the 2<sup>nd</sup> axiom by Paul Watzlawick, the relationship classifies the content and is therefore meta communication (Watzlawick et al. 2007).

- Argyris, C. & Schön, D.A., 1999. Die lernende Organisation - Google Scholar. Available at: [http://scholar.google.de/scholar?hl=de&q=Die+lernende+Organisa+%2B+Argyris+%26+Sch%C3%B6n&btnG=Suche&lr=&as\\_ylo=&as\\_vis=0](http://scholar.google.de/scholar?hl=de&q=Die+lernende+Organisa+%2B+Argyris+%26+Sch%C3%B6n&btnG=Suche&lr=&as_ylo=&as_vis=0) [Access August 15, 2011].
- Argyris, C. & Schön, D.A., 2008. *Die Lernende Organisation. Grundlagen, Methode, Praxis* 3., Aufl., Stuttgart: Schäffer-Poeschel.
- Baraldi, C., Corsi, G. & Esposito, E., 1997. *GLU: Glossar zu Niklas Luhmanns Theorie sozialer Systeme*, Frankfurt am Main: Suhrkamp.
- Beerel, A., 2009. *Leadership and Change Management*, Los Angeles, Calif. a.o.: Sage Publications.
- Britannica Encyclopedia, Management and the Worker (work by Roetlisberger and Dickson) - Britannica Online Encyclopedia. Available at: <http://www.britannica.com/EBchecked/topic/361229/Management-and-the-Worker> [Access April 7, 2011].
- Covey, S.M.R., 2009. *Schnelligkeit durch Vertrauen*, Offenbach am Main: GABAL-Verlag.
- Culen, J., 2013. *Zukunft von Arbeit und Organisation - Das neue Arbeiten in DNA*, Wien: Beratergruppe Neuwaldegg & Plattform DNA. Available at: [http://www.neuwaldegg.at/dateien/451\\_DNA\\_Umfrage\\_Ergebnisse\\_Gesamt.pdf](http://www.neuwaldegg.at/dateien/451_DNA_Umfrage_Ergebnisse_Gesamt.pdf).
- Danner, H., 1979. *Methoden geisteswissenschaftlicher Pädagogik Einführung in Hermeneutik*, München u.a.: Reinhardt.
- Deetz, S., 1996. Describing Differences in Approaches to Organization Science: Rethinking Burrell and Morgan and their Legacy. *Organization Science*, No. 2 (Vol. 7), pp. 191–207. Available at: [http://profjayfigueiredo.com.br/GON\\_AC\\_05.pdf](http://profjayfigueiredo.com.br/GON_AC_05.pdf) [Access May 30, 2011].
- Denzin, N.K. & Lincoln, Y.S., 2000. *Handbook of Qualitative Research 2* Sub. Thousand Oaks, London, New Delhi: SAGE Publications Ltd.
- Drucker, P.F., 2000. *The Ecological Vision: Reflections on the American Condition*, New Jersey: Transaction Publishers.
- Edmondson, A.C., 2011. Die Kunst zu Lernen. *Harvard Business Manager. Deutsche Ausgabe*, Spezial: Aus Fehlern lernen. Was Unternehmen besser und schneller macht, pp. 28–39.
- Gelink, J., 2011. The Three Cores to Building Leadership Trust. *Peter Drucker's Management Philosophy*. Available at: <http://druckerphilosophy.com/2011/07/07/the-three-cores-to-building-leadership-trust/> [Access February 15, 2012].
- Gläser, J. & Laudel, G., 2009. *Experteninterviews und qualitative Inhaltsanalyse: Als Instrumente rekonstruierender Untersuchungen* 3., überarbeitete Aufl., Wiesbaden: Vs Verlag.
- Gloger, A., 2013. Das Ende des Vorgesetzten. Führung 2020. In *managerSeminare. Das Weiterbildungsmagazin*, Heft 183 (Juni 2013), pp. 24–30.

Goleman, D.P., Boyatzis, R.E. & McKee, A., 2002a. *Primal Leadership. Learning to Lead with Emotional Intelligence*, Harvard Business Press.

Goleman, D.P., Boyatzis, R.E. & McKee, A., 2002b. *Primal Leadership. Realizing the Power of Emotional Intelligence*. United States of America: Harvard Business School Press.

Hubig, C. & Siemoneit, O., 2007. Vertrauen und Glaubwürdigkeit in der Unternehmenskommunikation. In A. Zerfaß, Hrsg. *Handbuch Unternehmenskommunikation*. Wiesbaden: Gabler Verlag, pp. 171–188.

Jancsary, P. & Wilms, F.E.P., 2009. Dialog ist nichts für Softies. *Trainer-Kontakt-Brief*, 01(01/09), p. 30. Available at: [https://homepages.fhv.at/wf/Artikel\\_files/Softy.pdf](https://homepages.fhv.at/wf/Artikel_files/Softy.pdf) [Access April 14, 2014].

Jumpertz, S., 2014. Brisante Beurteilungen. Feedback für Führungskräfte. *managerSeminare. Das Weiterbildungsmagazin*, Heft 193 (April 2014), pp. 38–45.

König, E. & Volmer, G., 2008. *Handbuch Systemische Organisationsberatung*, Weinheim und Basel: Beltz.

Lamnek, S., 2005. *Qualitative Sozialforschung: Lehrbuch 4.*, vollst. überarb. Aufl., Weinheim: Beltz, PVU.

Lincoln, Y.S. & Guba, E.G., 1989. *Fourth Generation Evaluation* E. G. Guba, Hrsg., Newbury Park, London, New Delhi: Sage Pub Inc.

Luhmann, N., 1973. *Vertrauen. Ein Mechanismus der Reduktion sozialer Komplexität 2.* erw. Aufl., Stuttgart: Enke.

Maturana, H.R. & Varela, F.J., 1980. *Autopoiesis and Cognition. The Realization of the Living*, Dordrecht (Holland): D. Reidel Publishing Company.

Maturana, H.R. & Varela, F.J., 2009. *Der Baum der Erkenntnis. Die biologischen Wurzeln menschlichen Erkennens 3.* Aufl., Fischer (Tb.), Frankfurt.

Mayring, P., 2002. *Einführung in die qualitative Sozialforschung. Eine Anleitung zu qualitativem Denken*, Weinheim und Basel: Beltz.

Mayring, P., 2008. *Qualitative Inhaltsanalyse: Grundlagen und Techniken 10.*, neu ausgestattete Auflage., Weinheim und Basel: Beltz. Available at: [http://books.google.at/books?id=9Yuq1mh1imYC&dq=mayring&source=gbs\\_book\\_other\\_versions\\_r&cad=2](http://books.google.at/books?id=9Yuq1mh1imYC&dq=mayring&source=gbs_book_other_versions_r&cad=2).

Mintzberg, H., 2009. The best Leadership is good Management. *BusinessWeek: Online Magazine*. Available at: [http://www.businessweek.com/magazine/content/09\\_33/b4143068890733.htm](http://www.businessweek.com/magazine/content/09_33/b4143068890733.htm) [Access February 14, 2011].

Pichler, M., 2011. So geht systemische Führung. *Wirtschaft & Weiterbildung*, Vol. 20(Heft 10/2011), pp. 20–24.

Pinnow, D.F., 2011. *Leadership - What Really Matters: A Handbook on Systemic Leadership*, Springer. Available at: [www.i3-ps.de/file\\_download/3](http://www.i3-ps.de/file_download/3).

- Probst, G., Raub, S. & Romhardt, K., 2006. *Wissen managen: Wie Unternehmen ihre wertvollste Ressource optimal nutzen* 5., überarb. Aufl., Wiesbaden: Gabler.
- Probst, G.J.B., 1998. *Organisationales Lernen. Wettbewerbsvorteil der Zukunft* 2., aktualisierte Aufl., Wiesbaden: Gabler.
- Sackmann, S.A., 2004. *Erfolgsfaktor Unternehmenskultur: Mit kulturbewusstem Management Unternehmensziele erreichen und Identifikation schaffen - 6 Best-Practice-Beispiele*, Wiesbaden: Gabler.
- Saunders, M., Lewis, P. & Thornhill, A., 2007. *Research Methods for Business Students* 4. Ed., Harlow: Financial Times Prentice Hall.
- Saunders, M.N.K., 2011. Trust and Strategic Change: An Organizational Justice Perspective. In *Trust and Human Resource Management*. Cheltenham (UK): Edward Elgar Publishing Ltd, pp. 268–286.
- Schein, E.H., 2010. *Organisationskultur. The Ed Schein Corporate Culture Survival Guide* 3. Aufl. G. Fatzer, W. Looss, & S. A. Sackmann, Hrsg., Bergisch Gladbach: EHP.
- Schein, E.H., 2000. *Prozessberatung für die Organisation der Zukunft: Der Aufbau einer helfenden Beziehung*, Köln: Ed. Humanistische Psychologie.
- Senge, P.M. u. a., 1997. *Das Fieldbook zur fünften Disziplin* 2. bzw. 3. Aufl., Stuttgart: Klett-Cotta.
- Senge, P.M., 2001. *Die fünfte Disziplin: Kunst und Praxis der Lernenden Organisation* 8. Aufl., Stuttgart: Klett-Cotta.
- Senge, P.M., 2006. *The Fifth Discipline: The Art & Practice of the Learning Organization*, New York: Broadway Business.
- Sprenger, R.K., 2003. *Die Entscheidung liegt bei dir! Wege aus der alltäglichen Unzufriedenheit*, 12. Aufl., Frankfurt a.M.: Campus.
- Sprenger, R.K., 2004. *Trust: The best Way to Manage*, Frankfurt/London: Cyan Books. Available at: [http://www.amazon.de/Trust-Manage-Reinhard-K-Sprenger/dp/3593385414/ref=sr\\_1\\_fkmr0\\_1?s=books-intl-de&ie=UTF8&qid=1396955048&sr=1-1-fkmr0&keywords=sprenger+reinhard+2003+%2B+trust](http://www.amazon.de/Trust-Manage-Reinhard-K-Sprenger/dp/3593385414/ref=sr_1_fkmr0_1?s=books-intl-de&ie=UTF8&qid=1396955048&sr=1-1-fkmr0&keywords=sprenger+reinhard+2003+%2B+trust).
- Sprenger, R.K., 2012. Vertrauen: Wichtiger als Strategie! In H. Bruch, S. Krummacher, & B. Vogel, hrsg. *Leadership - Best Practices und Trends*. Wiesbaden: Springer Gabler Verlag, pp. 77–86.
- Taylor, C., 2000. Systemic Leadership. Available at: <http://www.theknowledge.biz/resources/Systemic-Leadership.pdf> [Access February 15, 2012].
- Watzlawick, P., Beavin, J.H. & Jackson, D.D., 2007. *Menschliche Kommunikation: Formen, Störungen, Paradoxien* 11., unveränd. Aufl. R. I. Mental, Hrsg., Bern: Hans Huber Verlag.

Witzel, A., 2000. Das problemzentrierte Interview. *FQS Forum: Qualitative Social Research Sozialforschung*, Art. 22(1). Available at: <http://www.qualitative-research.net/index.php/fqs/article/viewArticle/1132/2519> [Access November 17, 2010].



## Regulation of electronic payment services

Otakar Schlossberger

### Abstract

The regulation of electronic payment services was first put into practice by Act no. 124/2002 Coll., on Transfers of funds, electronic means of payment and payment systems (the Payment Systems Act). This generally applicable legal norm introduced regulation of electronic payment services in the Czech legal system for the first time (even indirectly) and solved the protection of users of electronic payment services or the use of electronic means of payment, as appropriate. New legislation brought by Act no. 284/2009 Coll., on Payments, solves the protection of users rather differently.

The article will deal with the analysis of the original legislation aimed at the protection of electronic payment services and its comparison with the current legislation, going over the expected changes that can bring the expected transposition of legislation. This legislation will deal with integrated European market of payments performed via cards, internet, and mobile devices.

The paper has been prepared under GAČR project entitled “Post-crisis banking regulation and its impact on the economic activity within a small, export-oriented economy”, under reference number 13-08549S, with the University of Finance and Administration (VŠFS) as the grant beneficiary.

**Key words:** European Commission, electronic money, electronic payment services, legislation, consumer protection, financial arbiter.

### Introduction to the subject matter and legal definition

A great deal of attention has been paid to the European regulation of the payment system or payment services, as appropriate, in the past twenty years or so. The European Central Bank (hereinafter the “ECB”) and the European Commission (hereinafter the “EC”) have emphasized in their respective documents that monetary policy transactions carried out by central banks (and not just by central banks) cannot be performed effectively without a duly functioning payment system with certain level of quality and security<sup>8</sup>. Consequently several European documents were already adopted in the 1990s that set down uniform rules for performing transfers, their settlement, finality, and later also ensured regulation of electronic means of payment. It concerned the following legal norms:

- Directive 97/5/EC of the European Parliament (hereinafter the “EP”) and of the Council on Cross Border Credit Transfers;
- Directive 98/26/EC of the EP and of the Council on settlement finality in payment and securities settlement systems;
- Directive 2000/46/EC of the EP and of the Council on the taking up, pursuit of and prudential supervision of the business of electronic money institutions.

---

<sup>8</sup> Barák, J. et al. Zákon o bankách – komentář a předpisy související. Linde Praha, a. s. Prague: 2003. ISBN 80-7201-418-8, p. 287

The aforementioned primary norms were completed with Commission Recommendation 97/489/EC concerning the relationship between issuer and holder of electronic payment instruments.

However, in addition to setting down regulation in the area of payment system, all of the above mentioned documents had one thing in common – ensure, in principle, significant protection of consumers in the area of the payment system. Until then, this was basically unknown phenomenon. Consumers were generally protected by various other documents (in this case also in the area of financial services, as the payment system may also be considered a part thereof), such as, for example, Directive 97/7/EC of the EP and of the Council on the protection of consumers in respect of distance contracts<sup>9</sup>.

Midway through the first decade of the new millennium, the EC further strengthened the protection of consumers in the area of the payment system, payment services, and electronic means of payment or electronic money, as appropriate. Directive 2007/64/EC of the EP and of the Council on payment services in the internal market was elaborated and subsequently published in 2007. Moreover, the EC also revised the original Directive applicable in the area of electronic money and replaced by Directive 2009/110/EC of the EP and of the Council on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC<sup>10</sup> and 2006/48/EC<sup>11</sup> and repealing Directive 2000/46/EC.

Since selected payment system services should meet the same conditions for their implementation not only within the territory of a member state of the European Economic Area (hereinafter the “EEA”), but also in the area of the so-called cross-border payment system, the EC proposed and the EP approved several regulations to govern this area. However, they did not directly concern electronic means of payment or payment services, unless the regulated services were carried out electronically. It mainly concerned the following documents:

- Regulation (EC) No. 2560/2001 of the EP and of the Council on cross-border payments in euro;
- Regulation (EC) No. 924/2009 of the EP and of the Council on cross-border payments in the Community and repealing Regulation (EC) No. 2560/2001;
- Regulation (EU) No. 260/2012 of the EP and of the Council, establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No. 924/2009.

The aforementioned documents set up a foundation for the European regulation in the area of the payment system on the basis of integration of the terms and conditions for the execution thereof, particularly internally within member states of the euro area, but also externally. The given legal regulation also resulted in the formation of new financial market entities, such as, in particular, payment institutions and payment services providers, electronic money institutions and small electronic money issuers. A foundation was set up for increased protection of consumers and of small businesses, as appropriate.

---

<sup>9</sup> Máče, M. Platební styk: klasický a elektronický. Grada. Prague: 2006, ISBN 80-247-1725-5, p. 159.

<sup>10</sup> It governs the area of prevention of money laundering and terrorist financing.

<sup>11</sup> It governs the area of the taking up and pursuit of the business of credit institutions.

The original three Directives of the European Union (hereinafter the “EU”) were reflected in the historically first Payment System Act of the Czech Republic that came into effect in January 2003<sup>12</sup>. Directive 2007/64/EC, following its publication, was subsequently implemented in the national laws of the Czech Republic. Therefore, the original Payment System Act was repealed in 2009 and superseded by a new act, which has been in effect to this date<sup>13</sup>, particularly Act no. 284/2009 Coll., on the Payment system.

In connection with the requirements for protection of consumers or small businesses, as appropriate, set down by the EU laws, another important legal regulation was published – specifically Act no. 229/2002 Coll., on financial arbiter. **The key importance of the aforementioned Act consisted in the fact that it introduced an unprecedented possibility in the Czech Republic to resolve disputes between clients of banks and other financial institutions in selected areas of their respective activities out of court.** During the first state of its effectiveness, the Act stipulated that such areas shall include disputes arising from the payment system (or payment services, as appropriate), as well as disputes issuers of electronic means of payments and their users<sup>14</sup>. The Financial Arbiter of the Czech Republic was the entity competent to resolve such disputes.

Before proceeding to the analysis of the legal regulation relating to the definition of electronic money and consumer protection in this area, it is necessary to explain several basic categories that the European law or national laws, as appropriate, has had to work with.

### **Payment system vs. payment services**

The payment system may be viewed as the basic product (*service*) provided by, for example, banks and credit unions<sup>15</sup> to their clients.

The following definition may be considered as the definition of the payment system in a broad sense:

**The payment system is the relationship between payer and beneficiary, which is executed in certain forms via agreed payment instruments, either directly between them or via entities appointed for such purpose** (e.g. via banks or savings/credit unions).

