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HEADS I WIN, TAILS YOU LOOSE-THE NEED TO REFORM EXECUTIVE COMPENSATION

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Abstract: Executive compensation and incentives systems have been shown to be dysfunctional, misaligned and short-sighted. Greed and narrow self-interest have thrived, and risk and stewardship have been too often ignored. Added to this, the enormous disparities in remuneration levels between top executive pay levels and average wages is raising serious questions about equity and fairness that poses material risks to corporations. Reform of executive compensation is essential and if blunt and problematic regulation is to be avoided it needs to be led by boards. In the reform process, boards need to embrace responsible stewardship, enlightened governance, and sound risk management in reining in the excesses and realigning the incentives. In particular, incentives need to be restructured to better align executive behaviors with long-term value creation and to remove pressures and temptations on executives to pursue narrow self-interests.

Keywords: Executive compensation, stewardship, corporate governance, rewarding virtue, respecting risk

The Case for Reform

Executive incentives and remuneration systems have been firmly put back under the spotlight by the fallout from the Global Financial Crisis (GFC). Dysfunctional, misaligned and short-sighted incentives drove greed and narrow self-interest which crowded out sensible risk management and responsible stewardship, thereby triggering the crisis - just as they did in the string of corporate scandals over recent decades.

When such rivers of narrow self-interest and executive greed go unchecked - just as they did with the GFC - they ultimately form into seas of long-term economic and corporate value destruction. But equally, such rivers of narrow self-interest and greed can be checked, cleaned-up and redirected into seas of value and virtue when the excesses and systemic misalignment of executive incentives are rigorously addressed and reformed.

Despite the elevated debate on the urgent need for radical reform of executive compensation, regulators continue to struggle with reform proposals. In fact, few of the regulatory reform efforts go to the heart of the problem – the conflicts of interests between executives and the outcome that executive compensation has become largely decoupled from long-term shareholder wealth creation. Added to this executive incentives increasingly have been built around ever larger short-term rewards that have tended to incentivize increased risk taking. At the same time, executives too often have been shielded from any material downside or appropriate liability for such risk taking decisions.

Despite the problems, executive compensation is generally viewed as a potential instrument for addressing the conflict of interest and moral hazard issues that can arise between shareholders and managers - the so called agency problem. But at the current time, executive compensation structures themselves act in the opposite way and are a big part of the agency problem itself. In large part, this situation has developed because of the important influence that managerial power and executive rent extraction have had an on the design of executive compensation arrangements. Clearly, corporate boards need to urgently take back full control of executive compensation and embark on serious reforms to address these central problems.

For a start, boards need to ensure that all executive compensation and incentive schemes are designed against the reality that:

A. The CEO and his or hers executives are first and foremost employees. They are hired to serve the interests of the firm and are typically not owners entitled to legal rights of personal dominion over the assets of the firm.

B. CEOs and executives, as employees, act under the principles of agency law which requires them to: 1) demonstrate good governance; and 2) meet their duties of loyalty and due care in the execution of corporate office.

C. The principal test of executive success is long-term company performance and profitability, as reflected in fundamental market valuations.

Not only should executive compensation and incentive schemes reflect these facts, they should also be clearly set out in employment contracts as part of the rights, obligations, ground rules and duties within which executives must operate. The most basic of these duties are to: be honest; keep promises; treat stakeholders fairly, respect their rights, and take due care of their interests; and be accountable. Too often, these fundamental duties are ignored in the design of executive compensation and incentive schemes.

The Need to Rein in the Excesses

Executive compensation levels have increased at a remarkable pace over the past 30 years. In 1980, the CEOs of the top US companies, on average, received pay package worth 40 times the earnings of the average American worker. Leading into the GFC in 2007, the average annual pay package of CEOs of the S&P 500 companies had skyrocketed to 344 times the average American worker, or US$10.5 million (Institute for Policy Studies and United for a Fair Economy, 2007). That is, for just one day’s work, the top US CEOs got paid the equivalent of what the average US worker got paid for the full 2007 year.

In other developed counties the pay packets of CEOs have also skyrocketed. In Australia for example, CEO pay has dramatically increased over the last 30 years, with the CEOs of the top 20 companies in the 2008-09 year receiving on average 110 times the average wage of Australian workers, or approximately AUD$7.2 million (Productivity Commission, 2010).

Despite blazing headlines declaring falls in CEO pay on the back of the GFC (Lublin, 2010), the situation has changed very little. In fact, the total compensation of the CEOs of the largest US firms only declined by a modest 3% in 2008 (Wall Street Journal /Hay Group, 2009) but this was then offset by a similar 3% gain in 2009 (Wall Street Journal /Hay Group, 2010).

Perhaps of more concern are reports that many board compensation committees have sought to protect their CEOs from the full flow on impacts of the GFC by moving away from longer term performance-based compensation programs, lowering the bar on annual performance targets and paying out higher bonuses for less profitable results (Wall Street Journal /Hay Group, 2010).

The situation has been little different in Europe. While top executives' base salaries were stagnant on the back of the GFC in 2009/2010, bonus payouts jumped and drove higher total pay (Hay, 2010). Not surprisingly, the enormous disparity in remuneration levels between top executive compensation and average wages has already triggered vocal questions on equity and fairness. In fact, Peter Drucker, arguably the greatest management thinker of the last century, thought that a ratio around 25-to-1 was more appropriate - much beyond that, Drucker asserted, makes it difficult to foster the kind of teamwork that most businesses require to succeed over the long term (Wartzman, 2008).

Drucker described the pocketing of huge sums by CEOs, while they are laying off workers or presiding over corporate failures, as "morally unforgivable." Drucker's view was that the CEO's job is "to do what is right for the enterprise—not for shareholders alone, and certainly not for themselves alone", and that they have a special duty to show that they were "just a hired hand" (Wartzman, 2008).

Drucker's outrage is proving to be right in at least one critical respect – the extremely generous and growing CEO pay packages are proving to have very little to do with superior creation of shareholder wealth (Bebchuk & Fried, 2004). Larger compensation certainly has not prevented poor performance of firms and in some it looks like it has been a contributing factor to corporate problems (Daines, Nair, Vinay & Kornhauser, 2005).

Drucker is also likely to be ultimately right in his concern that the current extreme level of income inequality is not sustainable. Such income inequality is only readily tolerated when the rising tide is lifting all the ships. Given this is not happening, boards would be wise to act before equity and fairness issues begin to materially tear and erode internal company harmony as well as corporations' implicit community license to operate.

The Alignment Challenge

The CEO and the executive team lie at the fulcrum of corporate decision-making and the structure of executive incentives holds to the key to aligning executive behaviors with their responsibilities. These responsibilities extend first and foremost to the creation of long-term sustainable shareholder value through: successfully implementing the firm's strategic goals and objectives; inspiring and managing the hierarchy of employees; and providing vision, direction and responsible stewardship.

The executive compensation vehicles boards have used to attempt to align executive behaviors with the creation of long-term sustainable shareholder value have predominately been a base salary, sizeable short-term cash incentives, and so called long-term equity linked incentives (usually in the form of share options).

Typically, the sizeable short-term cash incentive component has been based around achieving sales, revenue or bottom-line targets. The problem with this is that such short-term targets can often only be achieved or bettered through increased risk taking. In fact, it was risk linked short-term incentive structures that sowed the seeds of the US sub-prime crisis which triggered the GFC. When the achievement of short-term incentives targets is made possible via increased risk taking, the risk is that executives are provided with a greater incentive to do the wrong thing than to do the right thing in terms of longer-term shareholder value. This is particularly the case when performance or sales are not tracking to plan (often due to external factors) or something else has gone wrong.

In designing such executive compensation schemes, boards appear to have placed considerable weight on the power of executive self-interest under the belief that you only get what you pay for. They are right in one respect. It is certainly a reality of human nature that when presented with the opportunity to secure attractive and large personal gains, nothing much gets in the way of self-interest. And when the short-term cash bonus carrots are so attractive, the longer-term interests of shareholders and other stakeholders are typically crowded out and don’t an appropriate look in.

Added to this, the share options based longer-term compensation structures have been poorly aligned with shareholder interests. The problem is that the returns to executives from executive options typically bear little resemblance to the returns to shareholders from holding ordinary shares. As the Australian Productivity Commission noted, “options provide more (possibly excessive) ‘upside’ incentive than shares, but little downside risk. Once ‘under water’, they provide little incentive to drive an incremental increase in share price” (Productivity Commission, 2009). These problems are largely removed if grants of fully paid but escrowed shares are used as longer-term incentives for executives, rather than grants of share options. Clearly reform is needed as the current structure of executive compensation falls well short of appropriately aligning the conduct and interests of executives with the longer-term interests of shareholders.

Restructuring Executive Compensation

Key Role of the Board

Enlightened action by boards to rein in excessive and misaligned executive compensation is essential as regulatory imposed requirements, such as caps on CEO salaries, are typically problematic and likely to have unintended consequences. But inaction by boards to reign in and restructure executive compensation is unfortunately forcing regulatory responses such as the Australian Government’s current proposed executive remuneration reforms which include a requirement that boards be spilled if the company’s remuneration report receives “no” votes of 25% or more at two successive AGMs (The Parliament of the Commonwealth of Australia, 2011).

Boards need to act and good corporate governance and stewardship should be the starting point. The board is at the apex of a company’s internal incentive structure and it is the board’s decisions that shape the incentives culture for the whole organization and determine whether or not virtue – or its opposite – will be rewarded.

Two fundamental good governance principles stand out and should be adopted by all boards:

- First, the board chair and the chair of the remuneration committee need to be truly independent. All boards should separate the roles of the CEO from that of the board chair and boards should not appoint former CEOs as the chair; and
- Second, executive compensation plans should be, at a minimum, put to a shareholder ‘advisory’ vote.

Beyond such governance fundamentals, ‘how executives are paid’ is more important than ‘how much they are paid’ in terms of the impacts on long-term value creation and on the alignment of executive behaviors. Boards should therefore start by fixing the obvious alignment problems with executive incentives structures.

For a start, boards need to recognize that beyond financial rewards, people are also motivated by power, status, approval and recognition, and the intrinsic value of their activities. If the board's incentive focus is too narrow or too short-term, and it ignores the legitimacy of the means by which success is achieved, it risks rewarding behaviors and outcomes that destroy long-term value. Boards therefore must give enough weight to the intangible aspects of executive compensation and behavior, and not simply evaluate and structure executive compensation in purely financial terms. In particular, boards need to make the penalties for irresponsible and value-destroying behaviors readily apparent and they need to incorporate the intangible drivers of responsible behavior into a 'balanced scorecard' gate opener for executive rewards to be triggered.

Avoiding the Perils of Short-term Incentives

As discussed above, the greatest weakness in many executive compensation structures is the linking of short-term incentives to the meeting of sales or pure revenue targets. Pressures to drive sales at all costs or to complete the big sale to trigger the lucrative cash bonuses loom large under these structures. This weakness is certainly not a theoretical one - incentivizing mortgage sales, without due regard for the suitability and the risk of those sales, drove the US sub-prime crisis. And examples of remuneration driven miss-selling can be readily found across other industry sectors.

These conflict of interest perils of revenue and sales linked incentives are compounded when the board allows the same executive to be ultimately responsible for both the design of the incentives and for: a) the setting of the income or sales objectives themselves; or b) product design with approval authority over the complexity of products, including the transparency of pricing and charging structures etc.; or c) product advertising including choices about how forthright or otherwise the copy should be.

Poorly aligned short-term incentives also pose conflict of interest challenges in dealing with possible health and safety, environmental, bribery and corruption, and purchasing risks. A more balanced reward structure - taking account of intangible value drivers such as the quality of sales, customer satisfaction levels, health and safety and so on – would assist in overcoming the conflict of interest challenges and make it easier for executives to behave appropriately.

Boards should therefore put much less weight on short-term incentives and much more on longer-term ones, so as to avoid driving behaviors that destroy long-term value. The over emphasis on achieving short-term financial goals simple heightens the risks that executives will ignore the reality that sustainable value for a company's shareholders only accrues over time. As already mentioned the over-emphasis on short term incentives simply heightens the likelihood that executives may not elevate material risks or emerging performance problems to the board in a timely way, particularly if it may impact the determination of sizeable short term cash rewards.

Key Reform Measures

Beyond the two good governance principles, relating the board independence and shareholder advisory votes on executive compensation plans, already mentioned, there are a number of other measures that boards should implement as part of broader reforms to executive compensation. Where short-term performance based rewards are utilized, a material part (50% or more) of the earned rewards should be deferred so as to better align the incentives with value creation beyond the immediate-term and to allow rewards to be clawed back should undisclosed problems emerge later.