**The contents** of such legal relationship, which is arranged by banks or savings/credit unions, shall be the set of rights and obligations associated with the execution of such transactions, where a payment system services provider (e.g. a bank) carries out payment system transactions, per client’s order, via payment instruments selected by such client.

---

<sup>12</sup> Act no. 124/2002 Coll., on Transfers of funds, electronic means of payment and payment systems (the Payment Systems Act).

<sup>13</sup> February 2014.

<sup>14</sup> Schlossberger, O., Marcela Soldánová. *Platební styk*. BIVŠ, Prague: 2007. ISBN 978-80-7265-107-8, Chapter 19; or Schlossberger, O. *Platební služby*. Management Press, Prague: 2012. ISBN 978-80-7261-238-3, p. 298 et seq.

<sup>15</sup> See, for example, Act no. 21/1992 Coll., on Banks, as amended, Section 1(3)(c) and (d); or Act no. 87/1995 Coll., on Savings and credit unions, as amended, Section 3(1)(d).

The **entities** then involve individuals or legal entities acting as clients of banks and savings/credit unions on the one part, with banks and savings/credit unions on the other part.

The payment system mainly involves payers and beneficiaries; in case a bank or another entity providing the payment system services enters the mutual legal relationship of the aforementioned entities, it only acts as an intermediary.

The payment system forms may vary based on the specific selection criteria used<sup>16</sup>:

<b>Criteria</b>	<b>Payment system form</b>
<b>Payment method</b>	<p><i>Cash payment system</i> – financial funds between the payer and the beneficiary are transferred in the form of banknotes and coins. The payment services provider only plays a minor role in this case – in case banknotes and coins are deposited to a payment account (e.g. payment for goods in a store using banknotes and coins).</p> <p><i>Cashless payment system</i> – it is always arranged by banks or savings/credit unions (and by other payment services providers, as appropriate – see below) and it takes place between current/ payment accounts of payers and beneficiaries (e.g. domestic transfers in the form of a payment order).</p> <p><i>Electronic payment system</i> – it is a payment system arranged via a payment instrument, in which financial funds are deposited electronically in the form of electronic money. Electronic funds between the payer and the beneficiary are transferred by deducting such funds from the payer's media – payment instrument – for the benefit of the beneficiary (in the beneficiary's terminal, whereas the funds are subsequently credited to the beneficiary's account with the payment services provider).</p>
<b>Territory</b>	<p><i>Domestic payment system</i> – a relationship between payer and beneficiary, provided the payment services provider of the payer and the payment services provider of the beneficiary are located within the same country.</p> <p><i>Cross-border payment system</i> – a relationship between payer and beneficiary, provided the payment services provider of the payer and the payment services provider of the beneficiary are located in different member states; however, only within the EEA.</p> <p><i>International (foreign) payment system</i> – a relationship between payer and beneficiary, provided the payment services provider of the payer and the payment services provider of the beneficiary are located in different countries, with the exception of member states of the EEA.</p>

<sup>16</sup> Schlossberger, O., Soldánová, M.: Platební styk, Prague 2007, BIVŠ, ISBN 978-80-7265-107-8, p. 25

**Requirements of Non-documentary payments** – a relationship between payer and accompanying beneficiary, where payments are not accompanied with any documents. These payments are sometimes referred to as the so-called clean payments.

*Documentary payments* – a relationship between payer and beneficiary, where both parties agree on such terms and conditions that the transfer of financial funds is associated with documents, which must accompany the payment; these payments are sometimes referred to as documentary payments; however, they are not considered to be a payment service.

**Express payment system (priority) deadlines** – a relationship between payer and beneficiary, where a bank / payment services provider of the payer ensures that financial funds are immediately deducted from the payer's current/payment account and the payment services provider of the beneficiary ensures the financial funds are credited to the beneficiary's payment account on the same day at the latest.

*Standard payment system* – a relationship between payer and beneficiary, where financial funds are transferred from the payer to the beneficiary in a standard manner, as arranged by their payment services providers and in line with predetermined terms and conditions.

**Bank's Non-liability payment system relationship to the transfer** – a relationship between payer and beneficiary, where a bank / another payment services provider only arranges the given transactions (e.g. clean payment).

*Liability payment system* – a relationship between payer and beneficiary, where the parties agreed that a bank / another financial institution may enter the liability relationship. In this case, the given institution does not solely act as an intermediary for the payment system execution, but it also assumes the payer's liabilities.

As mentioned above, a new economic term came into existence in connection with the effectiveness of Act no. 284/2009 Coll., on the Payment system (hereinafter the "Payment System Act" or the "PSA"), in fall of 2009, specifically the **payment services** category. The following activities<sup>17</sup> may be considered as payment services:

- Cash deposit to a payment account;
- Cash withdrawal from a payment account;

<sup>17</sup> Act no. 284/2009 Coll., on the Payment system, as amended, Section 3;

- Execution of transfer of financial funds ordered by the payer (settlement), beneficiary (direct debit), or ordered by the payer via the beneficiary (debit card transactions), on condition a loan is not provided;
- Execution of transfer of financial funds ordered by the payer, beneficiary, or ordered by the payer via the beneficiary (credit card transactions), where a loan is provided;
- Issuance and administration of means of payment and devices for acceptance such means of payments;
- Execution of transfer of financial funds, where neither the payer nor the beneficiary uses a payment account – i.e. the so-called cash advance;
- Execution of a payment transaction by an electronic communication services provider, provided the payer's consent to the payment transaction execution is given via an electronic communication device;
- Cashless transactions in foreign currencies, unless it concerns an investment activity pursuant to a special legal regulation<sup>18</sup>.

For the avoidance of various interpretations of payment services, the PSA also sets down the so-called negative definition of payment services. Therefore, the following are not considered to be a payment service (examples):

- Preparation, collection, processing, and delivery of banknotes and coins;
- Foreign exchange activities;
- Issuance of checks, bills of exchange, and traveler's checks in paper form;
- Issuance of paper vouchers for goods or services;
- Payment transactions carried out between payment services providers or their business representatives on their own account;
- Payment transactions carried out within the payment system;
- Payment transactions carried out as part of the securities management;
- Payment of cash by a goods supplier / service provider upon payment for goods/ services and other selected activities.

It is clear from the above mentioned that the term **payment system** may be considered as a **broader term than the term payment services**, in consideration of the fact that it comprises wider legal relationships arising between entities – clients and their banks – due to the wider range of payment instruments used. The aforementioned claim may be supported by legal provisions of the PSA. The payment system as well as any services associated therewith may only be provided by banks or credit unions pursuant to special legal regulations in terms of Directive no. 2006/48/EC, relating to the taking up and pursuit of the business of credit institutions.

**A payment service** is a category, which only comprises selected payment instruments; however, it may also be provided by other entities<sup>19</sup>. As already mentioned, the following shall not be considered a payment service: issuance and settlement of checks, execution of documentary payment system as payment/security instruments, provision of guarantee, or the collection of bills of exchange.

---

<sup>18</sup> Act no. 256/2004 Coll., on Capital market undertakings, as amended;

<sup>19</sup> Act no. 284/2009 Coll., on the Payment system, Section 7;

## Electronic means of payment/payment instruments and electronic money

Electronic payment instruments (means of payment) were codified by Directive 2000/46/EC or, as appropriate, they were legally regulated by the original Payment System Act of 2002 (see above). For the purpose of protecting consumers, the Act also included Recommendation No. 97/489/EC concerning the relationship between issuers and holders of electronic payment instruments. Consequently, new terms were introduced in the legal regulations of the Czech Republic in 2003, such as **electronic payment instrument, electronic money instrument, and electronic money**.

**Electronic money instrument** was characterized as one of the types of electronic payment instruments that stored monetary value in electronic form based on the specific definition features. Therefore, it was possible to use it for payments at other entities different from the issuer thereof.

**Electronic money** represented the monetary value stored in an electronic money instrument. The prepayment of an electronic money instrument – i.e. its issuance against the payment of the given monetary value, which could not be lower than the nominal value of electronic money contained therein<sup>20</sup> - represented an important precondition. However, Directive 2000/46/EC stated in its Article 1(3)(b) that: *“electronic money shall mean monetary value as represented by a claim on the issuer which is stored on an electronic device, issued on receipt of funds of an amount not less in value than the monetary value issued, and accepted as means of payment by undertakings other than the issuer.”* Therefore, the aforementioned resulted in the obligation of issuers to have the monetary value “stored” on the given device. In line with Recommendation No. 97/489/EC, the Czech legal regulation referred to the device as an electronic money instrument. New European legal regulation, set down by Directive 2009/110/EC, generalized this “storing” of monetary value and set down in Article 2(2) that *“electronic money means electronically, including magnetically, stored monetary value.....”*. The aforementioned statement is also used as the basis for the new legal regulation, set down by the PSA that came into effect on 1 November 2009. This practically means that the monetary value does not have to be stored directly on the device, which must be physically possessed and used by the holder (e.g. electronic wallet), but electronic money may also be stored in computer memory with its issuer, whereas the electronic money users may access their electronic money via another device that basically includes a payment instrument, which then “intermediates” the use of such electronically stored value (e.g. via internet, mobile phone, etc.).

Today, it is safe to say that the term “electronic money” has become a part of normal life. Electronic money may be issued not only by banks and savings/credit unions, but also by nonbanking entities, particularly small electronic money issuers and electronic money institutions<sup>21</sup>.

## Analyzing consumer protection in using electronic money

The consumer protection on the market of the payment system or payment services, as appropriate, with emphasis on consumer protection in using electronic payment

---

<sup>20</sup> Barák, J. et al. Zákon o bankách – komentář a předpisy související. Linde Praha, a. s. Prague: 2003. ISBN 80-7201-418-8, p. 293.

<sup>21</sup> As of February 2014, the CNB registered the total of small electronic money issuers and electronic money institutions.

instruments, has been addressed in several ways in the Czech Republic. In general, it is possible to mention the Consumer Protection Act<sup>22</sup> or the new Civil Code<sup>23</sup>. However, both legal regulations only represent general regulations that only complete special legal regulations. Special legal regulations in the Czech Republic mainly include Act no. 229/2002 Coll., on financial arbiter and both Payment System Acts, i.e. the PSA in effective in the period of 2003 – 2009 as well as the existing act, i.e. Act no. 284/2009 Coll. In order to resolve potential disputes, the institute of **financial arbiter** has been appointed; it is an entity that can resolve specific disputes in the so-called **extrajudicial (out of court) manner**.

The Financial Arbiter Act represented a legislative fulfillment of the requirement set down in Article 10 of Directive 97/5/EC on cross-border credit transfers, which required Member States of the EU to **ensure existence of adequate and effective complaints and redress procedures for the settlement of disputes of clients** in the area governed by the given Directive. The same applied in the area of electronic payment instruments. The reasoning relied on the idea that the standard judicial protection has not been sufficient and effective in many cases, as namely the costs of court disputes have often exceeded the disputed amount.<sup>24</sup> Moreover, court disputes are often viewed as complex and tedious, often discouraging consumers from commencing such proceedings.

The Financial Arbiter Act has been subject to several amendments, whereas the competences of the financial arbiter to resolve disputes arising from financial markets have been expanded (among others). Consequently, Section 1 of the Act stipulated the financial arbiter's competences, which were aimed at the authorization to resolve disputes arising from the transfer of financial funds between the so-called transferring institutions (e.g. banks) and their clients, as well as between the issuers of electronic payment instruments (i.e. those, who issue electronic money instruments containing electronic money) and their holders in the course of issuing and/or using thereof. The given competences were ultimately wider than those required by Directive 97/5/EC, because the financial arbiter was also authorized to resolve disputes relating to domestic transfers or the issue/use of electronic payment instruments. However, the protection set down in this manner did not apply to consumers only, but also to other clients of transferring institutions or holders of electronic payment instruments (e.g. businesses or legal entities).

The second basic pillar of the protection of consumers (and not just consumers) in the area of use of electronic payment instruments was the protection against distance (remote) unauthorized use of such instruments. In practice, this meant any unauthorized use of electronic payment instruments via the internet, for example. This legal protection resulted from taking advantage of the possible transposition of Recommendation No. 97/489/EC in the laws of the Czech Republic. The original Act no. 124/2002 Coll., on Transfers of funds, electronic means of payment and payment systems (the Payment Systems Act) set down the following rule in its Section 18: *"If an electronic payment instrument has been used without physical presentation, or without an identification of the holder with a personal identification code or similar proof of identity where the nature of the electronic payment instrument precludes physical presentation, and if the holder declares*

---

<sup>22</sup> Act no. 634/1992 Coll., on Consumer protection

<sup>23</sup> Act no. 89/2012 Coll., Civil Code

<sup>24</sup> Barák, J. et al. Zákon o bankách – komentář a předpisy související. Linde Praha, a. s. Prague: 2003. ISBN 80-7201-418-8, p. 331



*that he did not use the electronic payment instrument himself, he shall be entitled to require the issuer to refund without delay the funds withdrawn as a result of such use of the electronic payment instrument.*” This most frequently concerned unauthorized use of payment cards for the purpose of purchasing goods or services via the internet by submitting a card number, holder’s name, and card expiration in the store’s online application. Therefore, issuers – and banks in particular – reacted to the measure, considered very important for consumer protection at the time, by “disabling” internet payments with their cards.

Upon the effectiveness of the new Payment System Act (Act no. 284/2009 Coll.), which transposed the new Directive on the taking up, pursuit and prudential supervision of the business of electronic money institutions (Directive 2009/110/EC) as well as the requirements affecting the protection of (not only) consumers arising from the transposition of Directive 2007/64/EC of the EP and of the Council on payment services in the internal market, the original protection (as mentioned above) was annulled, with new protection being adopted that should be identical for all EU (or EEA, as appropriate) Member States.

The new solution may be viewed as more comprehensive, as it includes protection of not only transactions executed with the use of electronic payment instruments or electronic money, as appropriate, but also protection of any payment transaction. However, the new protection assumes mandatory participation of a client, acting as payer in this case, even though he was not a proper holder or user (as appropriate) of the relevant payment instrument (unauthorized transaction). The provisions of Section 116 of the Payment System Act (in connection to Article 61 of Directive 2007/64/EC) reads as follows: *“The payer shall bear the losses relating to any unauthorized payment transactions, up to an equivalent of EUR 150, resulting from the use of a lost or stolen payment instrument or, if the payer has failed to keep the personalized security features safe, from the misappropriation of a payment instrument.”* In practice, this means that in case a client – a payment card holder – lost his card and failed to report it, he will always bear the losses resulting from unauthorized use of such card up to the amount of EUR 150. In case the amount resulting from such unauthorized amount is higher, the difference between the actual amount and EUR 150 shall be borne by the issuer. However, since payment cards, which are also payment instruments, are protected by a PIN (Personal Identification Number), their unauthorized use is currently minimal in case of their physical presentation (e.g. an ATM withdrawal). The situation is different in case such payment instrument is used for online (internet) payments. A PIN is never submitted in the retailer’s system for this payment method and, consequently, the possibility of unauthorized use of a payment card in this manner is higher. The deductible for unauthorized card transactions on the internet is the same – i.e. EUR 150. The difference between the rightful cardholder’s deductible and the settled amount shall, once again, be borne by the issuer in this case.

However, the situation is different if electronic money is stored directly in the relevant payment instrument. In such case, the issuer shall not be liable for its use in any way in case such instrument is lost or stolen, whereas any losses shall be borne by its rightful holder (consumer).

With regard to the protection of consumers (in particular), it is also possible to underline the provisions of Section 120 of the PSA, which states that in case a user claims he did not authorize the given payment transaction or the payment transaction was executed incorrectly (author’s note: this may also apply to the use of electronic money), the provider of such service shall document that a procedure was followed, which allows the verification

that a payment order was submitted, that the payment transaction (including an electronic money transaction) was correctly recorded, settled and not affected by technical error or another defect. It is possible to deduce from the aforementioned that certain protection of consumers is set down by the fact that the burden on proof rests on the payment services provider / payment instrument issuer (including electronic money). However, in case he clears himself of guilt/blame (i.e. documents the requirements set down by law), any loss resulting from such transaction shall be borne by the user.

## Conclusion

It is safe to say that the legal protection of consumers in using electronic payment instruments and electronic money has undergone certain development in recent years. The basis of the legal protection consisted in the EU requirements that were mainly presented by the publication of various Directives, which Member States have been required to transpose in their national laws. The aforementioned obligation also applied to the Czech Republic. In the author's view, the protection of consumers (or clients, as appropriate) in this area was more severe during the initial stage in the Czech Republic, because legislators took advantage of the possibility to also transpose in the laws of the Czech Republic Recommendation No. 97/489/EC. Unlike in other EU Member States, clients using (mainly) payment card were protected against their unauthorized use on the internet. Provided the statutory terms and conditions were complied with, the relevant issuer was liable for any such transactions. However, since 2009, when the Payment System Act was re-codified, the liability of the providers of such services has been unified in terms of Directive 2007/64/EC on payment services in the internal market. The Directive set down a permanent deductible of clients in the amount of EUR 150, which is always borne by the payer (provided the statutory terms and conditions are met). Only amounts exceeding the aforementioned limit shall be borne by the relevant financial institution (issuer, payment services provider, etc.). In case of a loss and subsequent unauthorized use of electronic money stored in the lost/stolen payment instrument, any losses shall be fully borne by a rightful holder. However, in case a payment instrument is protected by a PIN, a third-party unauthorized use should not be possible. Nevertheless, in case such situation in fact occurs, it is necessary to analyze any and all facts. However, the issuer or provider of such service shall always have the burden of proof, because it is the professional party of the given transaction. This fact also serves as the basis of current legal regulation, not only on the European level, but also the national legal regulation, which is also included in the Civil Code.

## References

- Barák, J. et al. Zákon o bankách – komentář a předpisy související. Linde Praha, a. s. Prague: 2003. ISBN 80-7201-418-8, p. 331
- Máče, M. Platební styk: klasický a elektronický. Grada. Prague: 2006, ISBN 80-247-1725-5
- Schlossberger, O., Soldánová, M.: Platební styk, Prague 2007, BIVŠ, ISBN 978-80-7265-107-8,
- Schlossberger, O. Platební služby. Management Press, Prague: 2012. ISBN 978-80-7261-238-3,

Directive 2000/46/EC of the EP and of the Council on the taking up, pursuit of and prudential supervision of the business of electronic money institutions

Directive 2007/64/EC of the EP and of the Council on payment services in the internal market

Directive 2009/110/EC of the EP and of the Council on the taking up, pursuit and prudential supervision of the business of electronic money institutions

Act no. 21/1992 Coll., on Banks

Act no. 634/1992 Coll., on Consumer protection

Act no. 87/1995 Coll., on Savings and credit unions

Act no. 124/2002 Coll., on Transfers of funds, electronic means of payment and payment systems (the Payment Systems Act).

Act no. 256/2004 Coll., Capital market undertakings, as amended

Act no. 284/2009 Coll., on the Payment system

Act no. 89/2012 Coll., Civil Code

# Performance Measurement in Non-Profit Organisations – Exploring the Commonalities between Impact, Outcome and Performance Measurement in Open Youth Work Providers

Corinna Anja Hatzfeld  
Leeds Metropolitan University, UK

## Abstract

This paper seeks to understand the commonalities between impact, outcome and performance measurement in the context of open youth work providers in Germany.

Due to changes in the society, German youth club providers are facing strategic challenges which are threatening their future existence. To compete for donations, sponsors, volunteers and public funds they, like other non-profit organisations, are confronted with a growing need to measure activities and, thus, demonstrate competency to achieve legitimacy and future funding.

Based on a comprehensive literature review on open youth work and specifically its measurement, the author found that the dearth of research that is done on youth club providers is mainly based on educational or pedagogical foundations; there is hardly any research that focuses on managerial aspects of performance measurement.

Remarkably, researchers with an educational background typically use the same ideas as researchers with a managerial background and often just label the findings differently. What is called *performance measurement* in business studies often is called *outcome* or *impact measurement* in educational studies.

**Key words:** *non-profit organisation, youth work provider, performance measurement, outcome measurement, impact measurement*

## Introduction

Due to changes in the society, youth work providers like other non-profit organisations (NPOs) are facing several strategic challenges which are threatening their future existence. Consequently, the pressure to measure activities in order to demonstrate competency, to achieve legitimacy both by the public and investors, and to obtain future funding is increasing (among others, Paton 2003; Cairns et al. 2005; Barman 2007; Moxham 2009). Therefore, in the last few years, the topic of performance measurement in NPOs is receiving considerable academic and practitioner attention within the whole non-profit sector (Moxham 2009; Stötzer 2009; Greiling 2009; LeRoux and Wright 2010; Bagnoli and Megali 2011). As a result, a range of measurement frameworks, guidelines and manuals for the sector were developed. But despite all efforts, a consensus on how to measure the performance of NPOs was not yet achieved (Moxham 2009). There is still a dazzling array of concepts that are used within the sector and also a lack of exact delineations of terms like evaluation, outcome, impact, and performance measurement. With this article and future research activities, the author attempts to fill this gap in the body of knowledge.

The research activities are based on personal interest and the fact that within her professional position, the author has witnessed that especially German statutory and voluntary organisations that provide youth clubs or other forms of open youth work are faced with some existence-threatening challenges. The most important challenges of the organisations are: the continual cut back of government budgets (e.g., Greiling 2009, p. 71; Rauschenbach et al. 2010, p. 40; Deinet and Müller 2012, p. 11); the shrinking target groups due to negative demographic trends (e.g., German Youth Institute n.d.; Greiling 2009, p. 67; Rauschenbach et al. 2010, p. 37; van Santen 2010, p. 167; Deinet and Müller 2012, p. 10); the rising “*competition*” in terms of the enlargement of all-day schools in Germany (e.g., German Youth Institute n.d.; Rauschenbach et al. 2010, p. 39; Deinet and Müller 2012, p. 10); general value changes in the society like an increasing social inequality (e.g., Greiling 2009, pp. 61–63; Spatscheck 2009, p. 91); and the enlargement of general duties and responsibilities in relation to growing demands of various stakeholders (e.g., Greiling 2009, pp. 64–65). Therefore, it is understandable that the sector desperately seeks for evaluative concepts and solutions to legitimise their future work. Whereas, some authors (e.g., Liebig 2013), force a development of solutions out of the rows of youth work itself, the author believes that it is not necessary to reinvent that wheel if there are other areas of social work that are comparable.

As, this paper seeks to understand the commonalities between impact, outcome and performance measurement in the non-profit context, the author undertook a comprehensive literature review within the field. To get a better picture of the topic, German as well as international literature has been reviewed. Due to personal research interests, the further emphasis of the paper is set on open youth work providers in Germany and their use of evaluative concepts from a managerial point of view. Since open youth work originally is located in the field of education, educational literature has also been reviewed to reassure this gap in the existing body of knowledge. Hence, the paper starts with a substantial delineation of the terms to shed light on the topic.

## **Definitions and Commonalities of Evaluation and Performance Measurement**

### **Evaluation**

In simple terms, evaluation describes the process of determining whether a programme is accomplishing the desired results. It is “(...) *the method by which we demonstrate that we have accomplished what we said we would accomplish*” (Sabatelli and Anderson 2005). Thus, evaluation enables responsible managers to develop the best programmes possible, to learn from mistakes, to adjust programme changes as needed, to monitor progresses toward the programme’s goals and objectives, and to assess the programme’s outcome (Thompson and McClintock 2000).

In a more academic setting it can be defined as a form of social research that is characterised by a systematic and transparent procedure to describe and value an object of social reality on the basis of empirically gathered quantitative and/or qualitative data (Haubrich, Holthusen and Struhkamp 2005; DeGEval - Gesellschaft für Evaluation e.V. 2008). Those objects of social reality can be differentiated in regard to their various goal settings as evaluations of programmes, projects, products, activities, performances, organisations, policies, technologies or research (DeGEval - Gesellschaft für Evaluation e.V. 2008, p. 15).

## Performance / Performance Measurement

Especially in the not-profit environment, performance is often used interchangeably with the success of an organisation (Hatry 1978; Schwarz 2003; Bono 2006; Langthaler 2007; Bagnoli and Megali 2011). This is because it is believed that good performance has to somehow lead to the success of the organisation. The problem with success is, however, that in a non-profit oriented environment it cannot just be measured on a financial scale. To do successful community work, it is generally important to know the interests of various relevant stakeholders. Therefore, non-profit performance is more complex than performance of private organisations. To reduce complexity, Lebas and Euske advise that organisations should generally define a performance concept or causal model that applies to their own situation (2007, pp. 127–128).

An initial review of literature revealed several existing causal models that focus on various dimensions of performance, like *outputs* and *outcomes* (Poister 2003, p. 37; Lebas and Euske 2007, p. 128; Penna 2011; Urban Institute 2011), *impacts* (NCVO 2003; Schwarz 2003, p. 653; Bagnoli and Megali 2011, p. 161), or *effects* (Bono 2010, p. 80; International Group of Controlling 2010, p. 47).

### Dimensions of Evaluation and Performance: Outcome / Impact / Effect Measurement

As, there are particularities within the various academic disciplines the terms *outcomes*, *impacts* and *effects* that are not and probably can not be exactly delineated from each other and are sometimes even used interchangeably. Therefore, it is not an easy undertaking to find one definition that combines all views. For example, in educational sciences and other pedagogical and sociological circles, outcome is equated with short-term results and impact relates to long-term societal impact (Haubrich, Holthusen and Struhkamp 2005, p.3).

In business management the terms are used oppositely, as outcomes are connected with societal changes and impacts focus on a subjective level (Bono 2010; International Group of Controlling 2010, p. 47), as shown in the following figure:

**Figure 1: Dimensions of Evaluation and Performance Measurement. Adapted from Bono 2010, p. 80**

	Individual	Societal
Objective	Effects	Real Outcome
Subjective	Impact	Felt Outcome

Since most of the literature on open youth work is located in the educational sciences, the terms have to be used with caution especially as this research focuses on managerial aspects of performance measurement in open youth work providers.

## Conclusion

The initial literature review revealed that, on the one hand, the most common form of evaluation in open youth work related settings seems to be the evaluation of programmes because the majority of evaluative literature focused on outcomes and impacts of

programmes. On the other hand, literature and research on performance measurement mostly referred to organisational performance. This leads to the first assumption that outcome and/or impact measurement in open youth work settings mostly refer to the evaluation of programmes, whereas, performance measurement refers to an evaluation of the organisation, as shown in the following figure:

**Figure 2: Delineation of Evaluation and Performance Measurement**

Value Creation for Customer / Participant / Society	Outcome / Impact Measurement	Performance Measurement
Focus of Evaluation	Programme Evaluation	Organisational Evaluation

### Evaluation, Outcome and Performance Measurement in the Non-Profit-Sector

This literature review refers to impact, outcome and performance measurement in NPOs. A review of literature in the field of performance measurement, based on both German and international literature, revealed that there is a comprehensive amount of academic research either on performance measurement in general, or with focus on private, public and non-profit sector performance measurement. But despite a well established body of knowledge that focuses on performance measurement in private and public sector organisations, research on performance measurement of NPOs is still in an early stage of development (Moxham 2006). But since NPOs face a pressure to have to demonstrate their achievements (Paton 2003; Cairns et al. 2005; Barman 2007; Moxham 2009), the non-profit sector cannot close itself to various concepts and terms related to the topics of performance measurement including effectiveness, efficiency, accountability, quality standards, target achievement, outcome measurement and evaluation. Consequently, research on non-profit management themes in general (e.g., Merschen 2004; Helmig 2006; Pynes 2011) and non-profit financial management themes in particular (e.g., Eisenreich, Halfar and Moos 2005; Bono 2006; Schauer 2008; International Group of Controlling 2010; Bachert and Eischer 2010; Coe 2011) is increasing. As a result, not only in literature but also among non-profit leadership, the issue of measuring non-profit performance is receiving increasing academic and practitioner attention (amongst others, Poister 2003; Moxham 2006; Abraham 2007; Brüggemeier and Budäus 2007; Greiling 2009; Moxham 2009; Stötzer 2009; Penna 2011).

Over the last ten to fifteen years literature on *performance measurement* within the non-profit sector has gradually developed in several identifiable stages. In the late 1990's, a considerable amount of literature dealt with performance measurement either from the how-to-do level with focus on processes (e.g., Grobman 1999), the organisation's capacity and skills for strong performance (e.g., Edwards, Austin and Altpeter 1998; Letts, Ryan and Grossman 1999), or the identification of adequate performance indicators (e.g., Herzlinger 1999). But, according to Greiling, the lines between performance reporting, performance measurement and performance management were blurred over a long period of time (2007, p. 2). According to Greiling, this did not change until several years ago when performance reporting delineated itself as an accountability tool and performance measurement as a mere steering instrument. Unfortunately, Greiling does not define these notions any further especially when it comes to the differences between performance measurement and performance management. Greiling's cautions could cohere with the

fact that there is still no exact delineation between both terms in existing non-profit literature.

In more recent literature, a shift from output to *outcome measurement* can be perceived. This is from the academic perspective (e.g., Poister 2003) as well as from a practical perspective (e.g., Penna 2011; Urban Institute 2011). Some authors even widen the outcome measurement approach by an *impact dimension* (e.g., Bagnoli and Megali 2011) and especially in the German literature by the dimension of *effects* (e.g., Bono 2010; International Group of Controlling 2010).

Especially in the context of U.S. American literature on performance measurement, *outcome measurement* is gaining more and more importance over the past 20 years. It started getting a lot of attention during the mid 1990s as funders of the organisations started requiring measurable results to demonstrate the effectiveness of programmes and services. Its development is mainly dominated by tools and guidebooks that help NPOs to measure their programme outcomes. With regard to *evaluation and outcome measurement approaches* most of the literature found focused on so called programme logic models (among others, Poister 2003; Bono 2010; Carman 2010; Urban Institute 2011). Furthermore, other approaches can be summed up as evaluative approaches in the context of quality management and the Balanced Scorecard.

*Logic models* attempt to articulate the “*theory of change*” (Carman 2010) and with that illustrate connections between programme objectives, goals, activities, short-term, and long-term results with the help of flowcharts, diagrams, or tables. Generally, the idea of programme logic models is to show the underlying logic by which the organisation’s programme activities are expected to lead to planned outcomes. Therefore, *outcome measurement* is a major component of logic models (Bozzo 2000). With regard to youth work, the Urban Institute (2011) created a special outcome framework. They developed sequence charts for youth mentoring and youth tutoring programmes. Their sequence charts generally identify key outcomes and present them in the sequence they are normally expected to occur.

To reassure the assumption stated above logic model approaches assess measurement from a programme perspective and not from the perspective of organisational performance. It has to be proved whether or not Letts, Ryan and Grossman were right by saying: “*Behind every effective program, and especially every sustained effective program, is an organization that performs well*” (1999, pp. 15–16).

With limitation to this work, it has to be said that most of the literature found was based on applied research designs and manuals or guidebooks for practitioners. There is hardly any empirical research done on evaluation approaches within the non-profit sector. Interestingly, outcome measurement seems to be an U.S. American phenomenon as surveys of NPOs in the U.S. show that outcome measurement is, and with that continuing a trend in recent decades, the most common purpose for undertaking evaluative activities by NPOs (Fine, Thayer and Coghlan 2000; Reed and Morariu 2010, p. 17). But, outcome measurement guidebooks and manuals are mostly published by funding foundations, like the Kellogg’s Foundation or influential NPOs like United Way of America. Therefore, they are often not based on empirical foundations and mostly implemented in organisations from the top down. Guidebooks are used as sources of normative messages about what to measure to be able to prove effectiveness of the organisations towards funders and other stakeholders. They also carry normative ideas about the practice of performance



measurement by reflecting dominant conceptions of NPO performance, and direct NPOs in the process of measuring their performance (Benjamin 2012, p. 7). Therefore, it is still reality that as Bozzo (2000) once stated, the structure of the evaluation is driven by those who are requesting the evaluation.

### **Evaluation and Performance Measurement in the Context of Open Youth Work**

In Germany, academic research in the educational environment of open youth work has a relatively long tradition that dates back to the early 1960's (Müller et al. 1964). Especially in the context of beginning reforms in the public sector and the upcoming "*New Steering Mode*" from the 1990's, the aspects of quality management and quality assurance in youth work became significant. The main reasons for these developments in youth work were (and still are) to legitimise the prospective work (Deinet and Liebig 2006) and to improve youth work in general (Koss and Fehrlen 2003, pp. 10–11; Lindner 2009b, p. 10).

Before aspects of evaluation and performance measurement are deepened in the context of open youth work, it seems important to define what open youth work is. According to the European Confederation of Youth Clubs (ECYC) the purpose of open youth work is "*to offer young people, on the basis of their voluntary involvement, developmental and educational experiences which will equip them to play an active part in democratic society, as well as meet their own needs*" (Cummings 2007). Therefore, open youth work takes place in youth clubs, youth projects, youth houses, or on the street. Its main characteristic is that it generally takes place outside the formal education curriculum. Therefore, open youth work is often summed up to *out-of-school education*. Open youth work in Germany legitimises itself through Book VIII of the German Social Code - the so-called Child and Youth Services Act (KJHG) – that took effect on 1 January 1991. In accordance with Sec 2 KJHG and Sec 11 Subs 2 KJHG, youth work (and with that open youth work as part of the out-of-school education) is defined as a service of youth welfare that is offered by youth organisations and other statutory youth service providers as well as voluntary youth service providers (Hänisch 2009, p. 49). With respect to this paper, only voluntary youth service providers (subsumed under the generic term *NPOs*) are of relevance.

Open youth work generally belongs to the broad field of education and social work. Therefore, most of the literature and research published that deals with youth work in general or open youth work in particular, can be found in this field. There has been hardly any research done that is based on managerial aspects within the field. With this and future research activities the author hopes to fill this gap in the body of knowledge because she follows the stance that as open youth work providers are NPOs, there is a managerial potential like in other NPOs to measure their performance.

### **Evaluation in Open Youth Work**

What is known as evaluation in the context of social work today has its deeper roots in the U.S. American educational research of the 1930's and reached the German speaking regions in the 1970's as a so called "*accompanying research*" (Gregorz 2013). Gregorz described this form of research as an academic guidance of practitioners by experts from universities or specialised private institutions with the intention of drawing conclusions for their professional actions (p. 28). Against this background, there was a natural consensus between practitioners that it was their challenge to control standards and to define the outcomes of their work (Otto 2007). This steering model of professional self-control or "*professionalism*" was replaced by the orientation towards outcomes and efficiency during

the New Public Management movement in the 1990's when government actions were focused more on market economy principles. In recent years youth work has also been influenced by the concept of evidence-based practice and it became the "*big issue*" (Otto 2007, p. 11) in health care and social work. Evidence-based practice aims at the measurement of results and outcomes of the work instead of logic models, performance indicators or other output-oriented process, structure, or concept data or quality (Leser, Lindner and Reif 2009, p. 423). It is a concept that sees influences of managerial steering and influences of business administrative concepts in the context of social work critically (e.g., Otto, Polutta and Ziegler 2010).