A number of other important reforms have been spelt out by the Caux Round Table (CRT) that would promote improved disclosure and risk management relating to executive compensation plans and which would better align the plans with long-term shareholder wealth creation (Caux Round Table, 2009). As part of a broader reform agenda, the CRT recommended that:

- "Corporate boards should be required to make annual disclosures (and at the time of the appointment of any CEO) detailing conflicts of interest and other risks embedded in executive performance incentives, including how the Board proposes to manage such risks; and the degree to which the remuneration structure aligns executive interests with those of shareholders.
- All equity linked remuneration should be in the form of common equity, escrowed for a minimum period of five years regardless of continued employment.
- Board members and key executives should be prohibited from borrowing or hedging against the common equity they hold in the company, unless there is full and timely disclosure of all such borrowing or hedging.
- All termination payments should be capped at one year's remuneration, unless there is prior shareholder approval of a higher amount."

These recommendations sit alongside the CRT Principles for Responsible Business (Caux Round Table, 2010) which go to the heart of constructive and ethical business behaviors through which corporations can flourish and sustainable prosperity can become the foundation for a fairer, freer and more transparent global society.

Conclusion

The design of executive compensation systems is highly relevant if the interests of business executives are to be balanced with those of shareholders and other stakeholders and with the aspirations of society for mutual and sustainable prosperity. The can be no better example than the GFC of what can go wrong when the balance is wrong - opacity of risk, combined with incentive-fed greed and narrow self-interest in a rising market, proved a toxic mix for serious mischief.

Boards need to act given that current executive compensation and incentive structures are in large part dysfunctional, misaligned and short-sighted. Failure to act will inevitability result in blunt and problematic regulatory action. In reforming executive compensation, Boards need to embrace enlightened governance and sound risk management. In doing so, they need to restructure incentive structures so that they to better align executive behaviors with long-term value creation and remove the pressures and temptations on executives to pursue narrow self-interests in securing the large cash bonuses on offer.

Business of course must be profitable in order to meet its social obligation of wealth creation. But the sustainability of those profits depends greatly on how such profits are made and how the interests of relevant stakeholders are catered for – which is why executive compensation and incentive structures matter so much.

Notes

1. Similarly, just 60 percent of managers felt that CSR required them to consider the expectations of the general public when designing business strategies

2. GoldenBee Development Center for Chinese CSR finds that Chinese firms' submitted 582 CSR reports in 2009, up from 169 in 2008 and just 64 in 2007 (http://www.csr-china.net/en/second.aspx?nodeid=d5dad5b2-2453-4015-9bb2-d650db593831&page=contentpage&contentid=6514d4a1-1f4b-4df7-9047-ed408333254c) .
3. The 2009 Fortune China managerial survey finds only 26.1 percent of participating firms published an annual sustainability/CSR report in 2009.
4. See Williams, O.F. (2004) and Kell, G. (2005).

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CORPORATE SOCIAL RESPONSIBILITY: A CORPORATE STRATEGY FOR NEW BUSINESS OPPORTUNITIES

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Abstract: The concept of corporate social responsibility (CSR) is coming into light with the introduction of globalization and liberalization. With the promotion of the CSR concept globally and locally, it is becoming very important to know about business entrepreneurs' views about this concept because they are the ones who are going to implement it. The changing global market scenario is, also, changing the perception of business entrepreneurs towards society and business. Now, business is not merely about earning profits for an organization, but it is more about profit sharing with employees and society. The present work is an attempt to capture the importance of CSR in business, show how the implementation of CSR practices has helped business, reveal the drivers pushing businesses towards implementation of CSR practices. There is an urgent need to focus attention on the factors and drivers that motivate companies to implement CSR practices. Finally drivers and motivators for the companies to implement CSR practices are explained with the case study of the multinational Nestle corporation.

Keywords: Corporate social responsibility (CSR), globalization, liberalization, profit sharing

Introduction

The concept of corporate social responsibility (CSR) has been reinforced with the introduction of globalization and liberalization. Many world-renowned companies, like the World Bank, OECD, and European commissions are very actively supporting and promoting the concept of CSR. Modern corporations are putting considerable focus on the economy, politics, and on society of a nation (Baxi, 2006). Developing countries need to focus more on the CSR planning and implementation process. They can create alternatives for lifting social sector development; a suggested route is by developing viable, strategic public-private partnerships. Now, the biggest challenge for the governments in the developing countries like India is to create CSR practices policies and nurture a durable framework, which will help companies and society translate public policies into deliverables.

A developing country like India needs a strong institutional framework for putting into practice and achieving the multiple objectives of economic growth and development. The implementation of the developed framework will not be achieved unless there is strong commitment and support from top-management and the Government. A number of firms identify CSR practices with the core strategy and policy of the company based on the importance given to a) defining a plan for social action, b) intensity of investment in social programs, c) commitment of employees, d) Perceived impact of social action on competitive position, and e) measuring outcomes of programs (Husted et al., 2007).

Business impacts on society and environment have existed since the institution of business (Boyce & Ville, 2002; Youd-Thomas, 2005). CSR had already gained considerable interest in the 1960s and 70s, spawning a broad range of scholarly contributions (Cheit, 1964; Heald, 1970; Ackermann & Bauer, 1976; Carroll, 1979). The concept of CSR is regarded as a powerful way of achieving sustainable competitive profit and for achieving long-lasting value for the investors, shareholders and stakeholders. Entrepreneurs can use CSR as a win-win strategy or opportunity for businesses, financial investors, and society. Proper implementation of CSR practices can affect the perceptions of stakeholders customers, investors, local communities, environmental groups, governments, suppliers, and competitors. Many Indian multinationals, like the Tata Group, ITC, Infosys, and DuPont India, etc., have endeavored to create a better social image in society. The far most important step for these companies is that how they implemented CSR by providing a better and healthier work atmosphere to employees and producing the best services for society.

Davies (1973, p. 313) says social responsibility begins where the law ends. A firm is not being socially responsible if it merely complies with the minimum requirement of the law because this is what any good citizen would do. Social responsibility goes one step further. It is a firm’s acceptance of a social obligation beyond the requirement of the law, which is comprised, in Carroll’s pyramid of CSR, of economic, legal, ethical, and philanthropic responsibilities (1991).

The term “ethical consumerism” enlightens the public towards its rights and helps promote CSR. This also linked to the rise of global corporate CSR. Global population and its demands are increasing day by day, which increases pressure on limited natural resources. Technological advancement brings industrialization to many developing countries. All these factors lead to awareness among the consumers, and their buying behavior is very much affected by the companies’ social and global image.

Planning and implementation of CSR practices require a strategic framework or institutional structure. To integrate all the different perspectives of CSR design, planning, and implementation into a single strategic framework needs the development of a preliminary model that helps in testing of all the practices, suggests the desired changes, and has the support of multiple case studies. The organization must align its CSR goals and decision-making with its overall goals and strategies so that taking corporate social responsibility becomes as natural as taking a customer perspective (Maon et al., 2008). The implementation of CSR is, also, subject to various forces, which are outlined in Figure 1.

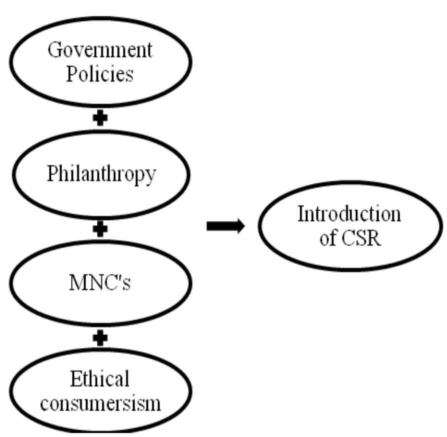

Figure 1. Forces Affecting CSR

Corporate stakeholders must work collectively by exerting pressure on corporations to change. Shareholders and investors should also exert pressure on corporations to behave responsibly. The role of NGOs is increasing further with the enhancing penetration of the media and internet. All these are increasing the attention on social corporate behavior. Through education and dialogue, communities are increasingly holding businesses responsible for their actions. The present work is an attempt to propose CSR as a new business opportunity for the companies. This will be further verified by the case study of Nestle, which will also show how the changing global market scenario is changing the perception of business entrepreneurs towards society and business. All this raises the following questions about whether or not organizations are changing their focus to CSR:

H1: What are the investments made by business enterprises to sustain and grow in the changing global scenario?

H2: What are the benefits that corporations or entrepreneurs are enjoying by implementing corporate social responsibility practices?

H3: What are the key drivers pushing business corporations or entrepreneurs to implement CSR practices?

CSR: Different Perspectives

Two issues regarding CSR research are: a) Do MNCs focus more on CSR? b) Is CSR still undertaken for philanthropy and community investment? A brief summary of the available research conducted in India and abroad includes the following: a) CSR and Multinationals and b) Philanthropy and Community Investment

CSR and Multinationals

A great deal of research has been conducted on CSR in Western countries, but relatively little focuses on Asia (Birch & Moon, 2004). Moreover, relatively little CSR research has compared national systems of CSR (Langlois & Schlegelmilch, 1990; Maignon & Ralston, 2002; Matten & Moon, 2004). The study by Ramasamy and Yeung (2009) increases understanding of corporate social responsibility from the Chinese consumer's prospective. Results confirm that Chinese consumers are able to differentiate among the economic, legal, ethical, philanthropic responsibilities of business.

Fukukawa and Teramoto (2009) explore the case of Japanese multinationals and corporate social responsibility practices. The evolution of CSR in these developing economies shows varying results. The study by Muller and Kolk (2009) highlights, that corporate social responsibility has increased in recent years in emerging markets. Corporate social responsibility performance was investigated across three dimensions: environmental, labor, and community. The study shows that local companies are engaged in the type of CSR activities commonly associated with corporate social responsibility in developed countries but are still in a nascent stage.

Some researchers are of the opinion that CSR practices of MNCs differ in their home and host countries. A CSR initiative taken by a multinational corporation in its home country was different and in comparison to its efforts in India (Lather, 2007). To know the changing relationship among companies, the state, and society, Krishnan and Balachandran (2004), studied the impact of emerging markets on corporate social responsibility. The findings of the study show that consumers prefer to boycott a company's products and services in case of negative corporate citizenship behavior.

There is a general consensus that, today, firms are beginning to grasp the importance of putting CSR into practice to enhance their market share and their reputation in the market. Thus, this can be inferred that in the near future only those firms will remain in the markets or survive those that have gained the goodwill of society. Hence, the firms have to work seriously on the implementation of CSR practices.

The organizations or business firms seriously planning and implementing CSR have a dominant position in the market. Either a multinational firm or a local firm changing its perception of philanthropy to social responsibility will enjoy the largest market share.

If the corporate organizations are implementing CSR practices, they will get more business partners, and this will give them new business opportunities. Organizations with a good social image will enhance their reputation and reduce the need for regulatory interventions by the government or shareholders. The enhanced reputation of the firm will attract more and more customers, which will increase the organization's sales, and the company will enjoy more profits. Corporations will be able to minimize risk by enhancing their reputation, improve themselves with new business opportunities, cut costs, and make good relations with stakeholders.

Drivers Pushing Business towards Corporate Social Responsibility

The literature review helped in extracting the different drivers pushing business towards CSR practices. How these key drivers are affected by an organization's basic objective has been presented in Table 1.

Table 1. ***Listed Drivers***

Drivers	**CSR and Multinationals**	**Philanthropy and Community Investment**
Enhanced Reputation	Experimentation	Improved
Alliance with business partner	Futuristic	New Opportunities
Better stakeholder relationships	Quick Decisions	Better Decisions
Attractive employer	High	Moderate
Customer satisfaction- loyalty	High	Considerable
New business opportunity	Strategic	Tactical
Cost savings	High	Moderate
Minimize risks	Quantitative	Quantitative & Qualitative
Reduced regulatory interventions	Relatively Difficult	Easy

Source: Kiran and Sharma (2011)

If the businesses are implementing CSR practices, they will gain business partners and new business opportunities. An organization's good social image will enhance its reputation and help reduce regulatory interventions by government or shareholders. An enhanced reputation will attract more customers, which will increase profits and minimize risk because of the enhanced reputation and with new business opportunities; finally, it will help organization cut costs and make good relations with stakeholders. This can be proved with the help of case study of Nestle.

Nestle is among the world's largest, renowned food and beverage companies. Nestle is an old company that began its operations over 130 years ago. Its major success is its product innovations. Along with its innovative capabilities, its new business acquisitions have made it into the largest food company in the world. With the passage of time, the Nestlé family has more grown and entered into the production of chocolates, soups, coffee, cereals, frozen products, yoghurts, mineral water, and other varieties of food products. In 1921, Nestle built its first factory in the developing world. For success, first Nestle had to work with the farmers, helping them to be productive and successful so that they could supply high-quality milk, coffee, and other raw materials. Today, Nestlé's milk district in Brazil is larger than the country of Switzerland, and it has made a major difference in economic development and improved standards of living for area farmers and their families.

In 1962, Nestle wanted to enter the Indian market and received the government's permission to build a dairy in the northern district of Moga. Poverty in the region was severe; people were without electricity, transportation, telephones, or medical care. A farmer typically owned less than five acres of poorly irrigated and infertile soil. Many kept a single buffalo cow that produced just enough milk for their own consumption. Nestle came to Moga to build a business, not to engage in CSR. However, Nestlé's value chain, derived from the company's origins in Switzerland, depended on establishing local sources of milk from a large, diversified base of small farmers. Establishing that value chain in Moga required Nestle to transform the competitive context. This created tremendous shared value for both the company and the region.