### **Outcome Measurement in Open Youth Work**

In general terms, the measurement of outcomes is a recent topic in social work and, with that, in the field of open youth work (among others, Lindner 2009a; Coelen and Wahner-Liesecke 2009; Deinet 2009; König 2009; Gregorz 2013; Liebig 2013; Lindner 2013). Due to substantial challenges in the field, the topic of outcome measurement is closely connected to the wish and subliminal need to legitimise future work and funding. Therefore, the discussions about outcomes and their measurement are often less objective, emotional discussions (Gregorz 2013, p. 27).

Owing to the actuality of the topic, outcome measurement in open youth work has a relatively short tradition compared with other fields of social work. This is accompanied by a general dearth of empirical research within the field. Given this, Gregorz (2013, p. 45) suggested a conclusion by analogy as a possible way to measure outcomes of open youth work. As a possible related field in social work he chose "*educational assistances*" as this field bears a structural resemblance to open youth work. He adopted four key areas for outcome measurement in open youth work (p. 49): personality development, decision-making and responsibility, identity development, and social integration. With respect to his work it has to be said that Gregorz corroborated his analogy with only three other sources. This seems not an adequate amount of sources to achieve reliable results.

All other reviewed sources on outcome measurement in open youth work focused on the level of participants or visitors of youth clubs. Therefore, again the assumption that outcome and impact measurement are related to a programme perspective of evaluation and with that an individual value creation for participants and visitors can be strengthened.

### **Performance Measurement in Open Youth Work**

Explicitly, there are only a handful of literature sources on performance measurement in the context of open youth work. This is related to the fact that open youth work belongs to the broad field of educational sciences and that within these fields a refusal of managerial topics is noticeable (Wendt 2010, p. 475). But as (Härdrich 2010, p. 18) stated, since open youth work produces outcomes, it has to be possible to describe those outcomes and then there has to be performance indicators that describe and measure this outcomes.

The work of Härdrich (2012) is one of the first that explicitly broaches the issue of performance measurement in open youth work. With limitations to Härdrich's work, it has to be said that he approached the topic from a practitioner's point of view. He grounded his work on only a dearth of secondary sources so future research has to prove whether his arguments really can withstand an academic enquiry. But, in the absence of alternatives, his work has attracted considerable attention. Despite his critical reflection of performance

indicators in open youth work, he generally follows the stance that youth work organisations should measure everything that is measurable but should be aware of the fact that especially the outcome of their work is often not, or only with an unreasonable effort, measurable. Based on Härdrich's recommendations, the following will discuss functions of performance indicators in open youth work; specific characteristics of performance indicators in open youth work; and boundaries and threats of performance indicators in open youth work.

Although, according to (Härdrich; 2012, p. 122) several open youth work providers have used performance indicators for several decades, they are mainly a result of the output-oriented steering of communal budgets. Consequently, performance indicators are often output-oriented ratios like *quantity of visitors per day* and *opening hours per week* that are used to justify the pedagogical work to members of the municipal councils and their personal target values. In recent years, the output-oriented ratios are often completed with outcome-oriented performance indicators. Härdrich pointed out that the problem with these outcomes is that they are only assumed and felt outcomes that cannot be seriously proved. In addition, the performance indicators in the field of youth work are often used unconsciously with a non-transparent background and are, therefore, often not exactly scrutinised. Consequently, actual ratios and performance indicators in youth work are merely numerical values without any common ground. In general, according to Härdrich the use of performance indicators in open youth work is not an easy undertaking. The main reason is the basic pedagogical model that underlies open youth work. This model of open youth work combines a general openness of services, the so called "*walk-in structure*" and with that a frequently changing visitor structure. Another specific characteristic of performance indicators in open youth work is that the goals whose achievement they try to measure are often formulated as qualitative outcome-related goals and to a lesser extent formulated as quantitative output-related goals (p. 123). In Härdrich's opinion this indicates that performance indicators that aim at measuring pedagogical outcomes in youth work should have a qualitative nature, whereas performance indicators that aim at measuring managerial aspects in open youth work providers should aim at outputs and, therefore, should have a quantitative nature. But as it is known from other NPOs a performance measurement system should always combine quantitative as well as qualitative aspects of organisational performance. This is only one aspect where Härdrich's argumentation is vulnerable as the following will show.

Härdrich ascribed the *boundaries and threats of performance indicators* in the pedagogical field to four main reasons: Firstly, the use of indicator-based measurement systems is limited mainly because it is a managerial tool that cannot be transferred to the context of open youth work. Härdrich drew this statement mostly on the fact that Kaplan and Norton's fundamental approach was built upon measurement processes in businesses. But although Kaplan and Norton devised the Balanced Scorecard for the use in private organisations, in their later work they explicitly recommend the adoption to the non-profit sector (Kaplan and Norton 2001; Kaplan 2001). Therefore, it is not comprehensible why Härdrich strictly refused the adaption of business approaches to the area of open youth work. Secondly, from Härdrich's point of view it is not possible to set up unambiguous cause-and-effect relationships within the human services because services like open youth work are fields that are confronted with many, often not measurable parameters. He reduced performance measurement to a "*technocratic tool to steer policy*" (2012, p. 121). Härdrich took his argumentation even further by saying that the attempt to measure all areas of policy is a "*fad*" that simulates objectivity and measurability where on a closer inspection is merely a "*delusion of objectivity*" (p. 121). Thirdly, he saw a problem in the

aspect that performance indicators give some sort of false security by giving the impression that everything is measurable as long as one defines the right indicators and collects the right data. Lastly, he pointed out the threat that things will be compared with other things that are actually not comparable.

Despite Härdrich's stance, there actually are attempts to use performance measurement, or explicitly the Balanced Scorecard in open youth work settings, as shown in the following. However, it is observable that the sector does not name these approaches *performance measurement* but *quality management*.

### **Other Approaches of Quality Management in Open Youth Work**

In terms of quality management in open youth work two controversial school of thoughts can be found in Germany. Both have their roots in the year 2000 when Schumann and his team from the University of Siegen developed a set of checklists and standards for "good" youth work, called WANJA (Appel, Schumann and Stötzel 2000). Almost in parallel Deinert, Stutzenhecker and von Spiegel developed the QQS Model (Quality development, Quality assurance and Self-evaluation) that advises that objectives of good youth work should be individually negotiated with providers, funders, children and youth (Spiegel 2000).

In 2003, Koss and Fehrlen published a documentation of the project "*Development of Quality in Open Youth Work*" methodically based on the so-called *Socio-spatial Conception Development Model* according to Deinet (1999). Through their publication, Koss and Fehrlen directly supported the QQS Model as they critique that it is not possible to use a set of checklists to cover all aspects of quality in an organisation, programme or service. One of their main findings was that there is no, and cannot be a, standard definition of "good" youth work (p. 20). This is due to the fact that, for them, quality is a social construct that depends on multiple factors that cannot be reduced to processes and results as processes and results in youth work develop in an "*action of coproduction*" (p. 23) of various stakeholders (p. 23-24).

From an European perspective, the European Confederation of Youth Clubs published a report on measuring and assuring quality (Cummings 2007). Some member organisations presented their findings as they developed their own methods or adopted existing approaches and applied them to their organisations. The general goal of the organisations was to create some common standards and baselines of quality that could be used by any youth work organisation to ensure that their services are of a high quality. Although, the findings can be summed up by saying that there was no such thing as "*one size fits all*"; regional differences in funding and the embedding of organisations in national structures had to be considered. Regardless, the main limitation of the work is that there is no additional information that proves or strengthens the soundness of the research. There are no references to secondary resources and no additional publications in the English language can be found.

Table 1 shows a summary of the results of the report:

**Table 1: Results of the European Confederation of Youth Clubs (Cummings 2007)**

# X<sub>1</sub>

What stands out is that most of the studies adopted approaches from the private sector. Especially, the European Foundation for Quality Management Excellence Model (EFQM Model) seemed to be the first choice when it came to quality assurance in open youth work. Only one study adopted a Balanced Scorecard approach implemented by external consultants. One main reason for the neglect of the Balanced Scorecard might be that the approach is particularly designed for larger organisations, and, therefore, it is likely to be too complex for smaller ones.

The Irish Quality Standards Framework seems the most reliable study of the ones named above and it is the only one that conducted a pilot study with 8 of the 21 regional youth services. It also had the intention of an external validation to add currency and credibility to the results. Therefore, future research has to have a closer look at the Irish results.

## Conclusions and Directions for Further Research

Due to changes in the society, German youth club providers are facing strategic challenges which are threatening their future existence. To compete for donations, sponsors, volunteers and public funds they, like other NPOs, are confronted with a growing need to measure activities and, thus, demonstrate competency to achieve legitimacy and future funding. Since there is a dazzling array of concepts that are used within the non-profit sector and also a lack of exact delineations of terms, this paper sought to understand the commonalities between impact, outcome and performance measurement in the context of open youth work providers in Germany.

Based on a comprehensive literature review on open youth work and respectively its measurement, the author found that the dearth of research that is done on youth club providers is mainly based on educational or pedagogical foundations. There is hardly any research that focuses on managerial aspects of performance measurement. The literature review also revealed that, the most common form of evaluation in open youth work is focused on individual value creation for participants of programmes and/or the visitors of the youth clubs. Therefore, so far the evaluative focus of the sector is mainly based on *programme evaluations* and with that the measurement of outcomes and impacts.

Whereas, *performance measurement* generally refers to the evaluation of organisational performance, the sector often refuses to use managerial concepts and language. Within the sector, the few attempts to use performance measurement in open youth work settings were not labelled performance measurement but *quality management*. Remarkably, researchers with an educational background basically use the same ideas as researchers with a managerial background and often just label the findings differently.

The literature review showed that there are some attempts of approaches like the Balanced Scorecard or the EFQM Model in the context of open youth work. But as there is no deepening research on these attempts, there can hardly be any conclusion drawn. Because managers of organisations are under pressure to measure organisational aspects, there might be other research that could be done within the next couple of years. No matter how long it will take, it seems important that any form of evaluation or performance measurement is not just used to compare organisations against each other. This would only stir up a common fear amongst youth workers. Like Deinet (2011) found, the biggest obstacle for the participants often was that they understood evaluation as a critical and drastic assessment of their personal work or organisation. Therefore, it is of fundamental importance to combine any form of evaluation with suitable human resources development activities (p. 376). Another important success factor is the inclusion of the various others stakeholders. Future research should focus on the inclusion of the stakeholders and try to let them create their individual forms of measurement.

## References

- Abraham, A. (2007) **An Embedded Model for Understanding the Development of Accounting Control Systems in a Nonprofit Organisation**. *The Journal of Global Business Issues*, 1 (2), pp 1–9.
- Appel, M., Schumann, M. and Stötzel, A. (2000) **Handbuch zum Wirksamkeitsdialog in der offenen Kinder- und Jugendarbeit**. Qualität sichern, entwickeln und verhandeln / Projektgruppe WANJA, Münster, Votum.
- Bachert, R. and Eischer, S. (2010) **Controlling in der Nonprofit-Organisation**, Freiburg, Lambertus Verlag.
- Bagnoli, L. and Megali, C. (2011) **Measuring Performance in Social Enterprises**. *Nonprofit and Voluntary Sector Quarterly*, 40 (1), pp 149–165.
- Barman, E. (2007) **What is the Bottom Line for Nonprofit Organizations? A History of Measurement in the British Voluntary Sector**. *VOLUNTAS: International Journal of Voluntary and Nonprofit Organizations*, 18 (2), pp 101–115.
- Benjamin, L. M. (2012) **Nonprofit Organizations and Outcome Measurement: From Tracking Program Activities to Focusing on Frontline Work**. *American Journal of Evaluation*, 33, pp 431–447.
- Bono, M. L. (2006) **NPO Controlling**. Professionelle Steuerung sozialer Dienstleistungen, Stuttgart, Schäffer-Poeschel.
- Bono, M. L. (2010) **Performance-Management in NPOs**. Steuerung im Dienste sozialer Ziele, Baden-Baden, Nomos.
- Bozzo, S. L. (2000) **Evaluation Resources for Nonprofit Organizations**. *Nonprofit Management and Leadership*, 10 (4), pp 463–472.
- Brüggemeier, M. and Budäus, D. (2007) **Controlling und Performance Management im öffentlichen Sektor**. Ein Handbuch; Festschrift für Professor Dr. Dr. h.c. Dietrich Budäus zum 65. Geburtstag, Bern, Haupt.
- Cairns, B. et al (2005) **Improving performance? The adoption and implementation of quality systems in U.K. nonprofits**. *Nonprofit Management and Leadership*, 16 (2), pp 135–151.
- Carman, J. G. (2010) **The Accountability Movement**. *Nonprofit and Voluntary Sector Quarterly*, 39 (2), pp 256–274.
- Coe, C. K. (2011) **Nonprofit financial management**. A practical guide, Hoboken, N.J., Wiley.
- Coelen, T. and Wahner-Liesecke, I. (2009) **Jugendarbeit kann auch mit (Ganztags-)Schulen wirken**. In: W. Lindner, ed. **Kinder- und Jugendarbeit wirkt. Aktuelle und ausgewählte Evaluationsergebnisse der Kinder- und Jugendarbeit**. 2nd ed. Wiesbaden, VS, Verlag für Sozialwissenschaften, pp 241–260.

Cummings, A. (2007) **Getting It Right: Quality Assurance in Youth Work**, Antwerp, European Confederation of Youth Clubs. Available from: <<http://www.ecyc.org/projects/getting-it-right-quality-assurance-youth-work>> [Accessed 9 November 2013].

DeGEval - Gesellschaft für Evaluation e.V. (2008) **Standards für Evaluation**. 4th eds., Köln, Geschäftsstelle DeGEval.

Deinet, U. (1999) **Sozialräumliche Jugendarbeit**. Eine praxisbezogene Anleitung zur Konzeptentwicklung in der offenen Kinder- und Jugendarbeit, Opladen, Leske + Budrich.

Deinet, U. (2009) **Qualität durch Dialog - Kommunale Qualitäts- und Wirksamkeitsdialoge in der Offenen Kinder- und Jugendarbeit am Beispiel Nordrhein-Westfalens**. In: W. Lindner, ed. **Kinder- und Jugendarbeit wirkt. Aktuelle und ausgewählte Evaluationsergebnisse der Kinder- und Jugendarbeit**. 2nd ed. Wiesbaden, VS, Verlag für Sozialwissenschaften, pp 125–138.

Deinet, U. (2011) **Evaluation und Qualitätstentwicklung in der Offenen Kinder- und Jugendarbeit**. Erfahrungen und Empfehlungen. deutsche jugend - Zeitschrift für die Jugendarbeit, 59 (9), pp 369–376.

Deinet, U. and Liebig, R. (2006) **Der Wirksamkeitsdialog für die Offene Kinder- und Jugendarbeit in Nordrhein-Westfalen**. Geschichte, Entwicklung und Funktionen. deutsche jugend - Zeitschrift für die Jugendarbeit, 54 (4), pp 153–160.

Deinet, U. and Müller, K. (2012) **Offene Kinder- und Jugendarbeit vor großen Herausforderungen**. Mit besonderem Blick auf Ausbildung, Personalentwicklung und Praxisforschung. deutsche jugend - Zeitschrift für die Jugendarbeit, 60 (1), pp 9–17.

Edwards, R. L., Austin, D. M. and Altpeter, M. A. (1998) **Managing Effectively in an Environment of Competing**. In: R. L. Edwards, J. A. Yankey and M. A. Altpeter, eds. **Skills for effective management of nonprofit organizations**. Washington, DC, NASW Press, pp 5–21.

Eisenreich, T., Halfar, B. and Moos, G. (2005) **Steuerung sozialer Betriebe und Unternehmen mit Kennzahlen**, Edition Sozialwirtschaft, 22, Baden-Baden, Nomos Verlagsgesellschaft.

Fine, A. H., Thayer, C. E. and Coghlan, A. (2000) **Program Evaluation Practice in the Nonprofit Sector**. Nonprofit Management and Leadership, 10 (3), pp 331–339.

German Youth Institute (n.d. ) **Projekt: Jugendhilfe und sozialer Wandel - Leistungen und Strukturen (Phase VI) - Erhebung bei Jugendzentren**. [Internet], München, Deutsches Jugendinstitut e.V. Available from: <<http://www.dji.de/cgi-bin/projekte/output.php?projekt=64&Jump1=LINKS&Jump2=9>> [Accessed 8 November 2011].

Gregorz, K. (2013) **Wirkungsorientierung in der Offenen Jugendarbeit**. Chancen und Grenzen. In: Land Steiermark - A6 Bildung und Gesellschaft and FA Gesellschaft und Diversität - Referat Jugend, eds. **jugendarbeit: wirkt. Versuch einer interdisziplinären Auseinandersetzung**. Graz, Verl. für Jugendarbeit und Jugendpolitik, pp 27–54.