Nestle built refrigerated dairies as collection points for milk in each town and sent its trucks to the dairies to collect the milk. When Nestle's milk factory first opened, only 180 local farmers supplied milk. Today, Nestle buys milk from more than 75,000 farmers in the region. As the quality has improved, Nestle has been able to pay higher prices to farmers than those set by the government. Today, Moga has a significantly higher standard of living than other regions in the vicinity. Nestlé's commitment to working with small farmers is central to its strategy. It enables the company to obtain a stable supply of high-quality commodities without paying middle men. In this way Nestle invested heavily to strengthen its supply chain and found many ways to tie local needs and opportunities to its business objectives. Business is the sole creator of wealth and the origins of all income and tax revenues, as well as charitable contributions. In a sound economy, people can afford both the necessities and the pleasures of life.

Nestle looks at a framework of Nestle for CSR from Figure 2 in terms of creating shared value. Creating shared value is a very different approach to CSR because it is not focused on meeting a set of standard external criteria or on philanthropy. The idea of winners and losers does not fit this model of CSR: business can help societies progress and all sectors can help business to improve and flourish.

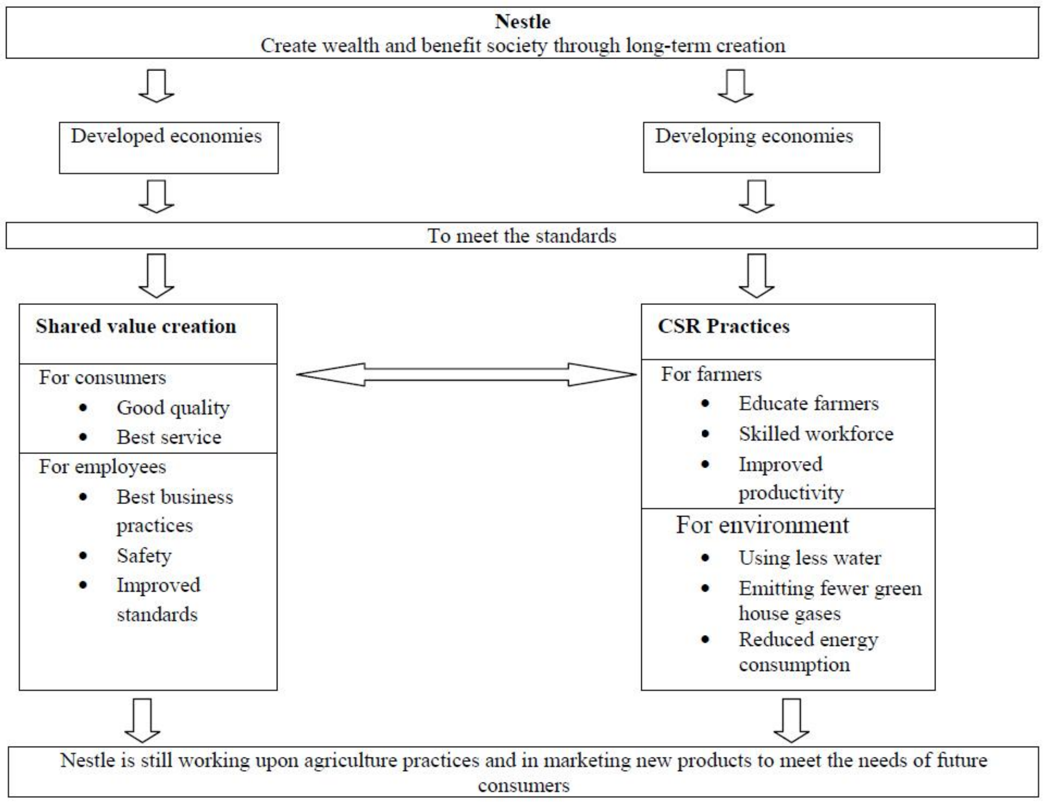

Figure 2. A framework of Nestle for CSR

Hypothesis Discussion

The following is hypothesis H1: Investments made by Nestle to sustain, as well as to grow in the changing global scenario, is improving day by day. As is very clear from the above shown framework, Nestle is continuously focusing upon the educating farmers, how production can be improved, and, also, making efforts to reduce environmental footprints. Nestle developed a shared value creation model to sustain employees and customers in the changing global scenario. Hence, this hypothesis has been partially accepted.

Hypothesis H2 proposes that benefits have been enjoyed by Nestle in implementing CSR practices. Nestle and CSR are positively related. Nestle enjoys the following benefits: more market shares, customers trust, and satisfied employees. In 1921, Nestle built its first factory; today it has 72 factories all over the world. This is a great achievement. So, this hypothesis may also be accepted.

The H3 hypothesis proposed that there are key drivers pushing Nestle/business organizations towards implementation of corporate CSR practices. Increased market share and satisfied customers are the major drivers of Nestle or acting as a back force to implement CSR practices, as the company believes that the true test of a business is whether to create value for the society.

The key drivers that have emerged from the literature review are *a)* enhanced reputation, *b)* alliance with business partners, *c)* better stakeholder relationships, *d)* attractive employer, *e)* customer satisfaction- loyalty, *f)* new business opportunity, *g)* cost savings, h) minimizing risks, and i) reduced regulatory interventions.

Today, Nestlé produces a great number of products in the market. All the products have one thing in common: high-quality products, for which Nestlé has become world renowned. The company's top priority is to produce the best products and most relevant products for the people, in spite of wherever they are working, whatever their own needs, throughout their production cycle.

Conclusion

This research is exploratory in nature and seeks to provide insight into CSR practices adopted by companies. Due to globalization and liberalization, CSR practices are becoming essential for the survival of every company. As is evident from previous literature, foreign multinationals are adopting CSR practices at higher levels, and customers prefer to buy their products more than the national/local companies' products. This suggests there is an increased responsibility for Indian corporations. Following the example of Nestle, the business corporations can create shared value by using the success mantra of CSR. The CSR model will help business corporations to develop, society to progress, and all sectors to improve and flourish. So, it can be inferred that by opting for CSR practices, business corporations will be able to enhance their market reputation and social image.

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IGNATIAN SPIRITUALITY & MANAGEMENT A STUDY OF "IGNATIAN EXECUTIVES"

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Abstract: We describe the results of a first empirical study conducted on the relationships existing between the fact that executives experienced St. Ignatius of Loyola's Spiritual Exercises and their managerial practices. Based on in-depth interviews of 20 senior managers and top executives who have practiced the Ignatian Spirituality for many years, we describe six general categories where these relationships appear to be the most important: Decision-making, Human Resource management, the organizational mission, social responsibility, career development, and the meaning of work. These results demonstrate that their leadership attitudes are influenced by discreet spiritual values. These values influence the organizations.

Keywords: Management, Leadership, Ignatian Spirituality.

Introduction

In this article, we report on the relationship observed between the experience of a particular spiritual practice and the exercise of management. Our research strategy springs from the fourth definition of spirituality proposed by Ken Wilber, i.e. that "spirituality is something you do, with your mind and your body, in actual practice, moment to moment" (Wilber, in Pauchant et al., 2004, p. 117). This research strategy thus attempts to better understand the effects that a distinct spiritual practice has on management thinking and doing. While we do respect other types of studies that attempt, for example, to better understand the overall influence of particular religious doctrines, values or rituals on management (see, for example, Cortright and Naughton, 2002, or Fermando and Jackson, 2006), we have chosen to focus on a personal, inner and reflective approach to spirituality. We are aware, however, that this strategy of research also incorporates elements belonging to the other definitions of spirituality which include the influence of values and faith. Indeed, the practice we have studied, the Spiritual Exercises of St. Ignatius of Loyola challenges the dichotomy, hinted above, between "religion" and "spirituality": while the Exercises are grounded in direct and concrete experience, they also belong to a distinct religious community, the Catholic Church and, in particular, the Order of the Jesuits.

Ignatian Spirituality and its Exercises

Currently, there exists a large body of research on the effect of different religious and spiritual practices (meditation, contemplation, prayer, chanting, etc.) on individuals. For example, a large number of rigorous studies have been conducted on the effects of such practices on medical and health care (see, for example, Koenig, 1999) and on psychological and social well-being (see, for example, Roof, 1999). In relation to work and the practice of management and leadership, there exists, comparatively, much less empirical work (Benefield, 2003; Delbecq, 1999; Lips-Wiersma, 2004; Neal & Biderman, 2004; Schwartz, 2006). The most studied spiritual practice has been the Transcendental Meditation (T.M.), with more than 500 studies (See Harung et al., 2009, for a review). Very interesting studies have also been conducted on practices used in different traditions, such as Buddhism (Kemochan et al., 2007), Christianity (Biberman & Whitty, 2000), Hinduism (Ramstedt, 2008) and many others.

In the spirit of inter-faith dialogue, we wanted to conduct an empirical study of one the world's major spiritual traditions which has never been examined with regards to its relation to the practice of management. While studies have found links between Ignatian Spirituality and the social engagement of individuals (Ryan, 1996), we are not aware of any empirical work conducted on its relationship with the practice of management per se. However, management experts, such as Casanova (1992), Delbecq (1999), Lowney (2005) or Falque and Bougon (2009) have presented and discussed the importance of the *Exercises* for the practice of management, and in particular its focus on "discernment".

The spiritual practice we have chosen is one of the major spiritual practices in the world. The "*Spiritual Exercises*", as they are called, were first published in 1548 by St. Ignatius of Loyola, the founding father of the Society of Jesus. Since its first publication, the book of the *Exercises* has been understood as a book of experience and of practice, rather than a book of doctrine (Ganss, 1992). For more than 450 years, orders in the Catholic Church have been educated and trained, using the Ignatian *Exercises* as a central component. We believe that it is important to better understand the effects of this specific spiritual practice on management as the Jesuits are the largest religious order in the Catholic church, close to 20,000 members in more than 100 countries, educating a very large number of professionals and potential leaders. In addition, the *Exercises* are practiced today by different protestant denominations, through organizations such as the Christian Life Community (CLC), counting more than 120,000 members. Further, management experts (Falque and Bougon, 2009) have recently revised the *Exercises* so they can be used by people of different faiths or by people who do not wish to be associated with a religious community.

Originally, the *Exercises* were meant to be undertaken over 30 days during a secluded retreat and under the guidance of a spiritual director. In another version, the *Exercises* are practiced over a 9 month period, by men and women of many different occupations without leaving their day to day occupations. Their purpose is to seek and find God's will, for one's life, and thus to fulfill the main principle of the Ignatian Spirituality "finding God in all things". This posits that the Divine is ever active in people lives, at work, in family, in meetings, everywhere. Through a process of attentiveness and responsiveness, Ignatian practitioners attempt to sense what the Divine is asking and to respond to this call in daily activities in order to trace God's footprints everywhere. *Ignatian spirituality* uses various prayers styles, meditations and techniques of contemplation as well as a spiritual self-review, a daily examination of one's actions and processes of discernment, to be used in making major decisions.

Methodology and Sampling

Since our study was the first on the subject, we decided that it should be exploratory and we have adopted the Naturalist Inquiry approach (Lincoln & Guba, 1985). This approach is particularly suited for ill-structured research projects and inquiries which require the interpretation of subjective experiences. Since we wanted to generate hypotheses on the relationship between the Ignatian Spirituality and the practice of management, we were careful to include in our sample respondents who have experienced the *Exercises* on a regular basis over many years.

Further, in order to strengthen the link with management, we have not included in this study men and women belonging to the clergy but only lay people who were managers in a variety of organizations of the private, public and associative sectors. In total, 20 leaders-executives took part in this study, all of whom were working in France. However, we made sure that a great variety of backgrounds, contexts and experiences would be represented. The 20 participants exhibited a wide age range (35 to 63, with an average of 55); they represented different professional backgrounds (engineering, business administration, medicine, science, etc.); and they worked in 15 industries or sectors (Pharmaceutical, aeronautics, petroleum, medicine, distribution, edition, health-care, public sector, not-for-profit, etc.).

In addition, we only chose managers holding executive positions, at the V.P. or CEO levels. These executives enjoy a certain amount of power and freedom of choice inside and outside their organization. Each interview was conducted in the natural setting of the interviewer. We used a very general set of questions, entered the data in a database and then generated six categories through a process of crystallization and saturation. In order to reduce the chance of misunderstandings, we communicated a synthesis of the results to the interviewees and, after incorporating their feedback, they all agreed that our results were representative of their experience.

Results

We present below the six general categories generated through this study and which have consequences on the leadership and the organization: 1) the Decision-making Process; 2) Human Resource Management; 3) Organizational Mission; and, 4) Social Responsibility; 5) Career Development; 6) Meaning of Work. For each, we will describe how “Ignatian executives” - as we shall call them - handled some typical managerial issues at work.