- Greiling, D. (2007) **Trust and Performance Management in Non-Profit Organizations**. The Innovation Journal: Public Sector Innovation Journal, Volume 12 (3) (Article 9)
- Greiling, D. (2009) **Performance Measurement in Nonprofit-Organisationen**, Wiesbaden, Gabler Verlag / GWV Fachverlage GmbH Wiesbaden.
- Grobman, G. M. (1999) **Improving quality and performance in your non-profit organization**, Harrisburg, White Hat Communications.
- Hänisch, D. (2009) **Child and Youth Services in Germany**. [Internet], Bonn, IJAB - Fachstelle für Internationale Jugendarbeit der Bundesrepublik Deutschland e.V. Available from: <[http://www.kinder-jugendhilfe.info/en\\_kjhg/cgi-bin/showcontent.asp?ThemaID=5002](http://www.kinder-jugendhilfe.info/en_kjhg/cgi-bin/showcontent.asp?ThemaID=5002)> [Accessed 21 November 2011].
- Härdrich, D. (2010) **Ist die integrierte Berichterstattung Niedersachsen IBN auch für die offene Jugendarbeit geeignet?**, Hohegeiß. 4 January
- Härdrich, D. (2012) **Ziel- und Kennzahlensteuerung in der Offenen Jugendarbeit - eine Annäherung**. deutsche jugend - Zeitschrift für die Jugendarbeit, 60 (3), pp 121–127.
- Hatry, H. P. (1978) **The Status of Productivity Measurement in the Public Sector**. Public Administration Review, 38 (1 (Jan.- Feb.)), pp 28–33.
- Haubrich, K., Holthusen, B. and Struhkamp, G. (2005) **Evaluation - einige Sortierungen zu einem schillerndne Begriff**. In: Deutsches Jugendinstitut e.V., ed. **DJI Bulletin Plus**. DJI Bulletin, Herbst 2005(72), pp 1–4.
- Helmig, B. (2006) **Nonprofit-Management**. Beispiele für Best-Practices im Dritten Sektor. 2nd eds., Wiesbaden, Gabler.
- Herzlinger, R. E. (1999) **Effective Oversight**. A Guide for Nonprofit Directors. In: Harvard Business School Press, ed. **Harvard Business Review on Nonprofits**. Boston, Harvard Business School Press, pp 29–52.
- International Group of Controlling (2010) **Wirkungsorientiertes NPO-Controlling**. Leitlinien zur Zielfindung, Planung und Steuerung in gemeinnützigen Organisationen. IGC-Schriften, Freiburg, Haufe-Lexware GmbH & Co. KG.
- Kaplan, R. S. (2001) **Strategic Performance Measurement and Management in Nonprofit Organizations**. Nonprofit Management and Leadership, 11 (3), pp 353–370.
- Kaplan, R. S. and Norton, D. P. (2001) **The strategy-focused organization**. How balanced scorecard companies thrive in the new business environment, Boston, Harvard Business School Press.
- König, J. (2009) **Qualitätskriterien zur Selbstevaluation in der Kinder- und Jugendarbeit**. In: W. Lindner, ed. **Kinder- und Jugendarbeit wirkt. Aktuelle und ausgewählte Evaluationsergebnisse der Kinder- und Jugendarbeit**. 2nd ed. Wiesbaden, VS, Verlag für Sozialwissenschaften, pp 295–308.

Koss, T. and Fehrlen, B. (2003) **Qualitätsentwicklung in der offenen und verbandlichen Kinder- und Jugendarbeit**. Eine Arbeitshilfe, Leinfelden-Echterdingen, Fehrlen.

Langthaler, S. (2007) **Die Balanced Scorecard als Instrument der Erfolgssteuerung in sozialen Nonprofit-Organisationen**. In: M. Brüggemeier and D. Budäus, eds. **Controlling und Performance Management im öffentlichen Sektor. Ein Handbuch; Festschrift für Professor Dr. Dr. h.c. Dietrich Budäus zum 65. Geburtstag**. Bern, Haupt, pp 81–89.

Lebas, M. and Euske, K. (2007) **A conceptual and operational delineation of performance**. In: A. Neely, ed. **Business Performance Measurement. Unifying Theories and Integrating Practice**. 2nd ed. Cambridge, New York, Cambridge University Press, pp 125–139.

LeRoux, K. and Wright, N. S. (2010) **Does Performance Measurement Improve Strategic Decision Making? Findings From a National Survey of Nonprofit Social Service Agencies**. *Nonprofit and Voluntary Sector Quarterly*, 39 (4), pp 571–587.

Leser, U., Lindner, W. and Reif, V. (2009) **Wirkungen und Qualität der kommunalen Jugendarbeit in Baden-Württemberg - WuQ**. Ergebnisse eines Modellvorhabens zur Weiterentwicklung der Jugendarbeit. *deutsche jugend - Zeitschrift für die Jugendarbeit*, 57. (10), pp 423–433.

Letts, C., Ryan, W. P. and Grossman, A. (1999) **High Performance Nonprofit Organizations**. *Managing Upstream for Greater Impact*, New York, Wiley.

Liebig, R. (2013) **Wirkungsorientierung in der Kinder- und Jugendarbeit Anmerkungen zu einer ungeliebten Debatte**. In: Land Steiermark - A6 Bildung und Gesellschaft and FA Gesellschaft und Diversität - Referat Jugend, eds. **jugendarbeit: wirkt. Versuch einer interdisziplinären Auseinandersetzung**. Graz, Verl. für Jugendarbeit und Jugendpolitik, pp 67–82.

Lindner, W. (2009a) **Kinder- und Jugendarbeit wirkt**. Aktuelle und ausgewählte Evaluationsergebnisse der Kinder- und Jugendarbeit. 2nd eds., Wiesbaden, VS, Verlag für Sozialwissenschaften.

Lindner, W. (2009b) **Kinder- und Jugendarbeit wirkt. Aber: wie und wo und warum genau?** In: W. Lindner, ed. **Kinder- und Jugendarbeit wirkt. Aktuelle und ausgewählte Evaluationsergebnisse der Kinder- und Jugendarbeit**. 2nd ed. Wiesbaden, VS, Verlag für Sozialwissenschaften, pp 9–20.

Lindner, W. (2013) **Jugendarbeit wirkt. Aber: wie und wo und wozu genau?** In: Land Steiermark - A6 Bildung und Gesellschaft and FA Gesellschaft und Diversität - Referat Jugend, eds. **jugendarbeit: wirkt. Versuch einer interdisziplinären Auseinandersetzung**. Graz, Verl. für Jugendarbeit und Jugendpolitik, pp 83–96.

Merschen, J. (2004) **Strategic management for non-profit organizations**. *Creating value in management education*, Stuttgart, ibidem-Verlag.

Moxham, C. (2006) **Measuring the performance of voluntary and community organisations**. PhD Thesis, University of Manchester.

Moxham, C. (2009) **Performance measurement: Examining the applicability of the existing body of knowledge to nonprofit organisations**. *International Journal of Operations & Production Management*, 29 (7), pp 740–763.

Müller, C. W. et al (1964) **Was ist Jugendarbeit?** Vier Versuche zu einer Theorie, München, Juventa.

NCVO (2003) **Measuring Impact - A Guide To Resources**. [Internet], London, The National Council for Voluntary Organisations (NCVO). Available from: <<http://www.ncvo-vol.org.uk/policy-research-analysis/research/measuring-impact>> [Accessed 18 November 2011].

Otto, H.-U. (2007) **Zum aktuellen Diskurs um Ergebnisse und Wirkungen im Feld der Sozialpädagogik und Sozialarbeit - Literaturvergleich nationaler und internationaler Diskussion**. Expertise im Auftrag der Arbeitsgemeinschaft für Kinder- und Jugendhilfe - AGJ, Berlin, Arbeitsgemeinschaft für Kinder- und Jugendhilfe.

Otto, H.-U., Polutta, A. and Ziegler, H. (2010) **Zum Diskurs um evidenzbasierte Soziale Arbeit**. In: H.-U. Otto, A. Polutta and H. Zeigler, eds. **What works - Welches Wissen braucht die Soziale Arbeit? Zum Konzept evidenzbasierter Praxis**. Opladen, MI, Verlag Barbara Budrich, pp 7–25.

Paton, R. (2003) **Managing and measuring social enterprises**, London, Thousand Oaks, Sage Publications.

Penna, R. M. (2011) **The nonprofit outcomes toolbox**. A complete guide to program effectiveness, performance measurement, and results, Hoboken, N.J, John Wiley & Sons.

Poister, T. H. (2003) **Measuring performance in public and nonprofit organizations**. 1st, San Francisco, Jossey-Bass.

Pynes, J. (2011) **Effective nonprofit management**. Context and environment, Armonk, N.Y, M.E. Sharpe.

Rauschenbach, T. et al (2010) **Lage und Zukunft der Kinder- und Jugendarbeit in Baden-Württemberg**. Eine Expertise, Stuttgart, Landeszentrale für Politische Bildung Baden-Württemberg.

Reed, E. and Morariu, J. (2010) **State of Evaluation 2010: Evaluation Practice and Capacity in the Nonprofit Sector**. [Internet]. Available from: <[http://www.innonet.org/client\\_docs/innonet-state-of-evaluation-2010.pdf](http://www.innonet.org/client_docs/innonet-state-of-evaluation-2010.pdf)> [Accessed 14 June 2012].

Sabatelli, R. M. and Anderson, S. A. (2005) **Assessing Outcomes in Child and Youth Programs: A Practical Handbook**, University of Connecticut, School of Family Studies and Center for Applied Research.

Schauer, R. (2008) **Rechnungswesen für Nonprofit-Organisationen**. Ergebnisorientiertes Informations- und Steuerungsinstrument für das Management in Verbänden und anderen Nonprofit-Organisationen. 3., überarb. u. erw. Aufl., Bern, Haupt.

Schwarz, P. (2003) **Erfolgsorientierung in Nonprofit-Organisationen: Zur Konstruktion eines Modells**. In: E.-B. Blümle, ed. **Öffentliche Verwaltung und Nonprofit-Organisationen. Festschrift für Reinbert Schauer**. Wien, Linde, pp 641–662.

Spatscheck, C. (2009) **The German perspective: youth work, integration and policy**. In: G. Verschelden et al., eds. **The history of youth work in Europe. Relevance for today's youth work policy**. Strasbourg, Council of Europe Pub., pp 84–93.

Spiegel, H. von (2000) **Jugendarbeit mit Erfolg**. Arbeitshilfen und Erfahrungsberichte zur Qualitätsentwicklung und Selbstevaluation: ein Modellprojekt des Landschaftsverbandes Westfalen-Lippe, Landesjugendamt/Westfälische Schulen, Münster, Votum.

Stötzer, S. (2009) **Stakeholder performance reporting von Nonprofit-Organisationen**. Grundlagen und Empfehlungen für die Leistungsberichterstattung als stakeholderorientiertes Steuerungs- und Rechenschaftslegungsinstrument, Wiesbaden, Gabler.

Thompson, N. J. and McClintock, H. O. (2000) **Demonstrating your Program's Worth**. A Primer on Evaluation for Programs to Prevent Unintentional Injury, Atlanta.

Urban Institute (2011) **Outcome Indicators Project**. [Internet], Washington, D.C., The Urban Institute. Available from: <<http://www.urban.org/center/cnp/Projects/outcomeindicators.cfm>> [Accessed 8 November 2011].

van Santen, E. (2010) **Weniger Jugendliche, weniger Jugendarbeit?** Demografische Veränderungen als Herausforderung für die Jugendarbeit. *deutsche jugend - Zeitschrift für die Jugendarbeit*, 58 (4), pp 167–177.

Wendt, P.-U. (2010) **"Es muss erstens den Problemlagen der Jugendlichen angepasst sein und zweitens von ihnen angenommen werden."** Ergebnisse eines Projekts zur Erforschung von Wirkungen der Kinder- und Jugendarbeit. *deutsche jugend - Zeitschrift für die Jugendarbeit*, 58 (11), pp 475–484.

## Forecasting Gold Spot Prices by Gold ETF's Using Multiple Linear Regression Model: *an Indian Context*

**Kirti Arekar**

Institute: K.J. Somaiya Institute of Management Studies & Research, India

**Rinku Jain**

Institute: K.J. Somaiya Institute of Management Studies & Research, India

### Abstract

**Problem Statement:** Indian economy has emerged as one of the fastest growing economies in the Asian Region. Forecasting is the decision making technique to predict Indian Gold prices. In a more general term, it is a time-series forecasting which is forecasting that uses historical time-series data to predict future values of variables. India is the world largest gold consumer market in the last ten years gold demand has increased at an average rate of 13% per annum while real GDP, inflation and population growth rate is only about 6%, 8% and 12% respectively Exchange traded fund or ETF's have lately emerged as popular investment vehicle for different classes of investors. The main feature that distinguishes an ETF's from our traditional index fund is that a basket of securities can be traded on a real time basis as a single stock through an ETF's.

**Approach:** Objective of the study was to develop a forecasting model for predicting Gold Spot prices on NSE traded Gold ETF's i.e. Goldman Sachs Gold Exchange Traded Scheme, UTI GOLD Exchange Traded Fund, Kotak Gold Exchange Traded Fund and Reliance Gold Exchange Traded Fund. Following the melt down of US dollar and Indian Rupee investors are investing their money into Gold ETF's because Gold ETF's plays important role as a Stabilizing Influence for investment portfolio.

A major contribution of this paper is that to understand the appropriate approach to estimate the Gold spot prices is the multiple linear regression model (MLR). MLR is the study to show the relationship between the single dependent variables and one or more independent variable, the dependent variable for the study is Gold Spot prices and there are four independent variables i.e. Goldman Sachs Gold Exchange Traded Scheme, UTI GOLD Exchange Traded Fund, Kotak Gold Exchange Traded Fund and Reliance Gold Exchange Traded Fund. Model I the naive model known as forecast 1 were consider to be benchmark model in order to evaluate the performance of the model.

**Results and conclusions:** In model 1, we have included all the potential independent variables i.e. Goldman Sachs Gold Exchange Traded Scheme, UTI GOLD Exchange Traded Fund, Kotak Gold Exchange Traded Fund and Reliance Gold Exchange Traded Fund and dependent variable is Gold Spot prices. All the potential Gold ETF's are having positive impact on gold spot price. The model is found to be significant to forecast the price of gold spot. 71.2% of the sample variation in monthly spot gold prices has been explained by the model1.

In model 2, we have implied the stepwise regression. The stepwise regression reduced the number of independent variables. In our model 2, two NSE traded Gold ETF's are removed. 73.5% of the sample variation in spot gold price has been explained by the model2.

In model 3, we have included significant potential independent variables i.e. Goldman Sachs Gold Exchange Traded Scheme and Reliance Gold Exchange Traded Fund. The model is found to be significant to forecast the price of gold spot. 71.2% of the sample variation in monthly spot gold prices has been explained by the model 3.

Keywords: Gold Spot price, Gold ETF's, Forecasting and multiple linear regressions

## 1.1 Introduction

Exchange traded fund or ETF's having newly emerged as popular investment vehicle for different classes of investors. The main feature that distinguishes an ETF's from our traditional index fund is that a basket of security can be traded on real time basis as single stock through an ETF's. It basically combines the features of mutual fund (offering diversification) and a stock (continuous tradability). ETF's offer several compensation over index fund. ETF's are characterized by being tax efficient and having lower expense ratios (as compared to index funds). The tax advantage can be attributed to the in-kind creation redemption process of the ETF's shares.

The first gold ETF's to be formally launched was the gold Billion security, listed in March 2003 on the Australian Stock exchange. The SPDR gold share listed on the New York Stock Exchange in November 2004 is the largest gold ETF with gold holdings of 1208.2 tons, representing an assets value of USD 58,481 million as on 30<sup>th</sup> June 2011. Benchmark assets Management Company in India was the first to conceptualize a gold ETF in a proposal filed with SEBI in May 2002. SEBI amended the mutual fund regulation to permit gold exchange traded fund in January 2006 and the first gold ETF's was launched in March 2007.

However the growth of assets under gold exchange traded funds (ETF's) in India slowed to 18% in the fiscal year ended 31<sup>st</sup> March 2013, compared with an average of more than 100% since its inception in 2007.

Presently, there are 14 Mutual Fund Houses present in this segment managing gold assets worth nearly Rs. 12,000 crore and have together garnered a staggering amount of 40,000 kg of this precious bullion as per the data available with industry body AMFI. The following table shows the Fund Houses which are offering Gold Exchange Traded Funds.

In the present study, we first present the forecasting model for predicting future gold spot price using Multiple Linear regression model. Then, we discussed the performance of the selected model and finally, the comparison between the model 1 and model 3 is presented.

## 1.2 Literature Review

Dirk G. Baur (2013), in his study observed that ETF's on indices provide entrance to diversified portfolio of assets at a low cost as against this a Gold ETF being based on a single commodity has a less advantage. On the observation of physical and synthetic gold ETFs (almost 80), concluded that it provides a low cost and more liquid alternative to physical investment in gold. Their study also provided new evidence on the financialization of commodities, the growth of Gold ETF and changes in the price of Gold.