The Decision-Making Process

The process of decision-making is central to management. However, Ignatian executives frame the process in a unique way by using “spiritual discernment” prior to making some decisions, specifically for important decisions like hiring or dismissal, new contracts, joint ventures, etc. Spiritual discernment allows for a pondering the arguments of the decision, as well as providing a choice of means and a study of each possible option. In addition, this offers a better integration of subjective elements such as the attentiveness to interior motions and emotions and feelings related to how the Divine may or may not be guiding the discernment. As explained by one interviewee:

> *(Bruno, V.P., Aeronautic sector). Ignatian Spirituality allows me to be aware of my interior motions as well to listen to my felling. I can then make more personal decision. God speaks through our actions and our emotions. In addition, I now find that it is*

> *natural for me to examine the positive and negative sides of each option after having reflected on the situation and its particularities. I also like the practice of the Ignatian review : When I imagine myself in the future or on my death-bed, I can review my life, in relation to an important decision that I made, or I can sense the taste in my mouth and in my heart. My practice of daily prayer is also important as it clarifies my work. Daily prayer allows me to review the decisions I have made in the past and to place future decisions before God, asking him to help me to be more vigilant, especially in the moments when I am easily tempted to use an authoritarian manner or to restrict myself with a narrow interpretation. I would say that decision-making is the primary service that an executive can offer to his team but it is also the first place where the temptation of pride or the desire for power can surface.*

While the above quotation is about an individual decision-making process, other Ignatian executives have used a particular process of consensus for collective decision-making processes. This involves seeking unanimity in the integration of the spiritual dimensions, listening systematic to everyone involved in the decision-making process without interruption, periods of silence, discernment, writing, dialogue and voting. As explained by an interviewee:

> *(Marc, executive in an investment network). We have an important rule, based on consensus and a communitarian discernment with different phases: 1. The decision team of seven people study the data; 2. The entrepreneur presents his project to the team for ten minutes, followed by twenty minutes of questions; 3. Each person takes a moment of personal reflection in silence and each submits his decision in writing; 4. Each member is then asked to explain his decision without commentary by the others; 5. The team then has an exchange on the different decisions; 6. A vote is taken and the investment is accepted if all seven members agree on, refused if two or more members disagree. 7. If only one member disagrees, he must meet the entrepreneur again for one day in order to study, one more time, the proposal and come to a decision. If he agrees the investment is accepted; if he disagrees, it is refused*

Human Resource Management

Just as the issue of decision-making, Human Resource Management is central to the practice of management. All interviewees emphasized the respect they give to their employees. They try to foster good interpersonal relationships and a climate that values human growth and personal development. They strive for a deep respect of each human being, and want to honor their spiritual nature. This attitude is also present in the process of evaluation where Ignatian executives are playing the role of a guide or of a coach, as opposed to an evaluative one or simply correcting mistakes. For example, they try to help people through attentive listening; they try to incorporate in their work elements of discernment in the process of the individual growth of their colleagues. They try to take into consideration the whole of the person, his or her personal or familial constraints as well. Some of them see their role as a helper for their collaborators to discover that they are in charge of their own development, helping them to find what they need. As stated by one interviewee:

> *(Marie, medical doctor, health care industry). The Ignatian spirituality helps me to better help people to develop all of their abilities. My role is more to assist each collaborator to discover that they are in charge of their own development, helping them to find what they need. An executive has more of a role as a guide who challenges and inspires. The employee has the responsibility to find his own path.*

While Ignatian executives attempt to preserve the freedom of their collaborators, they are also very aware of the constraints associated with working in organizations. Many acknowledge that one of the most difficult tasks is to terminate the employment of a collaborator due to economic necessities. In these cases, they attempt to keep as many employees as possible by using different strategies such as a salary freeze across the board, time sharing, voluntary retirements, etc. However, when they are forced to reduce their workforce they attempt to do it in the most human way possible. In times of lay-off the temptation to flee from interpersonal meetings is very strong. To sit down with each employee is a very difficult exercise. But in these difficult times, they have discovered that it really changes things when one attempts to meet with the employee and when people are authentic. During these times they discovered that one can give a promotion in a disdainful way and that one can terminate some one's employment in a very human way. As stated by one interviewee:

> *(Martin, General director of a research laboratory). In times of lay-off the temptation to flee is very strong. To sit down with each employee is a very difficult exercise. This is what I have done with my associates. But in these difficult times, I have discovered that it really changes things when one attempts to really see the employee and when you are authentic. During these times I have discovered that one can give a promotion in a disdainful way and that one can terminate some one's employment in a very human way.*

Organizational Mission

All the Ignatian executives that we have interviewed emphasized that for them the mission of their organization is centered neither on profit maximization nor on efficiency. While they take the notions of profits and efficiency very seriously both are at the service of human development. Their spiritual life has transformed things for them. Their relationship to others is different as well as the relationship to their organization's mission. Its official objective – profit and performance – is important, but it needs to be put into perspective and modified. Of course, they cannot afford not to be efficient, but efficiency is only one of the many pieces of the puzzle. True performance is really the development of people, the growth of each person. And this different conception has many implications for the notions of authority and power.

Many interviewees emphasized that these different conceptions in management can trigger conflicts with their colleagues and sometimes even with themselves. As emphasized by one respondent:

> *(John, Director, cosmetic industry). My spiritual life has transformed things. My relationship to others is different as well as the relationship to my organization's mission. Its official objective – profit and performance – is important, but it needs to be put into perspective and modified. Of course, we cannot afford not to be efficient, but*

> *efficiency is only one of the many pieces of the puzzle. True performance is really the development of people, the growth of each person. And this different conception has many implications for the notions of authority and power.*

Ignatian executives are, indeed, also attracted by power, honor and financial success. They, sometimes, feel some tensions around the notion of the purpose of the firm. They need to constantly check whether the firm's development serves not only their own needs but also those of the shareholders. Financial growth is important but so is also the question of how to stay with one's two feet on the ground! How to refuse financial growth for its own sake?

As explained by two of them:

> *(Dominique, V.P., industrial sector) Sometimes I disagree with the decisions taken by my colleagues when we do not share the same perspective on the mission of the organization. For example, recently, we had the opportunity to expand our market shares in two different countries, with the potential of very healthy profits. I refused to sign the contract because I believed we were not ready to expand internationally due to questions of human development. If I had not the habit of reflecting on fundamentals, I would have been seduced by the enthusiasm of the others. The decision was different for my colleagues since they were only considering the financial aspect of the opportunity.*
>
> *(Daniel, CEO, Mechanical engineering) I sometimes feel some tensions around the notion of the purpose of the firm. I need to check constantly whether the firm's development serves not only my own needs and those of our shareholders. Financial growth is important but so is also the question of how to stay with one's two feet on the ground! How to refuse financial growth for its own sake?*

Social Responsibility

As previously proposed, Ignatian executives are keenly aware of their responsibilities towards their employees. At the same time, their social responsibility is not limited to human resource management. Ignatian Executives attempt to integrate their personal quest for social justice into their interactions with their employees, clients, suppliers, i.e. all the stakeholders they deal with in their daily activities, including the natural environment. For example, as manager of a company, they have a responsibility to exercise an attitude of justice with the suppliers and subcontractors.

They try to be very strict and careful that they do not seek to lower their prices so exaggeratedly that it could cause their suppliers to loose money. Some of them have always defended the stance that suppliers or contractors should earn a just wage and therefore that they should not choke them by imposing unjust rates. When at times, they have had difficulties and had to lower their prices, they always succeeded in maintaining a good margin of profit for suppliers and contractors on other projects. Also, they have always tried to remain committed to the same suppliers, in order to help to ensure their financial viability. Conversely they know many companies which do not act justly as this and which, in the end, "kill" their subcontractors.

Further, some Ignatian executives use their power to attempt to stop projects with which they disagree from a moral standpoint. For example, one of them, an executive in the aeronautics industry tell us that he prefers not to conclude a contract, such as the sale of weapons to a country that will use them ostensibly against peace or the selling of material to people who are starving and where the money could be used for other more useful purposes. If justice is really at stake and if this Ignatian executive is in a position of responsibility, his margin for actions is always larger than what people think. He needs to dare to block a sale even if it could be an excellent one from a financial point of view. This is a decision that is never easy to make, since people and situations are never "all black and white".

Finally, Ignatian executives attempt to integrate in their working activities a number of disadvantaged people such as those with disabilities, those who suffer from racial discrimination or the unemployed.

But these choices are not easy. Some interviewees have even stated that they had to pay the price for their quest of personal integrity or of their social sensibility. For some of them, their guest for the absolute was very strong. However, their professional life was a life of constant compromise. They have often sought to be honest in the economic and political fields. Sometimes they have publically denounced what they had perceived to be an injustice and their colleagues did not like this. Sometimes, the consequences were that they were excluded from external political situations or that their career was deflected or stopped. But, as much as this was not easy to accept, still the kind of freedom they experienced was fundamental for them.

Career Development

Due to varying conceptions, career development of Ignatian executives can be rather different from the norm. Some attempt to complement their usual work with an engagement in humanitarian causes while others quit their organization if it cannot provide them with a sense of meaning. These behaviors are different from the more usual ones where the marketing of self and managing one's career in the hope of future promotions is quite important if not paramount.

Some Ignatian executives use the process of discernment for making these moves which go against a "traditional" career. Their experiences of discernment offered them the opportunity to think about the place of the work in their life. They discovered that they often forgot the spiritual dimension of their life. During their discernment process, some of them heard they could develop their career according to in a spiritual dynamic while working in business enterprises. Instead of choosing the way which gives them power, honour or riches, they chose the way of service. For example, one of them chose to keep working in headquarters and to develop a training department instead of going to India to become a director of sales department. He chose this option because during his discernment, he understood that to stay was the quest for a greater service rather than his career-building. It was the way of the Ignatian magis "mas".

Meaning of Work

In Ignatian Spirituality, the Divine is not found outside daily reality. It is uncovered at the heart of every action, every encounter and hence at work. It is therefore not surprising that practically all our interviewees stressed that the most important issue at work was finding meaning. To say it another way, Ignatian managers resisted the temptation to live a compartmentalized life. They strived for authenticity, where their life at home, at work and in other areas, including the spiritual world, is integrated. They tried to be “contemplatives in action”. Some of interviewees understood that work was a privileged place for relationship with others and a privileged place for confronting the dimensions of power and money. Working then becomes the place for a dialogue between themselves, God and the world, as well as with oneself.

For those who worked in social and medical care, they were led to be in touch with people who suffer. Through their encounter with these people, they became aware of the presence of God in the fragility of humanity. Marie, an M.D. working with terminal patients, expresses this special integration in a poignant way:

> *The spiritual life means to be in relationship with God. My work is relational. Encounters with patients and their families are ongoing contemplations of God which supports my way of being with others and with God. Monks separate themselves from the world in order to find the Divine. In the Ignatian spirituality, I am invited to be in the world to seek the Divine. I find God in sick people and most particularly when they are at the end of their lives. I find myself again facing the fragility of being and of its mystery. When I am with someone who has lost everything, everything that made him someone, I experience both God and the desert. There are no other things than the patient name and, yet, God is the face of all the people I encounter, without limiting myself to a particular face. For me, this is the Incarnation.*

Many Ignatian executives also emphasize their participation in the natural world or in what they call the “creation”, from the point of view of an enlightened stewardship. Through the innovative work, they believe that they participate in a certain way in the creation, in the transformation of the world. For example, to build a new instrument which will serve human-beings is a way to participate in the development of the creation. For them, there are three types of creative innovations: technological and material innovation, creation of employment, and development of relationships among people.

Conclusion

In this article we have presented how Ignatian executives, i.e. executives who share the spirituality and practice the St. Ignatius of Loyola’s Spiritual Exercises, manage their work in different organizations. Due to their integration into society, their practices and sensibilities are no different than those of managers whom we count as “humanists”. However, they do ground themselves in a specific faith and spiritual practice. We have also seen that Ignatian practitioners do not attempt to convert others. Theirs is not an attitude of proselytism but a contemplative attitude that includes the desire that their work become an opening to the Transcendent, letting the Divine to be present in their daily life and a mean to develop a leadership with values dissemination.

We do not claim that Ignatian spirituality is superior to others or that the categories we have described are unique. Indeed, it seems that many elements are similar to the ones emerging from other spiritual and non spiritual traditions. For example, the specific and sophisticated decision-making process Ignatian executives utilize has some similarities with other traditions and can be used outside of any tradition (Delbecq, 1999; Falque & Bougon, 2009). Similarly, the focus on Human Resource management, considering the other managerial functions of marketing, finance, production, etc., as means and not ends, has been emphasized by other authors. Peter Vail, for example, who wrote an influential book on spirituality and leadership (1998), affirmed that "All management is people management, and all leadership is people leadership. It's all people" (Vaill, 1989, p. 126). The refusal by the Ignatian managers to accept that profits and efficiencies are ends in themselves is also emphasized by, for example, the Buddhist community (Kemochan et al., 2007).

We have conducted this study in the spirit of a growing inter-faith dialogue and as a contribution of the expanding literature on spirituality at work. Further studies are necessary to verify the results of this research. Studies on this specific spiritual practice need to be conducted in different countries and to use an array of diverse methodologies, both qualitative and quantitative. It is also important to compare the effects on management of different spiritual, religious and ethical practices and to become more rigorous in assessing their positive and less positive effects.

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GROWTH THROUGH FINANCIAL INCLUSION IN INDIA

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Abstract: Financial inclusion is the ease of access, availability and use of the formal financial system by all members of the economy. The growing literature on financial inclusion has provided plenty of evidence of the merits of an inclusive financial system. However, we notice an absence of a comprehensive measure that can be used to measure the extent of financial inclusion in an economy. This study is an attempt to fill this gap, and, thus, make an original contribution. We propose an index of financial inclusion (IFI) following a multidimensional approach. The IFI developed here can be used to compare levels of financial inclusion across economies at a particular point of time. It can also be used to monitor the progress of policy initiatives for financial inclusion over a period of time. And, most important, such an index can be of interest to the research community in order to investigate empirical questions on relationship between development and financial inclusion. The IFI developed here incorporates information on various dimensions of an inclusive financial system, and it is easy to compute.

The promotion of an inclusive financial system is considered a policy priority in many countries. While the importance of financial inclusion is widely recognized, literature fails to offer a comprehensive measure to measure the extent of financial inclusion across economies. This study attempts to fill this gap by proposing an index of financial inclusion (IFI). The IFI is a multi-dimensional index that captures information on various dimensions of financial inclusion in one single digit between 0 and 1, where 0 denotes complete financial exclusion and 1 indicates complete financial inclusion in an economy. The proposed index is easy to compute and is comparable across countries.

Keywords: Financial inclusion, growth, multidimensional approach policy initiatives, financial system

Introduction

Financial inclusion is the availability of banking services at an affordable cost to disadvantaged and low-income groups. In India, the basic concept of financial inclusion is having a savings or current account with any bank. In reality, it includes loans, insurance services, and much more.

The Indian banking system will have to deliver on the plan for financial inclusion, the system, which demonstrated its resilience in the face of the recent global financial crisis, should adopt strong and urgent measures to reach the unbanked segment of society and unlock their savings and investment potentials.

An inclusive financial system has several merits. It facilitates efficient allocation of productive resources and, thus, can potentially reduce the cost of capital. In addition, access to appropriate financial services can significantly improve the day-to-day management of finances. An inclusive financial system can help reduce the growth of informal sources of credit (such as money lenders), which are often found to be exploitative. Thus, an all-inclusive financial system would enhance efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services.

The importance of an inclusive financial system is widely recognized in the policy circle, and, recently, financial inclusion has become a policy priority in many countries. Initiatives for financial inclusion have come from the financial regulators, the governments, and the banking industry. Legislative measures have been initiated in some countries.

The banking sector has also taken a lead role in promoting financial inclusion. In India, the Reserve Bank of India (RBI) has initiated several measures to achieve greater financial inclusion, such as facilitating "no-frills" accounts and "General Credit Cards" for low deposit and credit. Alternate financial institutions, such as micro-finance institutions and Self-Help Groups, have also been promoted in some countries in order to reach financial services to the excluded. Recently, the SKS Microfinance group was oversubscribed, which highlighted the need and significance of microfinance in India.

Financial inclusion is no less important than social inclusion. As we see in our society, millions of people are not considered for fair treatment either from the social institutions or from the financial institutions. It is commendable that, of late, the policy makers and banking institutions have come forward to address the issue of banking exclusion.

It is estimated that, globally, over two billion people are excluded from access to financial services, of which one third is in India. The Committee on Financial Inclusion (Rangarajan Committee, 2006) observed that in India 51.4% of farmer households are financially excluded from both formal and informal sources, and 73% of the farmer households do not access formal sources of credit. To be specific, those excluded are marginal farmers who happen to be women, who are further excluded right from the first stage of perception.

Financial inclusion is a complex issue, not simple. There are issues in our approach. When the excluded sections approach formal financial institutions, they are confronted with problems of accessibility, timeliness, and inadequacy of credit. For one reason or other, they are compelled to approach the informal agencies to meet their credit demands as we all know. An all-out effort has to be taken to address these problems that are not simple.

Objective

This is a detailed study of financial inclusion and findings on how financial inclusion has contributed to inclusive growth (in India with, citations from other countries). The study examines the relationship of financial inclusion and development and proceeds to propose an index for measuring financial inclusion.

Literature Review

According to Dr. Chakrabarty, Deputy Governor, Reserve Bank of India[1] "Economic growth in India has not been inclusive; unemployment and poverty remain high and a vast majority of the population remains excluded from health and education facilities." In order for growth to be inclusive, there needs to be not only the creation of economic opportunities, but also equal access to them. Inclusive growth can, thus, also contribute to poverty reduction by creating productive economic opportunities for poor and vulnerable groups. This address given by the Deputy Governor of the Reserve Bank of India discusses the important contribution of financial inclusion as a driver of inclusive growth. The definition of financial inclusion relied upon is the "process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost." The speaker notes that there is evidence which indicates that countries with a high degree of financial exclusion also show higher poverty rations and higher inequality.

Dr. Chakrabarty outlines supply-side and demand-side factors driving inclusive growth. On the supply side, poor individuals and small and micro-enterprises often have difficulties in accessing formal sources of credit. They have to rely on personal savings or internal sources to invest in health, education, housing, and entrepreneurial activities to make use of growth opportunities. Banks are expected to mitigate the supply-side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. On the demand side, lower income and /or asset holdings also impact significantly on financial inclusion. Agriculture plays a central role here, as the majority of India's population derives employment from this sector. Agriculture thus is important not only for high growth but also inclusive growth.

Methodology

As an inclusive financial system should be judged from several dimensions, a multidimensional approach is followed while constructing the index of financial inclusion (IFI). The approach is similar to that used by UNDP (offer expansion) for computation of some well-known development indexes, such as the HDI, the HPI, the GDI, and so on. As in the case of these indexes, proposed IFI is computed by first calculating a dimension index for each dimension of financial inclusion. The dimension index for the ith dimension, di, is computed by the following formula.[2]

$$di=Ai-mi/Mi-mi$$

where

Ai = Actual value of dimension i

mi = minimum value of dimension i

Mi = maximum value of dimension i

The formula ensures that $0 \leqslant di \leqslant 1$. The higher the value of di, the higher the country' s achievement in dimension i is. If n dimensions of financial inclusion are considered then, a country i will be represented by a point Di = (d1, d2, d3, ⋯.dn) on the n dimensional Cartesian space.

In the n-dimensional space, the point O = (0,0,0,…0) represents the point indicating the worst situation while the point I = (1,1,1,…,1) represents the highest achievement in all dimensions. The index of financial inclusion, IFIi for the ith country, then, is measured by the normalized inverse Euclidean distance of the point Di from the ideal point I= (1,1,1,….1). The exact formula is

$$IFI_i = 1 - \frac{\sqrt{(1-d_1)^2 + (1-d_2)^2 + .. + (1-d_n)^2}}{\sqrt{n}}$$

In this formula the numerator of the second component is the Euclidean distance of Di from the ideal point I, normalizing it by n and subtracting by 1 gives the inverse normalized distance. The normalization is done in order to make the value lie between 0 and 1 and the inverse distance is considered so that the higher the value of the IFI corresponds to higher financial inclusion.

Detailed Analysis of Financial Inclusion

According to the United Nations, three billion people around the world do not have access to formal financial services like savings accounts, credit, insurance, and payment services. More than half the population in developing countries and more than 80 percent of households in most of Africa is financially excluded. Financial inclusion aims to provide timely delivery of various financial services at an affordable price to financially excluded households and micro, small and medium-sized entrepreneurs. Through increased access to savings accounts and other financial services, the poor can build financial security, manage risks against adverse shocks, such as illness or natural disaster, and even invest in new business opportunities. More importantly, recent research shows that improving access to finance plays a crucial role in promoting economic growth and reducing poverty.

Microfinance was an initial effort to reduce poverty by improving access to finance for the poor. About three decades ago, Muhammad Yunus, the 2006 Nobel Laureate, established the Grameen Bank in Bangladesh. Microfinance institutions (“MFIs”) like the Grameen Bank make small loans to the poor who have no collateral or credit history and cannot borrow from mainstream financial institutions. MFIs’ unique group lending schemes incentivize borrowers to repay, and the global average repayment rates have been unexpectedly high (96 percent). However, microfinance alone cannot expand financial access for the poor. MFIs offer services to only 150 million poor people around the globe, and most financially excluded people still lack access to finance. Building an inclusive financial system is a more comprehensive effort. It emphasizes that formal financial institutions such as banks also have important roles to play in expanding financial access to the poor. It also stresses the importance of governments’ role in creating a proper environment to facilitate increased financial access.

Why Does Financial Inclusion Matter?

A well-functioning financial system is a crucial part of development, promoting economic growth and reducing poverty. Financial institutions and markets mobilize savings, provide payment services, allocate resources and transform risk by pooling and repackaging it. When a financial market functions well, funds will likely be allocated to the most productive users, which will contribute to economic growth and poverty reduction. However, when the market does not function properly, it loses growth opportunities. The financial system becomes more efficient and functions better when it is more inclusive. By being inclusive, it provides more growth opportunities to more individuals and entrepreneurs. Improving access to finance for the poor has been emphasized as an effective tool for achieving the Millennium Development Goals (MDGs). The way in which access to financial services can help achieve the MDGs is explained below.

- Goal 1: Eradicate extreme hunger and poverty

With access to financial services such as savings accounts, loans and insurance, the poor can build financial security, diversify income sources, and reduce their vulnerability to economic shocks. In addition, improving access to finance is likely to reduce inequality and poverty.

- Goal 2: Achieve universal primary education
  When households have access to microfinance, they are more likely to send their children to school, and the children are more likely to stay in school for a longer period of time. Also, with access to credit, savings and insurance, households are less likely to rely on their children's labor.
- Goal 3: Promote gender equality and empowering women
  MFIs have been targeting women as their main clients in an effort to enhance the status of poor women in their homes and the community by giving them ownership of assets.
- Goals 4, 5, and 6: Reduce child mortality, improve maternal health and combat HIV/AIDs, malaria and other diseases
  Many MFIs provide health education along with microloans to their clients. These programs help clients become more aware of health issues and take preventive actions, such as immunizing their children. Also, many MFIs provide health insurance products so that the poor clients receive timely treatment.
- Goal 7: Ensure environmental sustainability
  MFIs have been supporting the purchase of "sustainable energy products" such as solar powered lamps. Given that a large portion of microcredit is used for agricultural businesses, MFIs can promote environmentally sustainable practices in agriculture.

How to Measure Financial Inclusiveness?

Measuring and comparing access can be challenging because there are no readily obtainable indicators of access and different countries and institutions may define financial access differently. However, in order for policymakers to understand the impact of access to financial services and to design effective policies to improve access, it is very important to measure access and identify the barriers to access.

In 2005, the World Bank published indicators of financial access and updated them in 2010. In measuring financial inclusiveness, the Bank focused on the groups that are involuntarily excluded from financial services due to discriminatory lending policies, lack of the contractual or informational framework, or inadequate price and product (see Figure 1).

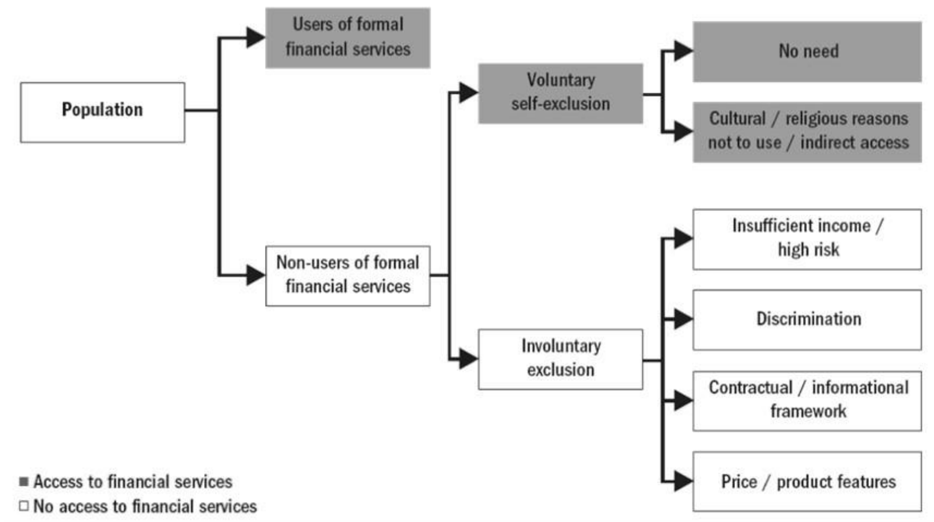

Figure 1. Distinguishing between access to and use of financial services[3]

There are three main approaches to measuring financial access.