**Table 1: Emergence of Gold ETFs in India**

Sr.No	Scheme Name	Managed By	NSE Symbol	Launch date
1.	Axis Gold ETF	Axis Mutual Fund	AXIS GOLD	20-Oct-2010
2.	Goldman Sachs Gold Exchange Traded Scheme	Goldman Sachs Mutual Fund	GOLDBEES	15-Feb-2007
3.	UTI GOLD Exchange Traded Fund	UTI Mutual Fund	GOLDSHARE	01-Mar-2007
4.	HDFC Gold Exchange Traded Fund	HDFC Mutual Fund	HDFCMFGETF	25-Jun-2010
5.	ICICI Prudential Gold Exchange Traded Fund	ICICI Prudential Mutual Fund	IPGETF	28-Jun-2010
6.	Kotak Gold Exchange Traded Fund	Kotak Mutual Fund	KOTAKGOLD	20-Jun-2007
7.	Quantum Gold Fund (an ETF)	Quantum Mutual Fund	QGOLDHALF	24-Jan-2008
8.	Reliance Gold Exchange Traded Fund	Reliance Mutual Fund	RELGOLD	15-Oct-2007
9.	Religare Gold Exchange Traded Fund	Religare Mutual Fund	RELIGAREGO	28-Jan-2010
10.	SBI Gold Exchange Traded Scheme	SBI Mutual Fund	SBIGETS	30-Mar-2009
11.	Birla Sun Life Gold ETF	Birla Sun Life Mutual Fund	BSLGOLDETF	25-Apr-2011
12.	IDBI Gold Exchange Traded Fund	IDBI Mutual Fund	IDBIGOLD	19-Oct-2011
13.	Motilal Oswal MOST Shares Gold ETF	Motilal Oswal Mutual Fund	MGOLD	02-Mar-2012
14.	Canara Robeco Gold Exchange Traded Fund	Canara Robeco Mutual Fund	CRMFGETF	16-Mar-2012

Monika, Gulati and Shelly (2013), in their study on GOLD ETF as insurance for asset portfolio observed that, traditionally gold is extremely popular in India and at the same time it helps in countering the inflation, stock market volatility and the currency volatility. They also stated that Gold is less volatile commodity in comparison with the rest of the class of commodities.

Swapan Sarkar (2012) in his article stated that Gold is the most important investment avenue due to the least risk, safe, most rewarding attributes. It is the most sought after investment as that was the only asset which gave positive returns during the financial crisis as well as during a period when the strongest economies were doubted for debt default. And as a result gold as well as products involving Gold as underlying asset has a bright future in India.

Athama and Kumar (2011), evaluate the performance of ETF's vis-à-vis index fund in India for study period of 2005-2009. They conclude that ETF's have given better opportunity for the small investors in terms of diversifying portfolio with a small amount of money; low expense ratio, reduce tracking error, lower risk and volatility as compared to index funds.

There are no many studies except Wang et al. (2010) who analyzed the developments and future prospectus of gold exchange traded funds in China. They suggest that China is short in Gold reserves as a percent of its total foreign reserve. China currency need to be linked with gold to avoid risk associated with assesses dollar reserve. Another factor that leads to the significant of gold ETF's in China is threat of inflation. They also highlighted the obstacles in the development of the gold ETF's market in China. They conclude that the launch of gold ETF's will improve China abilities to deal with problems such as diversification, inflation protection and currency hedging.

Dempster and Artigas (2009), analyzed the role of Gold, commodities, real estate and inflation linked bonds during the period 1974-2009. They had provided evidence that gold plays both roles as a tactical inflation is during high inflation period and as a long term strategies assets during low to medium inflation period.

### 1.3 Data and Methodology

The study is limited to only 4 Gold ETF which are considered as the independent variables in the model that are currently traded on NSE. The data used for the study is secondary data. The period selected for observation is from June 2008 to May 2012. The four Gold ETF selected are Gold BEES, Kotak Gold, Gold Share and REL Gold, since all these four being in existence since June 2008. Quantum Gold fund has not been considered due to the difference in the unit size. The source for the Gold Spot Price has been MCX and that the daily price has been arrived at as an average. The period has been so considered since it has a pre and a post US financial recession feature. Parameter estimation for the Multiple Linear regression (MLR) were carried out using statistical packages for Social science (SPSS) with mean square error as the fitness function to determined the forecast accuracy.

#### Objective of the study

1. In model 1, we have included all the potential independent variables i.e. Goldman Sachs Gold Exchange Traded Scheme, UTI GOLD Exchange Traded Fund, Kotak Gold Exchange Traded Fund and Reliance Gold Exchange Traded Fund and dependent variable is Gold Spot prices. Further to find the relationship between the variables we use the multiple linear regression models.
2. In model 2, we have implied the stepwise regression. The stepwise regression reduced the number of independent variables. In our model 2, two NSE traded Gold ETF's are removed.
3. In model 3, we have included significant potential independent variables i.e. Goldman Sachs Gold Exchange Traded Scheme and Reliance Gold Exchange Traded Fund. The model is found to be significant to forecast the price of gold spot.

### 1.4 Data Analysis and Interpretation

Proposed Model:

Let's denote the variables as follows:

$Y$  = Gold Spot prices (GPS);  $X_1$  = Goldman Sachs Gold Exchange Traded Scheme (GOLDBEES);  $X_2$  = UTI GOLD Exchange Traded Fund (UTI GOLD Exchange Traded



Fund); ██████ = Kotak Gold Exchange Traded Fund (KOTAKGOLD) and ██████ = Reliance Gold Exchange Traded Fund (RELGOLD)

A first –order regression model is:

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \epsilon \tag{1}$$

With normal error terms.

**Model 1**

This model includes all the potential independent variables that have being identified. The model is:

Initial Coding vs Final Coding – Environmental Pressures



Gold ETF's	p- value	Decision
██████ = Goldman Sachs Gold Exchange Traded Scheme (GOLDBEES)	0.000	P < α ; Coefficient is significant
UTI GOLD Exchange Traded Fund (UTI GOLD Exchange Traded Fund)	0.999	P > α ; Coefficient is insignificant
Kotak Gold Exchange Traded Fund (KOTAKGOLD)	0.132	P > α ; Coefficient is insignificant
Reliance Gold Exchange Traded Fund (RELGOLD)	0.000	P < α ; Coefficient is significant

From the above table, it is observed that the coefficients of two potential independent variables i.e. Goldman Sachs Gold Exchange Traded Scheme and Reliance Gold Exchange Traded Fund are statistically significant. And, the coefficients of two potential independent variables i.e. UTI GOLD Exchange Traded Fund and Kotak Gold Exchange Traded Fund are statistically insignificant. The model appears to be useful for predicating the price of gold. 71.2% of the sample variation in monthly gold prices has being explained by the model.

**Model 2**

In stepwise regression, the probability of F to enter the variable is 0.050 while the probability of F to remove a variable is 0.100. The stepwise regression, reduce the number of independent variables to two which include Goldman Sachs Gold Exchange Traded Scheme (GOLDBEES X1) and Reliance Gold Exchange Traded Fund (RELGOLD X4). Thus, our modeling effort will focus on these two independent variables.

The model consists of two independent variables. The model is as follows:



The variance inflation factor (VIF) for  $X_1$  &  $X_4$  is 5.913 and 4.685 respectively. Since all these values are less than 10, the multicollinearity problem is removed by employing stepwise regression. All of the coefficients are significantly different from zero in the above model. 73.5% of the sample variation in Y, monthly gold prices has been explained by the model. However, the computed value of D, 2.58 is higher than the tabulated value of  $d_L$ , 1.28 ( $\alpha = 0.01$ ). This statistics indicates the model able to estimates the model's coefficients.

**Model 3**

The fitted equation on the original variable is as follows:

$$\hat{y} = -0.007 + 0.424X_1 + 0.304X_4$$

Gold ETF's	p- value	Decision
$X_1$ = Goldman Sachs Gold Exchange Traded Scheme (GOLDBEES);	0.000	$P < \alpha$ ; Coefficient is significant
Reliance Gold Exchange Traded Fund (RELGOLD)	0.000	$P < \alpha$ ; Coefficient is significant

From the above table, it is observed that the coefficients of two potential independent variables i.e. Goldman Sachs Gold Exchange Traded Scheme and Reliance Gold Exchange Traded Fund are statistically significant. The model appears to be useful for predicating the price of gold. 71.2 % of the sample variation in monthly gold prices has being explained by the model.

**Forecasted Gold ETF's prices from the proposed models**

Gold Spot Return	
	Predicated Value ( Y )

Period	Y (Gold Spot Return)	Model A	Model B	Model C
2008	-0.072	-0.072582	-0.07434	-0.06105
2009	-0.005	-0.077326	-0.07956	-0.06524
2010	-0.08	-0.072278	-0.07503	-0.0616
2011	-0.103	-0.093356	-0.09611	-0.07853
2012	-0.043	-0.03936	-0.04184	-0.03497

### Measures of Models predicative ability

	Model A	Model B	Model C
MSE	0.001079455	0.001127641	0.00095

## 1.5 Conclusion

In order to develop the regression model, we used Gold Spot prices i.e. the dependent variable. Four factors were identified to have influenced the gold price as the independent variables in the regression model. These factors are the  $X_1$  = Goldman Sachs Gold Exchange Traded Scheme (GOLDBEES);  $X_2$  = UTI GOLD Exchange Traded Fund (UTI GOLD Exchange Traded Fund);  $X_3$  = Kotak Gold Exchange Traded Fund (KOTAKGOLD) and  $X_4$  = Reliance Gold Exchange Traded Fund (RELGOLD). In the process of developing a forecasting model using MLR, there are two main problems multicollinearity and correlated error terms. In this study, stepwise regression is used in an attempt to remove the correlation between the independent variables. The stepwise procedure has successfully solved the problem of multicollinearity by reducing the total number of independent variables to two. The variables selected by stepwise regression are Goldman Sachs Gold Exchange Traded Scheme (GOLDBEES) and Reliance Gold Exchange Traded Fund (RELGOLD). The total variance explained slightly increased by 2.3% as we applied the stepwise procedure. In this study, we attempt to remove the correlated error terms. From the table of measures of model predictive ability, it is clear that the mean square error for model C is much lower than the value given by model A and B as our choice to relate mean gold spot return  $E(Y)$  to lagged independent variables.

## References:

Dirk G Baur, July 2013, "Exchange Traded Funds on Gold- A Free Lunch?" FIRN Research Paper, Social Science Research network, Available at SSRN: <http://ssrn.com/i.d.2297756>

Dr. Sybilla Pius Fernandez, 2011, "A Study on the Prospects of Gold Etf's in India", StudyMode.com. Retrieved 04, 2011, from <http://www.studymode.com/essays/A-Study-On-The-Prospects-Of-656283.html>

Dr. Goyal Alok, Dr. Kaur Harvinder and Narang Praveen, 2011, "A comparative study of gold etf with national stock exchange indices in india", Asia Pacific Journal of Research in Business Management, Volume : 2, Issue : 3, 196-213.

Goyal, Alok, and Amit Joshi, 2011, "Performance appraisal of gold ETFS in India.", Elixir Fin. Mgmt, 2057-2060

Investment Option – An Analysis", CPMR-IJT, Vol. 2, No.1, June 2012

Jim Willie, C.B., 2002, 25 reason why gold will rise : The vicious circle behind the US dollar decline. <http://www.321gold.com/editorials/willie111202.html>

Joubert, D., 2003. The dollar and gold.<http://www.sagolds.com>

Lixia Wang and Ifitikhar Hussain, 2010, "Gold Exchange Traded Fund: Current developments and Future prospects in China", Asian Social Science, Volume 6, No. 7, 119-125

Madhavi Lokhande and Shruti Manisha , September 2011– "ETF: In Indian Market", The Management Accountant, , 770-774

Monika Gulati and Shelly, 2013, "Gold ETF: An insurance of asset portfolio", International Research Journal of Business and Management, Volume No. I, 154-160

Nedeljkovic, V. (2005). The Impact of ETFs on the Gold Market. The LBMA Precious Metals Conference 2005, Johannesburg, 127-130.

Noblett, Jackie, 2010, "Soaring gold prices spur ETF marketing rush, Financial Times.

Suganth Subramanian and Dr. K. Mohan, "E-gold as an Effective and Innovative

Swapan Sarkar, "The Glittering. Gold ETFs", The Management Accountant, Volume

World Gold Council. (2010). Gold Demand Trends. [Online] Available: [www.gold.org](http://www.gold.org).

# Influencing Factors for Managing Foreign Subsidiaries of Multinational Companies of the German Mittelstand

**Bernd Bernecker**  
University of Gloucestershire

## Abstract

This paper aims to contribute knowledge to the appropriate management of multinational companies (MNC) belonging to the German Mittelstand. In particular, the research seeks to examine the simultaneous pressures for global integration and local adaption when managing foreign subsidiaries and considers consequences for a fit of strategy and structure of the MNC (Doz and Prahalad, 1991).

Existing research identified models to assign an MNC typology (Bartlett and Ghoshal, 1988, Bartlett et al., 2008b) and roles for foreign subsidiaries (Bartlett and Ghoshal, 1986, Bartlett et al., 2008b), which both address the mentioned dichotomy. However, the constituting dimensions of these models lack of detail as they rather provide a macro view perspective. In addition, research for companies belonging to the German Mittelstand is scant even though they play an important role within their defined niche market (Simon and Lorenz, 1996, Simon, 2012) as well as for the German economy (Federal Ministry of Economics and Technology, 2013).

Thus, the most important dimensions, criteria, and factors, which influence multinational management are derived from existing knowledge and matched with the success factors of Mittelstand companies. The result is verified by 10 semi-structured interviews with selected industry experts before it is used with the mentioned models for MNC typology and foreign subsidiary roles in an in-depth case study in a selected company belonging to the Mittelstand in Germany.

This paper shows the outcome of the literature review and the conducted interviews with the corresponding analysis of the derived qualitative data. According to this, the three MNC dimensions are (1) the environmental pressures to an MNC, (2) the MNC's response to these pressures, and (3) the managerial implications for the MNC. The corresponding criteria and factors are adjusted in a way that the selected models of Bartlett and Ghoshal can be applied in the described case study.

**Key Words** - Multinational Company / Multinational Corporation (MNC); Foreign Subsidiaries; German Mittelstand; Expert Interview

## Introduction

Multinational corporations are often structured as a major organisation with various affiliated subsidiaries. These subsidiaries are managed by their local management while at the same time guided by corporate management. This might lead to different focuses and even to contrary directions, as the leading organisation might be willing to set a corporate directive with a global perspective whereas the subsidiaries could have their own perspective on business and success (Bartlett et al., 2008b). When it comes to success regarding turnover and costs, subsidiaries may also have different mind-sets and different interests than their parent company. At any rate, globalisation will force multinational

companies and their subsidiaries to cooperate more closely than before due to the global presence of customers and the impact of the company's activities (Ohmae, 2007). Therefore, it is a challenge to manage subsidiaries of multinational corporations (MNCs) adequately to the requirements from the perspective of the headquarters as well as of the subsidiaries and their local markets.

The described practical challenge is even more relevant in companies of smaller size, which are often not capable or willing to manage their international presence in a systematic way. In order to turn this into an operational practice, an approach for managing foreign subsidiaries of multinational corporations needs to be developed, especially for international sales organisations of the Mittelstand in Germany large German Mittelstand. The term "Mittelstand" is used to describe the SME sector in Germany. Both quantitative and qualitative criteria may be used to define German Mittelstand companies, which have a substantial role in their market (Meyer-Stamer and Wältring, 2000, Hausmann et al., 2006). Hausmann names annual sales, number of employees, and percentage of foreign business as quantitative criteria, as well as shareholder structure, leadership values, and orientation to niche markets as qualitative criteria. In addition, the German industry landscape differs also from other markets like the UK or the USA, as the Mittelstand sector is comparatively large and important in Germany with a high level of internationalization (McDonald et al., 2003) and innovation (Simon, 2012). The author of this paper limits the group of German Mittelstand companies based on the definition Hausmann (2006) and considers only those, which are of international presence and are of a certain size. The author sets the quantitative criteria as follows: (1) turnover EUR 1000m or less, (2) staff: 10.000 employees or less, and an (3) export share of at least 40%.

This paper aims to show the key influencing MNC factors derived from the research fields "MNC – strategy and structure", "MNC – subsidiary roles", and "German Mittelstand". These factors are verified by 10 semi-structured interviews with selected industry experts. After this, the overall aim of the corresponding research study is to apply existing MNC knowledge (MNC typologies, and subsidiary roles) to a selected case of the German Mittelstand and to modify this knowledge accordingly.