1) Number of Users of Financial Services. While aggregated indicators, such as the total number of bank accounts, abound, the exact number of people who possess a bank account is unknown. The aggregated indicators can be unreliable, as some households or enterprises may own several accounts. Due to this limited value of aggregated data, researchers created so-called "headline indicators" by using a census or survey of users along with aggregated data.

According to the World Bank, these headline indicators show that less than 50 percent of households in many developing countries have some kind of account. In many African countries, more than 80 percent of households do not have a bank account. In contrast, more than 90 percent of households possess a bank account in several European countries.

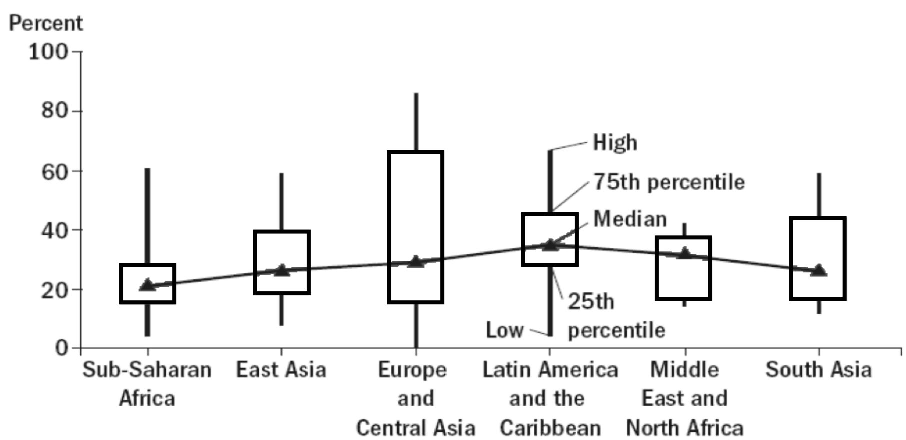

Figure 2. Proportion of households with an account in a financial institution[4]

(NOTE: This figure shows "the highest and lowest national % as well as median and quartiles, for the countries in each region.)

2) Firms' Subjective Assessments. In the case of firms, there are several useful surveys, such as "the World Business Environment Survey" and "the Investment Climate Assessment" surveys. These surveys provide information regarding to what extent firms experience difficulties in operating and expanding their businesses due to inaccessibility to finance or high cost of external finance (obtaining funds from outside of the firms). These surveys suggest that small firms tend to experience more difficulties in obtaining external finance. For small firms, only less than 20 percent use external finance, while around 50 percent of large firms use external finance. Also, small firms say that lack of access to finance is one of the most critical business impediments they face. In regions such as Africa, the Middle East, and Latin America, at least 40 % firms respond that their growth is constrained by lack of access to and cost of external finance (see Figure 3).

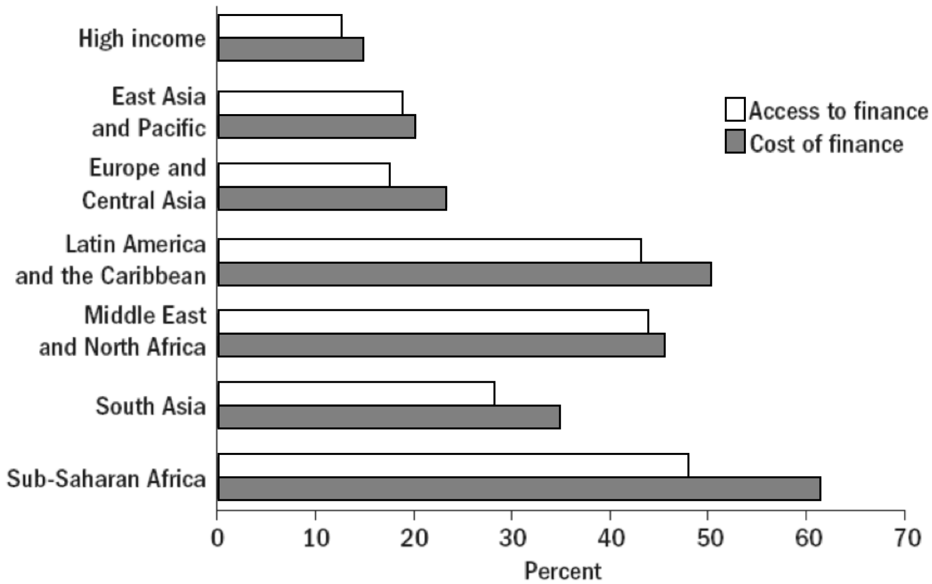

Figure 3. % of firms reporting finance as a problem[5]

(NOTE: This figure demonstrates the % of firms which reported that "access to finance or cost of finance" is a "severe or major obstacle" to expanding their businesses.)

3) Geographical and Cost Barriers. Identifying barriers to access to financial services is also an important part of measuring access. Major barriers include limited geographical access to a bank, lack of appropriate documents (e.g., drivers licenses), and account fees or minimum balance requirements. In the case of geographical access barriers, for example, access can be measured by knowing how far clients are located from the nearest bank branch or an ATM (or measuring the "density of branches per square kilometer or per capita"). For example, Botswana has only one branch per 10,000 square kilometers and Ethiopia has even fewer than one branch per 100,000 people. In comparison, Spain has a more inclusive financial system, with 96 branches per 100,000 people and 790 branches per 10,000 square kilometers. When the density of branches is high, more individuals are likely to have a bank account.

How Does Access to Finance Impact Households?

By having access to financial services, poor households obtain reliable tools for managing their money.

Since the incomes of poor households are unstable, their needs for reliable financial services are greater than those of richer households. By borrowing and saving, poor households can meet basic consumption needs, such as having food on the table every day. Furthermore, they can save money for education expand their business opportunities or use during emergencies.

Moreover, poor households also benefit from higher incomes and more and better employment opportunities as financial development reduces poverty through economic growth. In order to foster financial development, it is important to promote more efficient capital allocation. When 50 to 80 percent of the population around the globe lacks access to finance, it will be hard to achieve efficient allocation of capital without improving access to those large parts of the population. In this regard, the World Bank's report, "Finance for All," emphasizes the need to broaden the focus of financial inclusion from poor households to all excluded households and firms, including non-poor micro and small- and medium-sized entrepreneurs.

How Does Access to Finance Impact Firms?

When a firm has access to external finance, it is likely to grow faster. In India, for example, small- and medium-sized firms have expanded their operations after becoming eligible to borrow from a bank at subsidized interest rates. Moreover, by having access to finance, small firms can allocate assets more efficiently, and can increase innovation. By contrast, when small firms face difficulties in obtaining external finance, they lose opportunities to grow and innovate.

Foreign banks entry into developing countries tends to improve access to finance for firms. Although most large foreign banks focus on lending to larger firms rather than small- and medium-sized enterprises (SMEs), often this forces local banks, facing increased competition for large firm business, to look for profitable services in segments that they had previously ignored–like SMEs. Also, when the market share of foreign banks is higher, there are fewer firms that face obstacles to external finance.

Computation of IFI[6]

In the index of financial inclusion presented here, we consider three basic dimensions of an inclusive financial system: banking penetration (BP), availability of the banking services (BS) and usage of the banking system (BU). These dimensions are largely motivated by two factors -- data availability for a large number of countries and recent development in the literature

Dimension 1: Banking penetration. An inclusive financial system should have as many users as possible; that is, an inclusive financial system should penetrate widely amongst its users. The size of the "banked" population, i.e. number of people having a bank account is a measure of the banking penetration of the system. Thus, if every person in an economy has a bank account, then the value of this measure would be 1. In the absence of the data on "banked" population, we use number of bank accounts as a proportion of the total population as an indicator of this dimension.

Dimension 2: Availability of banking services. The services of an inclusive financial system should be easily available to its users. Availability of services can be indicated by the number of bank outlets (per 1000 population) and/or by the number of ATM per 1000 people, or the number of bank employees per customer. In the absence of comparable data on the number of ATMs and number of bank staff for a large number of countries, we use the number of bank branches per 1000 population to measure the availability dimension.

Dimension 3: Usage. This dimension is motivated by the notion of "under banked" or "marginally banked" people, as observed by Kempson et al (2004)[7]. They have observed that "in some apparently very highly-banked countries, a number of people with bank account are nonetheless making very little use of the services on offer". These people are termed "under-banked" or "marginally banked". Thus, merely having a bank account is not enough for an inclusive financial system; it is also imperative that the banking services are adequately utilized. In incorporating the usage dimension in our index, we consider two basic services of the banking system –credit and deposit. Accordingly, the volume of credit and deposit as proportion of the country's GDP has been used to measure this dimension.

Thus, considering the above three dimensions –penetration, availability and usage– we can represent a country i by a point (pi, ai, ui) in the three dimensional Cartesian space, such that 0 ≤ pi, ai, ui ≤1, where pi, ai and ui denote the dimension indexes for country i computed using formula (1). In the three dimensional Cartesian space, the point (0, 0, 0) will indicate the worst situation (complete financial exclusion) and the point (1, 1, 1) will indicate the best or ideal situation (complete financial inclusion). The IFI for the country i is measured by the normalized inverse Euclidean distance of the point (pi, ai, ui) from the ideal point (1, 1, 1). Algebraically,

$$IFI = 1 - \sqrt{\frac{(1-p_i)^2 + (1-a_i)^2 + (1-u_i)^2}{3}}$$

Data

While computing an index such as the one proposed here, availability of data is an important challenge. We found that the latest year for which some data are available is 2008. For financial (banking) penetration dimension, we have used the data on "Bank Deposit Accounts" from World Development Indicators (2008) of the World Bank. These are deposit accounts, including checking (or current), savings, and time deposit accounts for business, individuals and others. For the availability dimension, we have taken the data on deposit money bank branches from the same source. Deposit money banks comprise commercial banks and other financial institutions that accept transferable deposits, such as demand deposits. For the usage dimension, we have used the data on "domestic claims on the private and resident sector" and the data on "total deposits" from International Financial Statistics (IFS, 2006) of the IMF.

Results

Using data on all three dimensions (*penetration*, *availability* and *usage*) for India and data for *availability* and *usage* dimensions for the year 2008, IFI values have been computed. Depending on the value of IFI, countries are categorized into three categories, viz.:

1. $0.5 < IFI \leq 1$ – high financial inclusion
2. $0.3 \leq IFI < 0.5$ – medium financial inclusion
3. $0 \leq IFI < 0.3$ – low financial inclusion

It was calculated that:

Degree of Penetration (D1) was: **0.185**

Degree of Availability (D2) was: **0.096**

Degree of Usage (D3) was: **0.186**

Thus the Index of Financial Inclusion of India came out to be: **0.194** which means it is below 0.3 and has a **low** financial inclusion

Strategies for Inclusive Growth

The key components of the 'inclusive growth' strategy includes a sharp increase in investment in rural areas, rural infrastructure and agriculture; spurt in credit for farmers; increase in rural employment through a unique social safety net; and a sharp increase in public spending on education and health care. There is a pressing need for making banking and financial services available to every part of the country. Also, in a country like India with diverse social and economic profile, financial education is particularly relevant for people who are resource poor and who operate at the margin and are vulnerable to persistent downward financial pressures.

Measures Used in the Past[8]

Access to financial services is in a very dismal state in the country. Typically one branch in India caters to banking needs of around 16,000 persons (RBI, 2010). Introduction of the Self Help Group (SHG)-bank linkage programs in the early 1990s through the National Bank for Agriculture and Rural Development (NABARD) with the policy support from Reserve Bank was to facilitate a concept called "door step banking." By developing habits of pooling up their savings, handling loans and keeping accounts the program gradually build financial discipline among SHG members, and they get ready for larger loans. Today, 12 million poor women have access to savings and credit services through 800,000 SHGs all over the country. Over 30,000 branches of regulated banking structure are involved in this phenomenon. They have mobilized loans of over 2000 Crore Rupees (NABARD, 2008).Micro finance is considered as a viable tool for reaching the unreached.

The Kisan Credit Cards (KCC) scheme was started by the GOI in consultation with the RBI and NABARD in 1998-99 to join the features of two of the then existing schemes namely, Agricultural Credit Cards and Cash Credit Facility offered by PSU banks and to overcome their shortcomings. However for this scheme to be successful, education of both the farmers and also the bank officials about the scheme are required. Swarnjayanti Gram Swarozgar Yojana (SGSY) was setup with the objective of bringing the assisted poor families (Swarozgaries) above the Poverty Line by ensuring appreciable sustained level of income over a period of time. But the poor credit absorption capacity of the poor can be illustrated by the prevalent credit-subsidy ratio under SGSY at about 2:1, much below the target ratio of 3:1, partly due to failure to strengthen the demand side of the credit by improving the capacity of the poor to absorb credit for income generating activities.

To achieve the objective of greater financial inclusion, RBI advised all banks to make available a basic banking "no-frills" account either with "nil" or very low minimum balances, as well as reduced charges that would make such accounts accessible to vast sections of population. The Reserve Bank of India said there has been a considerable progress in most regions; where Gujarat has 90% financial inclusion, the progress in Bihar and North East has not been good. As of May 2010 the domestic banks have opened 1.8 million no-frills accounts in the country, but it is still very early to reach a conclusion about it.

Government Policies to Improve Access to Finance

Governments can contribute to improving access to finance through appropriate policies, legislation, etc. However, experience suggests that not all government policies are helpful, and governments' direct intervention could be counterproductive. In order to share successful policies and avoid ineffective ones, policymakers in developing countries formed a global network, called "Alliance for Financial Inclusion" in 2008. Although reforming overall institutions and building infrastructure will take a long time, governments can improve access to finance relatively fast by prioritizing certain institutional reforms and focusing on specific infrastructures. Reforming information infrastructures such as building credit registries and improving debt recovery procedures, tend to generate fast results in improving access to finance. For example, India established Debt Recovery Tribunals ("DRTs") to speed up a debt recovery procedure. Under this system, banks can recover loans faster by filing claims in DRTs without going through court proceedings that may involve corrupt judges and delays. This new mechanism has contributed to increasing loan recovery rates and lowering interest rates on loans.

In particular, it is noteworthy that governments can improve access by providing legislation and regulations that would allow market participants to use innovative technologies (e.g., the Internet and cell phones) to reduce the cost of providing financial services significantly. While banks invest substantial amounts of money for infrastructure and personnel under the traditional branch-banking approach, mobile banking allows banks to provide financial services at reduced costs

The government's appropriate policy actions made this impressive success possible. A recent paper by the Brookings Institution identified several factors that contributed to such success. First, the government created a favorable environment to expand the mobile phone market. Although mobile phone penetration rates in Kenya were very low in 1990s compared to some countries in Africa, the number of mobile phone users rose sharply from 15,000 in 1999 to 16 million in 2008 after the government facilitated reforms in the telecommunication sector by enacting "the Kenya Communication Act." The government also provided an efficient tax system and a stable legal structure and encouraged innovation. Second, the government engaged the private sector in its policy-making process to make sure that government will provide support for service providers and to evaluate possible risks to financial stability (e.g., possibility of fraudulent movement of funds). In introducing M-PESA, the private sector's contribution was especially effective, since it was well supported by their research and evidence. Third, the government strategically chose to allow technological innovations before enacting appropriate legislation in order to expand access to finance. Allowing new products into the market in the absence of relevant legislation may compromise financial stability. However, the government successfully balanced access with stability by carefully monitoring the market and enhancing oversight capacity to ensure the financial stability.

Governments can also improve access by facilitating competition. As competition intensifies, incumbent financial institutions are likely to extend services to a new market and try new, cost-effective technologies in an effort to find new ways to increase profits. However, it is also important to make sure through regulatory measures that intense competition would not result in reckless and improper lending practices. One of those measures is setting a ceiling on interest rates. Although many governments have used this measure, clients are still vulnerable to abusive lending practices because banks tend to require higher fees and additional charges to offset lower interest rates.

While governments' role in creating an appropriate environment to facilitate access is important, the scope of their direct intervention is limited, and direct intervention programs require careful monitoring. In most cases, providing direct credit through government-controlled financial institutions has not worked well in part because the lending decisions are likely to be distorted by political influences. By initiating the public/private partnerships, however, governments can play a role in starting new financial services and widen access to finance.

Financial Education

Given all these challenges of financial inclusion under difficult circumstances and with few resources to fall back upon, could be accentuated by the lack of skills and well informed decisions. It encourages under banked consumers to get into or may be to make better use of the financial mainstream and, also, to help them to retain as successful account holders in the shorter perspective. It also contributes in keeping them as savers for the longer perspective and can contribute to asset building among households.

a) Community Finance Learning Initiatives (CFLIs) should be introduced with a view of promotion of basic financial literacy among the rural people

b) A Dominant Perspective that finance for the rural people and the poor people was a social obligation and it is not a potential business opportunity

Recommendations

The major reasons for failure of Financial Inclusion in the past in spite of initiatives were: a) absence of technology, b) absence of reach and coverage, c) inefficient delivery mechanism, d) absence of business model, and e) lack of compassion for poor among rich. But, today, there is an increase in focus on inclusive growth. Banking technology has progressed fast enough and more importantly the realization that the poor is bankable has arrived. Various immediate measures which government of India should implement or which are under implementations but should be executed in a more effective manner are

- Strengthen agency banking (micro finance institutions, business facilitators and business correspondents). Our very old post offices will be an ideal channel to pursue the future long term goals of agency banking especially in rural India. A Post Office Card Account may be created for those who are not able or unwilling to access a basic bank account.
- Achieve synergies between the technology providers and banking channels to expand reach. Application developers will be required to synergize core banking with micro financial applications.
- Increase coverage under mobile banking and satellite banking and develop new platforms. Recent developments from private players like Nokia, which has introduced Nokia Life Tools, should be targeted as potential partners in achieving such goals.
- Have interest rate ceilings specified for NGO/MFI for they tend to charge higher rates of interest in a sugar coated form. These legalities can be introduced once an NGO/MFI enters into partnership with a bank.
- Corporate social responsibility: The CSR cells of MNC's and other firms can contribute by means of a common platform or even individually. Contribution can be cash grants to registered NGO/MFI's, which will be responsible for disbursement, or the CSR cell can act as potential

customers for goods produced by the cottage industries. This model has been highly successful in the United Kingdom and even in eastern rural regions.

Long Term Measures

- Legal requirement that each and every citizen or resident should have access to transaction banking and payment services with an independent supervisory body to enforce and control the implementation.
- Financing infrastructure development: The rural economy has a big need to upgrade necessary infrastructure and, thereby, contribute to enhanced development capacity, poverty reduction, and improved living standards. To this it was agreed to work towards adopting sustainable and viable financing policies and supporting technical assistance, capacity-building, and knowledge-sharing initiatives to make infrastructure markets operate more effectively.
- National registers of information of payment defaults, as well as bankruptcies and court judgments, to address credit use difficulties by protection of vulnerable consumers from exploitative lending and ensuring the provision of appropriate credit on the market.

Conclusion

Financial inclusion has been a catch phrase for the past few years. Delivering financial services to all sections of the population will remain a challenge that central banks around the world will face over the next few years. Increasing educational levels means more financial inclusion; therefore, a literate population must be created in order to create a meaningful financially included population. Innovation and out-of-the-box thinking are what has made the world what it is today. We can never be complacent with what we have or what we have achieved; the human life is an endeavor for progress and a better life. This should be the case with financial inclusion; we cannot become complacent and become victims of our own success. Not only should people have access to basic financial services but should also actively use them. A modern and a globalized economy cannot be successful unless it is inclusive. With enthusiasm and foresight, this challenge would be overcome rather simply. We should not lose the enthusiasm with which we started and that mediocrity or partial success cannot considered as same as success.

Developing and under-developed economies all over the globe are looking for new modes and means to contain poverty and include their citizens in the financial system. It is becoming increasingly apparent that addressing financial exclusion will require a holistic approach on the part of the banks in creating awareness about financial products, education, and advice on money management, debt counseling, savings and affordable credit. The banks would have to evolve specific strategies to expand the outreach of their services in order to promote financial inclusion.

The main focus of the banks in the country has been towards using business correspondents for reaching out to the unbanked population. However, with the increasing penetration of telecommunications in the country and greater reach, mobile based business models (also referred to as M-Banking) will prove to be instrumental in realizing branchless banking and taking it to higher grounds by enabling low cost and real time transactions over secure networks.

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PERSONAL VALUES, BEHAVIOR AND CONFLICT RESOLUTION STYLES: A STUDY OF CONTEMPORARY MAINLAND CHINESE BUSINESS STUDENTS

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Abstract: This article presents analysis from surveying 766 Chinese students over six years, 2005 to 2010. All data were derived from self-assessment questionnaires on four measurements: personal values, Machiavellianism, conflict resolution approaches and leadership beliefs. We report that Confucian values for family and social ("guanxi") relationships remain entrenched, and see low levels of commitment to "community", defined as those outside the spheres of family and social relationships. We note that Chinese students displaying higher levels of Machiavellianism also place less emphasis on all personal values measured, except financial success. We see an equally strong, but direct relationship, between Theory Y proponents and all personal values except financial; however, Theory X beliefs do not appear significantly correlated with personal values. Finally, we note significant male/female differences on Machiavellianism levels and a compromising approach to conflict resolution, yet on only two personal value measures: family and physical pursuits.

Keywords: Confucian values, gender differences, conflict resolution, Machiavellianism, culture's consequences, leadership

Introduction

We present the results from six years of researching Mainland Chinese business student attitudes. These data are part of an eight year, ongoing self-assessment study of Chinese, U.S. and Canadian business school students referred to as "SSARP", a Student Self-Assessment Research Project. SSARP was developed from 2004 to 2005, by comparing self-assessment results in the classroom. We selected five questionnaires based on the opportunities they offered for researching cause and effect, then "reverse-translated" each to ensure consistency between the English and Mandarin versions.

Our goal is to contribute to the understanding of the relationship between managerial values, attitudes and behavior. The study design provides the opportunity to consider these dynamics in a cultural context, and ultimately to be able to compare results both across cultures and on the basis of international experience. Our research question asks "What are the value attitudes of contemporary undergraduate Chinese business students? Subsidiary research questions include "How do the value attitudes of male and female Chinese business students compare?"; "What relationship(s), if any, exist between certain value attitudes and traditional Chinese Confucian value attitudes"; "Do the data on contemporary Chinese business student value attitudes support existing research findings"?

Literature Review

There has been a large amount of research comparing the value attitudes of citizens of various nations. For research on Chinese, particularly in Mainland China, there is a wide range of research that identifies traditional Chinese values and the degree of their vitality in the dynamic China of the past few decades.

The foundation of cultural values analysis is the four dimensions of national cultural variability first set forth by Hofstede in Culture's Consequences (Hofstede, 1980). Hofstede originally posited that cultures differ along four dimensions:

1. Power Distance – the extent to which the less powerful in organizations and institutions expect and accept that power will be distributed unequally
2. Individualism vs. Collectivism
3. Masculinity vs. Femininity – a continuum where male values in a culture run from very assertive and competitive to modest and nurturing (similar to women's values).
4. Uncertainty Avoidance – the extent to which a culture programs its members to feel uncomfortable or comfortable in unstructured or ambiguous situations.

Hofstede's Culture's Consequences has since grounded research in a wide range of cross-cultural research topics including change management, conflict management, decision-making, human resource management, leadership, organizational citizenship behaviors, work related attitudes, negotiation, etc., (Kirkman et. al., 2006).

Hofstede and others expanded his initial research to consider the economic rise of East Asia through the lens of cultural values (Hofstede and Bond, 1988). Their conclusion was that the cultural values of Confucianism are a major factor in Asian economic success and that culture is important in the fate of nations.

Others have rejected Hofstede's fifth dimension of Confucian Values. Tong rejected the validity of this measure for methodological and other reasons (Tong, 2003). Tong notes that while the first four cultural dimensions offer polar extremes, the Confucian Dynamism measure offers values at the two ends that "are not contrasting or opposing values, but rather closely interrelated with one another" (Tong, 2003, p. 354). Also, while the Confucian Dynamism dimension argues in favor of a competitive advantage based on long-term orientation, in fact a recognized major Mainland Chinese business practice is chasing short-term gain at the expense of a long-term vision of business ethics. Tong also questions that Hofstede and Bond classify Confucian Values as positive versus negative, arguing that the Chinese Values Survey ("CVS") has design flaws because values are interrelated and more important values are omitted: There should be at least 71 CVS values and that this list is not exhaustive. (p. 359-361)

Woodbine found that the traditional Confucian values found in Chinese Work Dynamism were poor predictors of moral choice (Woodbine 2004). When financial institution employees were confronted with a hypothetical situation involving insider trading and the decision to report this conduct, the employees were more likely to withhold the information from management.

Leung and Bozionelos (2004) compared Chinese and U.S. culture through the lens of personality type. They measured the influence of the "Big Five" personality types of openness, agreeableness, conscientiousness, neuroticism, and extraversion on leader emergence. They relied on Bond and Hofstede's observation that Confucian culture values conformity and low profile. They were surprised to find the importance of the trait of extraversion associated with the prototypical notion of an effective leader in both cultures. They explain this finding by noting that national cultures may be slowly converging due to globalization.

Peppas (2004) sought to compare the five Confucian values of humanity/benevolence, righteousness, propriety, wisdom, and trustworthiness with the U.S. values of individual achievement, self-reliance, a belief in equal opportunity, competitiveness, hard work, materialism, informality, directness, timeliness, and the belief that change is good. He used ten paired value statements to identify differences and similarities between U.S. and Chinese employees. These value statements related to the importance of individual achievement, self-reliance, equal opportunity, competition, hard work, material wealth, change as progress, informality, directness in communication, and meeting time targets. He found that the Chinese responses differed from the U.S. responses for the values of competitiveness and formality (Peppas, 2004, p. 67). Hofstede has since proposed that the Big Five be expanded to a sixth Asian measure of "dependence on others" (Hofstede, 2007, p. 419).