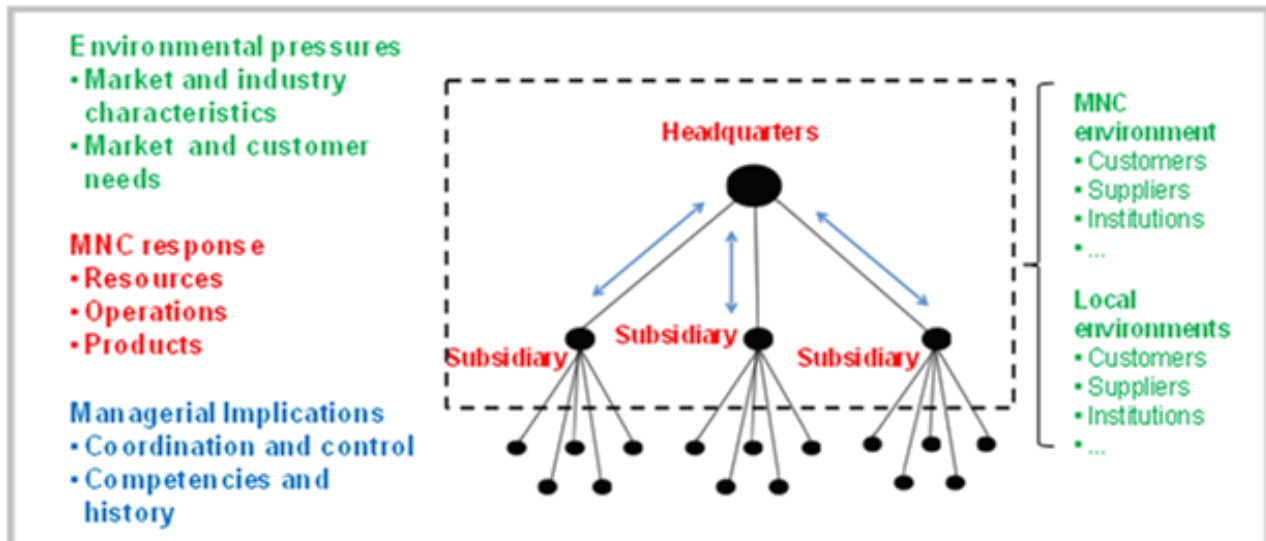
## Literature Review

Strategic and structural fit requires a congruency between strategy and organizational context (Xu et al., 2006), which implicates that the overall MNC strategy and the corresponding organizational structure should be in line with the subsidiaries' strategies and their roles within the MNC. In addition, the permanent forces to innovation and worldwide learning within an MNC implicates, that a company cannot rely any longer only on their strong capabilities provided by headquarters (Bartlett et al., 2008a). Hence, the role of a single subsidiary gets more important for the overall MNC. For multinational companies and their management, academics derived various organizational models and typologies, which enhance the fit of strategy and structure (Bartlett and Ghoshal, 1988, Rugman et al., 2011) In order to collect the key influencing factors for multinational management, the relevant knowledge on MNC typologies and organizational models is reviewed according to three areas of interest within in MNCs. This paper uses the following elements to describe the fit of strategy and structure according to Bartlett and Ghoshal (2008b) as shown in figure 1.

1. The environmental pressures that appear to the MNC from a market perspective (market and industry characteristics, market and customer needs)

2. The response of the MNC to build a competitive advantage in form of strategy and structures (resources, operations, products)
3. The managerial implications resulting from the above, which are covered by coordination and control as well as the characteristics of the company (history and competencies)

**Figure 1: Basic Dimensions for Multinational Management**



Source: Author

Subsequently, key influencing MNC factors are derived and assigned to the derived dimensions and criteria for multinational management. The overlap the research fields of (1) MNC's structure and strategy, (2) MNC subsidiary roles, and (3) German Mittelstand serves for getting appropriate results via the extraction of the identified research and existing knowledge.

First, the environmental pressures, which have an effect on the MNC, are structured via the characteristics of the industry and market as well as the needs from market and its customers. The market and industry characteristics consist of the size and growth of the market (Bartlett and Ghoshal, 1986, Bartlett et al., 2008b), the competition (Prahalad and Doz, 1987), and the technological aspects in industry and markets (Prahalad and Doz, 1987, Nohria and Ghoshal, 1994). Bartlett and Ghoshal use the mentioned characteristics in order to describe the strategic importance of the local market for an MNC. In addition, Prahalad and Doz derive both the competition landscape as well as the technological intensity to decide for the appropriate balance of global integration or local adaption. Nohria and Ghoshal (1994, 1997) aim for the same when they use the technological dynamism for structuring the MNC as a differentiated network. A similar usage of the key factors can be transferred to the needs of markets and their customer, which are made up by product needs, the required support, and the corresponding proximity (Prahalad and Doz, 1987, Bartlett et al., 2008b). These needs and requirements are crucial in order to set a structure and a strategy for the MNC, that enables the MNC to serve the customer's needs. Thus, the variables and their measures above serve both for a usage of the environmental pressures in order to categorize the required typology of an MNC.

**Table 1 - Variables for Environmental Pressures**

MNC Dimension and Criteria		MNC Factor	Variables (Source)
Environmental pressures	Market characteristics	Size and growth	Strategic Importance of local market (Bartlett & Ghoshal, 1988)
		Competition	Importance of multinational competitors, intensity of competition, global/local allocation of competitors (Prahalad & Doz, 1987)
		Innovation	Technological dynamism (Nohria & Ghoshal, 1994), technological intensity (Prahalad & Doz, 1987)
	Customer needs	Products	Need for product adaption , need for standardization(Prahalad & Doz ,1987),
		Support	Differences in customer needs (Prahalad & Doz, 1987),
		Proximity	Customer demand intensity (Bartlett & Ghoshal ,2006), importance of multinational customers (Prahalad & Doz ,1987)

Source: Author

Second, the MNC's responses to the environmental pressures, to which they are exposed to, are structured by aligning resources, products, and operations. The resources of an MNC could either be the allocation of skills and capabilities for management and operations (Nohria and Ghoshal, 1994), or the management of physical assets like capital and technology (Nohria and Ghoshal, 1994, Nohria and Ghoshal, 1997). As the customer needs regarding products can be seen as the most important response to customers, the question of where and for whom development efforts for new products are set-up (Nohria and Ghoshal, 1997) is avoided. This corresponds to the willingness and the openness for product adaptations and modifications for local markets (Jarillo and Martínez, 1990). Furthermore, the required operations have to be set and managed, as the sales and marketing activities need to be in accordance with the customer's needs (Prahalad and Doz, 1987, Jarillo and Martínez, 1990, Nohria and Ghoshal, 1994), which is again a question of global integration and local responsiveness according to the characteristics of the local markets. This influences the interdependencies within the MNC, i.e. the headquarters' management of activities and the exchange of products between the subsidiaries (Birkinshaw and Morrison, 1995), which has also an impact on the configuration of the MNC's value chain activities (Rugman et al., 2011). Finally, not only the development of strategy and structure, but especially the implementation of them requires high management attention, especially as the fit of strategy and structure could vary between MNC and subsidiaries and among subsidiaries as well (Harzing, 2000). The composed key factors and the corresponding variables and measures regarding the MNC's response serve for both the categorization of the entire MNC and the allocation of subsidiary role according to the characteristics of the local markets.



**Table 2: Variables for MNC Response**

MNC Dimension and Criteria		MNC Factor	Variables (Source)
MNC response	Resources	Operational Skills	Allocation of human capabilities/skills (Nohria & Ghoshal, 1994)
		Management Skills	Allocation of human capabilities/skills (Nohria & Ghoshal, 1994)
		Technology	Allocation of quality of physical assets (Nohria & Ghoshal, 1994)
		Capital	Allocation of amount of physical assets (Nohria & Ghoshal, 1994)
	Operations	Marketing activities	Integration / Adaption of product launches/introductions (Prahalad & Doz, 1987), integration/adaption of marketing activities (Nohria & Ghoshal 1994/1997; Jarillo & Martinez, 1990)
		Sales activities	integration/adaption of marketing activities (Nohria & Ghoshal 1994/1997; Jarillo & Martinez, 1990)
		MNC interdependencies	Value chain configuration (Birkinshaw/Morrison, 1995; Rugman et.al, 2011), Intergroup sales/purchases (Birkinshaw/Morrison, 1995)
		Strategy and structure	Corporate level strategy and MNC organizational design (Harzing, 2000), Subsidiary role and organizational structure (Harzing, 2000)
	Products	Development	Set-up, allocation, and purpose of development resources (Nohria & Ghoshal 1997)
		Adaptation	Proportion of products developed or adapted for local markets (Jarillo & Martinez, 1990)

Source: Author

Third, the resulting managerial implications are split in coordination and control, and the historical roots of the company. Next, coordination and control is structured according to the findings of Nohria and Ghoshal (1994), which are: centralization, formalization, and socialization. The researchers define centralization with the direct headquarters control as well as the management of the processes and activities in the subsidiaries and the MNC. Formalization consists of possible sets of rules and policies, the documentation for the course of action of a company (Nohria and Ghoshal, 1994), as well as existing control mechanisms (Harzing, 2000). The key factors and their variables mentioned above provide the basis for coordination and control within an MNC. However, the historical roots should not be left aside. The review of both MNC and Mittelstand knowledge shows that the concentration on the core competencies (Simon, 1996), the importance of a certain depth of value adding activities in the company (Simon, 1996, Haussmann et al., 2006), and the values and the administrative heritage of a company, which are existent in the knowledge and experience of the entire staff (Bartlett and Ghoshal, 1991).

Thus, the following collection of key influencing factors is derived. This framework serves as an initial coding scheme for the expert interviews, which aim to verify and enrich both the structure as well the content of the literature review result.

**Table 3: Dimensions, Criteria, and Factors for Multinational Management**

MNC Dimension	MNC Criteria	MNC Factors
Environmental pressures	Market and industry requirements Market and customer needs	<ul style="list-style-type: none"> <li>• Size and growth, competition, innovation</li> <li>• Products, support, proximity</li> </ul>
Firm response	Resources Operations Products	<ul style="list-style-type: none"> <li>• Operational skills, management skills, technology, capital</li> <li>• Marketing activities, sales activities, MNC interdependencies, strategy and structure</li> <li>• Development, adaption</li> </ul>
Managerial implications	Coordination and control History	<ul style="list-style-type: none"> <li>• Centralisation, formalisation, socialisation</li> <li>• Core competencies, depth of value adding, values and administrative heritage</li> </ul>

Source: Author

## Methods

### *Expert interviews*

The plausibility of the literature review results is verified via semi-structured expert interviews. The main purpose of an interview is to get data on the knowledge, the perspectives, and the experiences of interviewees regarding a particular research phenomenon (Wahyuni, 2012). In particular, the experience and opinion of the selected industry experts not only verify, but also possibly enrich and extend the dimensions, criteria, and influencing factors of multinational management.

The conduction of the plausibility check is done via 10 expert interviews, which take place personally and via phone. The characteristic of the interview is semi-structured with three main questions, which refer to the constituting MNC dimensions from the literature review: (1) environmental pressures, (2) MNC response, as well as (3) managerial implications. The derived MNC dimensions and criteria from existing knowledge serve as a pre-coding for the interviews. The descriptive approach collects qualitative data to extend and enrich existing knowledge. In order to represent the German Mittelstand, senior managers are selected, which have corporate and international sales management experience within Mittelstand companies, which market electronic products in need of an explanation.

There are two basic approaches to analyse textual transcripts of qualitative data according to Easterby and Smith (2008): grounded analysis and content analysis. In addition, if the broader context, relations, ideologies, or further language components than transcripts are taken into consideration, the researchers suggest discourse analysis. As the data collection of expert interviews focuses only on the textual result in the corresponding interview transcripts, only grounded analysis and content analysis are appropriate. When using grounded analysis, "the researcher tends to let the data speak for itself...and allows for more intuition to guide him or her in the development of understanding the data" (Easterby-Smith et al., 2008). Besides, the analysis is more on the inductive procedure (Saunders et al., 2012), as codes and categories are derived from the data instead of from existing theory and knowledge. The author opines that this approach for

analysis does not suit the objective of the expert interviews to confirm and possibly extend the MNC dimensions from the literature review. Therefore, the author selects content analysis, as it (1) it possible to search for content, (2) is more deductive, (3) can be used for causally linked variables, and (4) aims for clarity and unity (Easterby-Smith et al., 2008).

Content analysis “it is a systematic, replicable technique for compressing many words of text into fewer content categories based on explicit rules of coding” (Stemler, 2001) where “the researcher interrogates the data for constructs and ideas, that have been decided in advance” (Easterby-Smith et al., 2008). Hsieh (Hsieh and Shannon, 2005) names three approaches for content analysis: conventional, directed, and summative. The expert interviews aim to check the plausibility of the results of the literature review. Thus, the directed content analysis is the most appropriate choice, as the research study starts with existing knowledge as initial codes. In particular, the analysis seeks:

- To check, whether basic construct of environmental pressures, MNC response, and the corresponding managerial applications is appropriate
- To verify and possibly extend the constituting dimensions of the environmental pressures, i.e. the market and industry characteristics and the market and customer needs
- To verify and possibly extend the constituting dimensions of the MNC’s response, especially concerning resources, operations, and products
- To verify and possibly extend the constituting dimensions of the managerial implications, which consist of coordination and control as well as history and core competencies of the MNC

In this way, existing research benefits from further description by adding refining, extending, and enriching conceptual framework. In addition, the approach is structured, which suit the epistemological position of the researcher and it offers supporting as well as non-supporting evidence of a theory by predefining categories and codes (Hsieh and Shannon, 2005).

#### *Ethics:*

While conducting research, which is involving people, ethics need to be considered constantly. The collected data and the entire process can be influenced or even manipulated by both the participants and the researcher (Booth et al., 2003). For instance, participants may act opportunistically, driven by personal objectives, which might be out of the scope of the research itself. The author on the other hand may act in his own favour in order to steer the research into a desired direction. Additionally, people participating in the research need to be protected so that they are ready to provide openly valuable data without fearing any consequences. The only way to avoid such a negative behaviour - from the author’s perspective - is to be aware and reflective about one’s own behaviour and to follow certain rules while interacting with others (Easterby-Smith et al., 2008):

- Get fully informed consent from participants, avoid any harm to participants and respect the dignity of participants

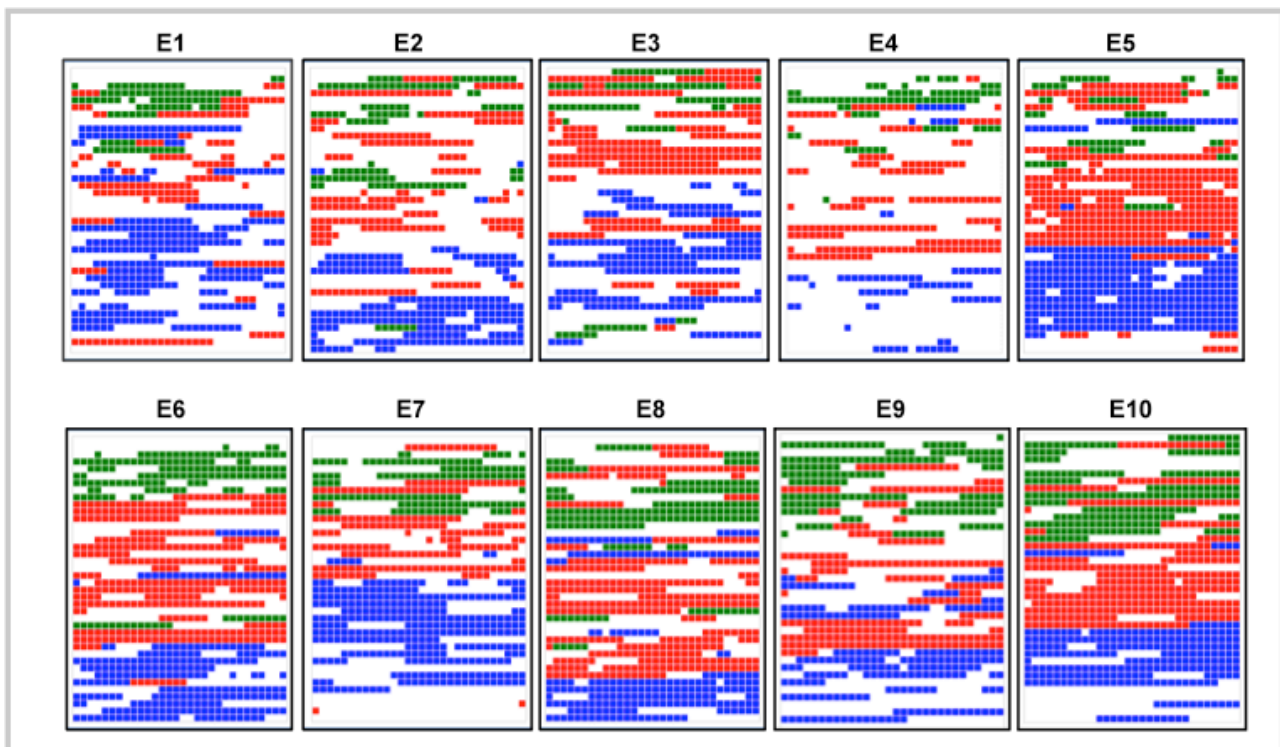
- Ensure confidentiality of data and protect anonymity of individuals and organisations if necessary
- Avoid any misleading behaviour and communicate transparently about the research

The described ethical issues are constantly taken into consideration by the author while planning, preparing, conducting, analyzing, and finalizing this research study as it belongs to the skills, which are necessary to conduct such a research study. The following points are presented and mutually agreed with all participants: the (1) overall research aim and conduction is presented, the (2) anonymity is guaranteed, as well as the (3) position and the ethical confirmation of the author is assured to all participants. The general ethical requirements for this research are ensured by following the “Handbook of Research Ethics” (2013) of the University of Gloucestershire.

## Results

The majority of interviewees agree to the structure of the three MNC dimensions (1) environmental pressures, (2) MNC response, and the corresponding (3) managerial implications. However, the detailed criteria under each of the three MNC dimensions are not confirmed in the first instance. There is a need and a wish from the interviewees’ perspective to discuss the individual criteria. The practicability of the overall structure is also confirmed by the interview participants, as it may support multinational management in practice. This is as a basic requirement of the underlying DBA programme and a key objective of the author as mentioned in the first chapter. Again, the respondents aim for discussing further details by the overall topic cannot be treated with a “binary thinking”.

The author states, that this described facts cannot be seen a confirmation of the overall structure, but the acceptance of the interviewees enable the author to move forward by verifying the three MNC dimensions and their criteria, as well as their corresponding factors influencing multinational management. Therefore, the following three subsections discuss and describe the results of the three remaining interview parts. These parts also reflect the segments of the semi-structured interview guide. Moreover, Figure 2 displays the distribution of the coded segments out of the interview transcripts of the interviewees with the colours green, blue, and red, which correspond to the colour coding of the initial coding scheme and the semi-structured interview guide. The illustration shows the three basic parts of the interview, and the fact, that these parts overlap during the interviews and discussions. This is logical, as the three dimensions are interlinked thematically, which makes a sharp differentiation during discussion very difficult.

**Figure 2: Visual Portrait of Interview Structure and Coding Categories**

Source: Author – coded interview transcripts (software MAXQDA 11)

### *Changes and Modifications of Initial Coding Scheme – Environmental pressures*

The initial coding scheme for “environmental pressures” is split to the criteria “market and industry characteristics” and “market and customer needs. These criteria remain unchanged. However, the factors are updated as described.

The following factors are initially set for the MNC criteria “market and industry characteristics”: (1) size and growth, (2) competition, and (3) technology and innovation. First, according to the industry experts, the market size and its growth are important crucial, as this sets the basis for sufficient business opportunities in a local market, which then possibly justify and investment. However, the level of maturity of a market is at least equally important, as this factor determines whether a market is accessible with complex products, that are high-tech and on the upper pricing segment. Due to this, the scope of the factor is extended. Second, competition is mentioned by every interviewee, and the majority of respondents name local and global competition. The different types act with a different market approach and need to be distinguished. Third, technology and innovation is also important. However, after conducting and analysing the interviews, the authors is convinced, that this factor fits better to the criterion “market and customer need” as it is closely related to the product, and therefore a specific requirement from a customer or even a market rather than a characteristic of an industry or a market. Instead, the factor “norms, standards, and approvals” is added as it reflects the common agreement within certain industry or market regarding a particular product or technology. These regulations not only provide the basis for technology and product specifications and requirements, but also define markets. They deliver the technical definition of technology and products according to the local infrastructure of market. Therefore, the factor is highly important for all companies participating in a market, as they all need to respond to this appropriately.

Moreover, norms, standards, and approval may also enlarge a market size, as further local markets could also apply a certain standard.

The initial coding scheme for the MNC criteria “market and customer needs” consists of three factors: (1) proximity, (2) support, and (3) products. First, the requirements and expectations to a product are important such as technology and innovation, as well as quality, availability and pricing. Therefore, the actual product itself is more just a part of the MNC response, as it is a creation according to the needs of the market and the customers. For this reason, the factor “technology and innovation” is merged with “products” and integrated here. The proximity to customers is seen as very important, as only a very close relationship to customers facilitates an understanding of the application of the customer and enables the Mittelstand company to provide a solution for the customer. This is crucial in the industry experts’ opinion, as selling complex products require this. It is stated as one of the key different characteristics between a Mittelstand company and a global competitor or a local company, which acts as a representative or distributor for a global competitor (see above). The factor “support” was renamed to “support and service”, as Mittelstand companies not only provide unique products but also an extended service to their customers. The customers may need flexibility, also small-volume orders, and customized solutions. This commitment often leads to a close and long-standing relationship.

Table 4 shows the revised coding results for the MNC dimension “Environmental pressures” illustrating changes in red and additions in green writing.

**Table 4: Coding Results for "Environmental Pressures"**

MNC Dimension and Criteria		MNC Factors
Environmental pressures	Market and industry characteristics	Size and growth Competition Technology and innovation
	Market and customer needs	Proximity Support Products
↓		
MNC Dimension and Criteria		MNC Factors
Environmental pressures	Market and industry characteristics	Size, growth, and level of maturity Competition Norms, standards, and standards
	Market and customer needs	Technology and innovation of products Proximity Service and support

Source: Author – coding schemes after analysis of transcripts (software MAXQDA 11)

### *Changes and Modifications of Initial Coding Scheme – MNC Response*

The initial coding scheme for the dimension “MNC response” consists of three criteria: (1) resources, (2) operations, and (3) products. The fourth criterion strategy is created, as various amendments and additional codes are added to all criteria, which are described below.

The initial coding scheme for the dimension “MNC response” consists of three criteria: (1) resources, (2) operations, and (3) products. The fourth criterion strategy is created, as

various amendments and additional codes are added to all criteria, which are described below.

The latter mentioned criterion “strategy” is put in front, as the author considers this as the leading criterion, which has an impact on the remaining criteria. This is also confirmed by the MNC literature. However, the issue that the MNC’s response includes both strategy and structure is not reflected appropriately in the literature review’s result. For this reason, the factor “market strategy” is added, as the focus market(s) and the segment in these markets, which is of great influence for any strategic and structural decision. This is considered as an important factor. In addition, the selected factor “sales approach” is highly important, as it looks at how MNCs set their sales resources and activities to approach a market. This could be own resources like subsidiaries or individual sales personnel, partner companies like representatives, distributors, or agents, as well as other sales channels like brand label partners. Finally, the “set-up and mindset” of the Mittelstand MNC is included, as this factor expresses the implications of the two mentioned factors. Mittelstand MNCs of the defined population are highly specialized and develop, produce, and offer high quality as well as high-tech products, which require a unique organizational behavior.

Second, for the factors of the criterion “resources” are reduced. The prior distinction of the factors reflecting both operational and management skills are melted to “skills and competencies”. This is concluded out of the interviewees’ responses, as the local resources develop over time and often start with an individual sales person before a complete subsidiary develops. The overall size of a sales subsidiary of a Mittelstand MNC usually not allows a subsidiary manager, who only fulfils management tasks. Instead, the subsidiary manager needs to be close to the sales and marketing activities, which is again a Mittelstand management characteristic. In addition, the factors considering technology and capital are merged to “Technology and Know-How” as the differentiation is difficult. Furthermore, Mittelstand MNCs tend to act as international companies concentrating their R&D resources in their corporate headquarters in Germany. This fits to the Mittelstand characteristics of being a technology leader resulting from capable and long-term employees in Germany.

Third, within the criterion “resources”, the initially separated factors of “sales activities” and “marketing activities” are merged to “sales and marketing activities”, as the distinction of processes and activities, especially for small subsidiaries, is difficult. The factor “MNC interdependencies” remains unchained, even though real interdependencies on a transactional level are not present and wanted according to the responses of the interviewees. Instead, communication and information exchange between foreign subsidiaries is present and supported both individually and in groups. However, the headquarters is informed and included in this communication and possible decisions on mutual transactions. The last factor of this criterion “strategy and structure” stays but is renamed to “decision-making”, as the factual strategy and structure is represented by the first criterion “strategy”. Therefore, this factor clarifies the scope of freedom in decision making when it comes to strategic and structural decisions as indicated by Bartlett and Ghoshal(2008b).

For the criterion “products”, both initially set factors “development” and “adaption” stay, as they reflect the results from the interviews very well.

Table 5 shows the revised coding results for the MNC dimension “MNC response” illustrating changes in red and additions in green writing.

**Table 5: Coding Results for "MNC Response"**

MNC Dimension and Criteria		MNC Factors
MNC response	Resources	Management skills Operational skills Technology Capital
	Operations	Strategy and structure MNC interdependencies Sales activities Marketing activities
	Products	Development Adaption

↓

MNC Dimension and Criteria		MNC Factors
MNC response	Strategy	Niche market strategy Sales approach Specialist setup and mindset
	Resources	Skills and competencies Technology and know-how
	Operations	Strategic and structural decisions Sales and marketing activities MNC Interdependencies
	Products	Development Adaption

Source: Author – coding schemes after analysis of transcripts (software MAXQDA 11)

### *Changes and Modifications of Initial Coding Scheme – Managerial Implications*

As the initially factors of criterion “coordination and control” remain unchained, the author presents the reason for the importance according to the interviewees’ responses. A certain degree of centralisation is necessary, as the direct headquarters control of subsidiaries’ decision-making is important. This means, certain topics, processes, or decisions need to be set or decided in or with participation of corporate headquarters. Topics like corporate design, systems like IT or CRM, as well as processes budgeting and corporate accounting serve as examples. Although Mittelstand companies aim for flexibility, the interviews show, that formalisation, i.e. the use of systematic rules and guidelines, is also present for the coordination and control of foreign subsidiaries. The typical example is a certain structure for goal setting and the corresponding review scheme. Socialisation as the commitment to close cooperation within the company, shared values, as well as to a common consensus, is very important according to the interviewees. For instance, a constant communication and mutual visits is seen as very important in order to exchange information, discuss business activities and results, improve skills, and set the basis for personal business networks and relationships, which simplify and improve daily business.

The reworded criterion “MNC and Mittelstand characteristics” aims to point out the differences of a big MNC in contrast to Mittelstand MNCs. Thus, the factor “values and history”, which is closely linked to the idea of administrative heritage (Bartlett and Ghoshal, 2002) is still important but extended with the Mittelstand management mentality and values. These are considered as an important factor for any managerial implication in a Mittelstand company. The second factor “depth of value adding” stays unchained as it is seen as important measure for the company’s independence, flexibility, and control.



Therefore, it can be seen as a consequence out of “support and service” and the MNC response niche “market strategy” and the specialist “mind-set and set-up”. The same applies for the focus on “core competencies”, because this is seen as a competitive advantage, which cannot be copied rapidly and easily according to the interviews.

Table 6 shows the revised coding results for the MNC dimension “MNC response” illustrating changes in red and additions in green writing.

**Table 6: Coding Results for "Managerial Implications"**

MNC Dimension and Criteria		MNC Factors
Managerial implications	Coordination and control	Centralisation Formalisation Socialisation
	History and core competencies	Values and History Core Competencies Depth of Value Adding

↓

MNC Dimension and Criteria		MNC Factors
Managerial implications	Coordination and control	Centralisation Formalisation Socialisation
	MNC and Mittelstand characteristics	Mentality, values, and history Core competencies Depth of value adding

Source: Author – coding schemes after analysis of transcripts (software MAXQDA 11)

## Conclusion and next steps

The review of existing knowledge and the plausibility check confirm the three MNC dimensions for multinational management: (1) environmental pressures, (2) MNC response, and (3) managerial implications. In addition, the conduction and the analysis of the interviews showed, that the three dimensions are closely linked, sometimes even hard to differentiate. The most relevant modifications and extensions of the initial coding scheme are discussed via comparing them to typical success factors of the German Mittelstand.

First, the majority of environmental pressures are verified. The most remarkable result within this dimension is the importance of the level of maturity of the local market, which is classified as more important as the pure size and growth of a market. This results from the strategic approach of the German Mittelstand, which tackles the upper market segment by selling complex products and acting as a technology leader (Hausmann et al., 2006, Radow and Kirchfeld, 2010). In addition, the market and customer needs are determined by customer proximity and a superior service and support for customer. This corresponds to the Mittelstand success factor of having a close and long-lasting relationship with the customer in order to enable the company and its employees to fully serve the customers (Meyer-Stamer and Wältring, 2000, Simon, 2012).

Second, the basis for the overall MNC strategy but more importantly the local subsidiary strategies is set by the environmental pressures, both globally and locally. Therefore, the

most important modification to the literature review result is the local market strategy, the sales approach, as well as the mindset and set-up of the local organization. This suits the fact that Mittelstand companies tend to follow the “international MNC typology” from Bartlett and Ghoshal (2008b), as they carefully select the local markets to exploit their home market success (Hausmann et al., 2006).

Finally, the coordination and control mechanism “socialisation” (Nohria and Ghoshal, 1997) is considered as highly important, as this reflects the management mentality of personal relationships, intensive training, as well as a consistent information exchange of market activities, both from a headquarters perspective as well as from a subsidiary perspective (Simon, 1996, Meyer-Stamer and Wältring, 2000). For operations, the industry experts suggest a high level of local freedom with a frequent communication on activities, results, and goal achievement.

The derived key influencing factors are subject for a case study in a selected Mittelstand company, in order to apply a subsidiary role model and derive the corresponding managerial implications.

## References

- BARTLETT, C. A. & GHOSHAL, S. 1986. Tap your subsidiaries for global reach. *Harvard Business Review*, 64, 87-94.
- BARTLETT, C. A. & GHOSHAL, S. 1988. Organizing for Worldwide Effectiveness: The Transnational Solution. *California Management Review*, 31, 54-74.
- BARTLETT, C. A. & GHOSHAL, S. 1991. Managing Complexity: Developing Flexible Coordination.
- BARTLETT, C. A. & GHOSHAL, S. 2002. *Managing Across Borders: The Transnational Solution*, Boston, Harvard Business School Press.
- BARTLETT, C. A., GHOSHAL, S. & BEAMISH, P. 2008a. Managing Conflicting Demands: Global Integration, Local Responsiveness, and Worldwide Learning. In: BARTLETT, C. A., GHOSHAL, S. & BEAMISH, P. (eds.) *Transnational Management: Text, Cases, and Readings in Cross-Border Management*. New York: McGraw Hill.
- BARTLETT, C. A., GHOSHAL, S. & BEAMISH, P. 2008b. *Transnational Management: Text, Cases, and Readings in Cross-Border Management*, London, McGraw Hill Higher Education.
- BIRKINSHAW, J. & MORRISON, A. 1995. Configurations of Strategy and Structure in Subsidiaries of Multinational Corporations. *Journal of International Business Studies*, 26, 729-753.
- BOOTH, W., COLOMB, G. & WILLIAMS, J. 2003. *The Craft of Research*, Chicago&London, B&T.
- DOZ, Y. L. & PRAHALAD, C. K. 1991. Managing DMNCs: A Search for a New Paradigm. *Strategic Management Journal*, 12, 145-164.
- EASTERBY-SMITH, M., THORPE, R. & R. JACKSON, P. 2008. *Management Research*, London, Sage Publications.
- HARZING, A.-W. 2000. An Empirical Analysis and Extension of the Bartlett and Ghoshal Typology of Multinational Companies. *Journal of International Business Studies*, 101-120.
- HAUSSMANN, H., HOLTBRÜGGE, D., RYGL, D. & SCHILLO, K. 2006. Erfolgsfaktoren mittelständischer Weltmarktführer. In: FRISCH-STIFTUNG, K. B. U. (ed.).

- Nuremberg: University of Erlangen-Nuremberg, Department of International Management.
- HSIEH, H.-F. & SHANNON, S. E. 2005. Three Approaches to Qualitative Content Analysis. *Qualitative health research*, 15, 1277-1288.
- JARILLO, J. C. & MARTÍNEZ, J. I. 1990. Different Roles for Subsidiaries: The Case of Multinational Corporations in Spain. *Strategic Management Journal*, 11, 501-512.
- MCDONALD, F., KRAUSE, J., SCHMENGLER, H. & TÜSELMANN, H.-J. 2003. Cautious International Entrepreneurs: The Case of the Mittelstand. *Journal of International Entrepreneurship*, 1, 363-381.
- MEYER-STAMER, J. & WÄLTRING, F. 2000. Behind the Myth of the Mittelstand Economy - The Institutional Environment Supporting Small and Medium-Sized Enterprises in Germany. In: PEACE, I. F. D. A. (ed.). Duisburg: Gerhard Mercator University.
- NOHRIA, N. & GHOSHAL, S. 1994. Differentiated Fit and Shared Values: Alternatives for Managing Headquarters-Subsidiaries Relations. *Strategic Management Journal*, 15, 491-502.
- NOHRIA, N. & GHOSHAL, S. 1997. *The Differentiated Network: Organizing Multinational Corporations for Value Creation*, San Francisco, Jossey-Bass.
- OHMAE, K. 2007. *The Next Global Stage, Challenges and Opportunities in our Borderless World*, New Jersey, Wharton School Publishing.
- PRAHALAD, C. K. & DOZ, Y. L. 1987. *The Multinational Mission: Balancing Local Demands and Global Vision*, New York, The Free Press.
- RADOW, J. & KIRCHFELD, A. 2010. Germany's Mittelstand Still Thrives. *BusinessWeek.com*, 5-5.
- RUGMAN, A., VERBEKE, A. & WENLONG, Y. 2011. Re-conceptualizing Bartlett and Ghoshal's Classification of National Subsidiary Roles in the Multinational Enterprise. *Journal of Management Studies*, 48, 253-277.
- SAUNDERS, M., LEWIS, P. & THORNHILL, A. 2012. *Research Methods for Business Students*, Harlow, Pearson.
- SIMON, H. 1996. *Hidden Champions: Lessons from 500 of the World's Best Unknown Companies*, Harvard Business Press.
- SIMON, H. 2012. *Hidden Champions - Aufbruch nach Globalia*, Frankfurt, New York, Campus Verlag.
- SIMON, H. & LORENZ, J. U. 1996. *Die heimlichen Gewinner*, Campus-Verlag.
- STEMLER, S. 2001. An Overview of Content Analysis. *Practical assessment, research & evaluation*, 7, 137-146.
- UNIVERSITY\_OF\_GLOUCESTERSHIRE 2013. *Handbook of Research Ethics. Cheltenham*.
- UNKNOWN 2013. German Mittelstand - Motor der deutschen Wirtschaft (German Mittelstand - Engine of the German Economy). In: TECHNOLOGIE, B. F. W. U. & TECHNOLOGY), F. M. O. E. A. (eds.) 1 ed. Berlin: Bundesministerium für Wirtschaft und Technologie (Federal Ministry of Economics and Technology).
- WAHYUNI, D. 2012. The Research Design Maze: Understanding Paradigms, Cases, Methods and Methodologies. *Journal of Applied Management Accounting Research*, 10, 69-80.
- XU, S., CAVUSGIL, S. T. & WHITE, J. C. 2006. The Impact of Strategic Fit Among Strategy, Structure, and Processes on Multinational Corporation Performance: A Multimethod Assessment. *Journal of International Marketing*, 14, 1-31.