In recent years, Hofstede addressed the issue of "What is Asian Management?" (Hofstede 2007) He referenced his earlier research on perceived goals of successful business leaders (Hofstede et al., 2002). According to this research the Chinese perceived goals values were 1) respecting ethical norms 2) patriotism, national pride 3) power 4) honor, face, reputation and 5) responsibility towards society. For the U.S. these goals were 1) growth of the business 2) personal wealth 3) this year's profits 4) power and 5) staying within the law.

In another recent study that compared Mainland Chinese and Canadian students, Dunn and Shome (2009) examined cultural crossvergence and social desirability bias. They also were interested in examining the theories of divergence, convergence or crossvergence. Students were asked to comment on various business ethics issues. Scenarios at the micro-level (individual) were found to be less unethical by the Chinese students. Because scenarios at the macro-level (corporate activities) had similar findings of unethical behavior, the authors concluded that there was a crossvergence of attitudes (p. 536). One limitation to this study is sample selection bias; the Chinese student subjects were limited solely to those studying abroad in Canada (p. 537).

McDermott and Obar (2009) compared the value attitudes of Mainland Chinese and U.S. business school students. They identified a crossvergence of values with Chinese students rating more highly certain Confucian based values such as patriotism, a belief in cultural superiority, and a desire for clear ordering of relationships in the workplace.

Wang and Hu (2009) examined Chinese cultural values from the vantage point of consumer behavior. They identify the relative consistency of certain Chinese cultural values which they attribute to the traditional Chinese learning system (p. 400). They then identify those values that appear to be changing such as the trend toward individualism, materialism, and consumerism (p. 404). Nevertheless, they argue that a successful marketing strategy must consider the continuing power of traditional Chinese values.

The development of a new generation of Chinese managers with different values has been called the “Chinese Me” generation (Ralston et al., 1999). Ralston found that these new managers were more willing to take risks than prior generations while still possessing Confucian values. Ip (2009) identifies the recent renewed interest and popularity of Confucian values on the Mainland – values that the New China had sought to minimize due to their support of the pre-1949 feudalist tradition (p. 473). Ip questions when these values provide sufficient norms for a modern firm to compete in today’s business world.

Because the literature on Chinese values offers wide-ranging observations, additional contemporary research can identify trends in younger Chinese values within the context of China’s economic and social dynamism. Our data measures students’ attitudes in what can be described as the “decade of China” where China completes the transition from a lesser-developed nation to the restoration of its historical position as the economic and cultural anchor of East Asia.

Methodology

Our survey was conducted from 2005 to 2010 at Dongbei University of Finance and Economics in Dalian, China (DUFE) and King’s University College at The University of Western Ontario. Over 80% of the surveys were completed at DUFE with the remainder completed in Canada by Mainland Chinese students studying business at King’s. DUFE draws students from all parts of China. The sample universe is university students in the sophomore year of a business, economics or professional program. In developing this methodology we recognized both the value and limitations of this survey group (Greenberg, 1987).

Questionnaires were administered in one sitting, without prior notice and with no opportunity for respondents to consult or discuss their responses with others. Respondents were provided a survey set including an ethical standards letter, a permission form, a short demographic survey, plus five self-assessment questionnaires. Respondents were asked to read a letter of permission and to freely and anonymously choose to allow, or not allow, their responses to be included in SSARP. The self-assessment questionnaires were classified into the following areas:

- Assumptions in Management (Theory X/Y)
- Personal Values
- Persuasion (“Machiavellianism”)
- Conflict Management Styles
- A “Cultural Context” Inventory

We report our results for the first four measurements above, as each offers the potential to gain insight on ethical considerations. We first identify the literature underlying the development of each measure.

Theory X/Y Measurement

Douglas McGregor (1960, 1961, 1967) addressed the issues of managers’ assumptions about the nature of their workers. The Theory X manager assumes that employees are interested only in money, do not want to accept responsibility and shirk their work duties whenever possible. In this view, management needs to assume a more authoritative or autocratic approach, including close supervision through a comprehensive system of controls and "positional power".

By contrast, Theory Y managers assume that, given the proper conditions, employees will seek out and accept responsibility, are self-motivated and will exercise self-control and self-direction in accomplishing objectives to which they are committed. Theory Y managers believe that the satisfaction of doing a good job is a strong motivator.

For McGregor, Theory X and Y are not different ends of the same continuum. Rather they are two different continua in themselves. McGregor thought that Theory Y managers are more likely than Theory X managers to develop a climate of trust with employees, through more open communication with subordinates, minimizing the difference between superior-subordinate relationships, and creating a comfortable environment in which subordinates can develop and use their abilities (Papa et. al., 2008).

McGregor's theories have received support from a number of authors. Likert (1967) indicated that the type of supervision behavior affects employee loyalty and attitudes towards managers, which in turn affect production levels. Sager (2008) explored the possibility that McGregor's Theory X/Y assumptions serve as cognitive determinants of superior communicator style, a multidimensional set of style variables that can have considerable effects on subordinate well-being and organizational viability. The research found that Theory X assumptions were positively related to the "Dominant" and "Impression Leaving" styles. In contrast, Theory Y assumptions were negatively related to the "Anxious" style, and positively related to the "Supportive", "Impression Leaving", and "Nonverbal Expressive" styles.

Pan et al. (2010) discuss the recent failure of Chinese joint ventures due to cultural conflict that touches on Theory X and Y values. They note that the Chinese manage in a high power distance culture and typically use a non-participatory approach to decision making.

Personal Values

Other studies (Triandis et al., 1986; Ralston et al., 1997; Ralston et al., 1999) have examined the relationship between Hofstede's cultural values dimensions and personal values, and concluded that the Individualism-Collectivism continuum may offer the strongest correlation.

Ralston et al. (1997) investigated the issue of work values across cultures from a "convergence, divergence, crossvergence" framework. Convergence theory posits that as nations industrialize they will embrace common ideas with regard to economic activity and work related behavior in a capitalist model. Divergence theorists argue that national culture drives work values, regardless of the economic model (p.183). Crossvergence theory argues that the result of development is a mix of national culture values and values from the dominant economic ideology. Proponents of crossvergence note that the evolution of crossvergence values could take generations to manifest. The authors measured the influence of national culture (Eastern collectivist vs. Western individual values) and economic ideology (capitalism vs. socialism) on the work values of 855 managers from the United States, Russia, Japan, and China using the Schwartz Value Survey (SVS). They found that Chinese and American respondents represented ideological opposites, with U.S. workers' values reflecting both an individual-oriented culture and economic ideology while Chinese workers' values reflected a group-oriented culture and ideology. However, the authors also concluded that there is evidence of crossvergence of values among the managers, particularly noting a new generation of Chinese managers with different values.

Fauvre's observations on China noted a diminishing of collective values and a rise in individualism; change from self-effacement to brashness in fashion, increasing materialism and a greater focus on making money (xiang qian kan) (Fauvre, 2008). Fauvre also found that the competition and uncertainty of today's China, where anyone can be laid off, has shifted the traditional harmonious society where relationships (guanxi) were valued, to a more competitive culture.

Woodbine (2004) used a scenario based on agency theory to assess finance sector operatives employed in the Shenzhen Special Economic Zone located in Guangzhou, China. He found that traditional Chinese culture-based issues played a limited role in determining the ethical responses and subsequent subject behavior (p. 58).

Lan et al. (2009) summarized the three competing views of the present day values in China. The first view is that the rapid economic change and free market orientation causes an adoption or move toward Western values (convergence). The second view, championed by Hofstede among others, is that cultural differences are persistent and not subject to easy change (divergence). The third view records the integration from such forces resulting in a unique value system (crossvergence), as suggested by Fauvre. They used the Schwarz Values Questionnaire (SVQ) to assess the values of practicing Mainland Chinese accountants and graduate accounting students. The authors concluded, "Chinese traditional values, especially Confucian teachings, are still ingrained in the Chinese way of life" (p. 72).

Machiavellianism

Machiavellianism (Mach) is a term derived from the works of Niccolo Machiavelli in his infamous 1513 work, The Prince. The term has become synonymous with manipulative, exploitive, aggressive and unethical political behavior, and has been more broadly applied to management and individual actions. The Mach IV Scale, developed by Christie and Geis in 1970 to measure students' Mach levels, has been widely used by management researchers, and even with faculty in academia (Calhoon, 1969; Hunt & Chonko 1984; Siegel 1983). Mach as a value attitude has been found to have consequences in the workplace. For example, Mudrack (1989) found that those with high Mach scores reported lower job involvement. Siu and Tam (1995) analyzed the level of Mach among Hong Kong bankers and found that low Mach respondents were more likely to attain higher job titles.

Kuo and Marsella (1997) also used Christie's and Geis' measurement cross-culturally for American and Taiwanese students, and for students in Hong Kong by Cheung and Scherling. Kuo and Marsella conclude "The Mach IV Scale is not measuring equivalent concepts for Chinese and American students." The latter study focused more on ethical predisposition, asserting that Mach is a "super-ordinate factor" reflected in ethical reasoning (Cheung & Scherling, 1997).

Miesing and Preble (1985) tested Mach self-assessment among 487 MBA students. They found that women compared to men and those with more religious conviction reported lower levels of Mach. Also, postgraduates and those with work experience were less Machiavellian in approach. SSARP applied a shortened, ten-item version of the Christie and Geis Mach IV scale, which originally was a twenty-item Likert scale. We were seeking to determine the overall level at which Chinese respondents reported their Mach. Given the research to-date on other subject groups, we also were interested in identifying any gender differences.

Conflict Resolution Style

Much has been written about the five styles of conflict management first proposed by Blake and Mouton (1973). Kilmann and Thomas (1997), then Rahim (1983), applied this same concept but offered alternative words for some styles, such as "smoothing" and "obliging" rather than "accommodating" and "forcing". Song (2005) included this concept in his broad study comparing American and Chinese managers' approaches to conflict. Song's research reports the labels developed by Rahim, while this paper uses the labels developed by Kilmann and Thomas. Exhibit I presents the five styles with definitions, behaviors and intended outcomes.

The research suggests that each individual will have a predominant or preferred style, but that in certain situations we might abandon our preferred style for another (Lulofs & Cahn, 2000). Three of the styles in Table 1 also represent strategies in conflict resolution: Collaboration, Competition and Avoidance. Medea (2004) proposes that there are four levels of conflict, and that most strategies would be effective for some levels and ineffective at other levels, which supports the idea of a situational approach to conflict management. If we accept the concept of predominant styles and of a situational approach to managing conflict, then it follows that a person's effectiveness would be affected by the extent to which their predominant style could be abandoned in favor of another.

This conflict style measure for younger Chinese business students is interesting given contemporary interest in Chinese negotiation style. Pye (1982) identifies the great importance that Chinese negotiators place on the relationship; he cautions negotiators to understand the importance of emotional factors in negotiations with the Chinese.

Methodology Validity

The SSARP Questionnaires are adapted from a text which Professor Bowlby has adopted for his course on Organizational Behavior: Schermerhorn, Hunt & Osborne, Organizational Behavior, 8th edition, New York, John Wiley & Sons, Inc., 2003. These assessments also appear in subsequent editions of that text, as well as other textbooks on Organizational Behavior:

- "Managerial Assumptions" appeared in Schermerhorn, John R. Jr., Management, 5th ed. (New York, John Wiley & Sons, Inc., 1996, p.51)
- "Personal Values" was derived from Robert N. Lussier, Human Relations in Organizations, 2nd ed (Homewood, IL: Richard D. Irmin, 1993)
- "Machiavellianism"originates with R. Christie and F. L.Geis, Studies in Machiavellianism (New York Press, 1970)
- "Conflict Management Styles" is adapted from Thomas-Kilman, Conflict Mode Instrument, Copyright C 1974, Xicom, Inc., Tuxedo, NY 10987.

Some of the questionnaires are 20+ years old, and newer approaches may offer more precise insights. That said, we note that these questionnaires have the value of having been repeatedly used by others so that one can compare the same questionnaire results against other findings in the past and across other cultures, etc.

Four of our five questionnaires use Likert scales, and approaches to applying Likert scales remain controversial after fifty years of use. Carifio and Perla (2008) state: "S. Jamieson asserts that Likert scales are ordinal in character and must be analyzed using non-parametric statistics. However, G. Pell argues that

Likert items are interval, not ordinal, in character and must be analyzed parametrically with all the associated benefits and power of these higher levels of analyses" (p. 1150).

Our findings are tempered by certain demographic factors: by virtue of the programs they are registered in, Chinese respondents' families would have greater wealth than the typical Chinese family. We also acknowledge the effect on the results from including a group who are, or are becoming, significantly "westernized"; however, Lan reports the continuing vitality of Chinese values (Lan, 2009).

A measure of the degree to which the respondents' values are influenced by other cultures may be gleaned from their experience with living in or visiting other countries. Eighty-two percent of the Chinese respondents (82%) have not visited other countries. Finally, as noted by Greenburg (1987) and others, the value attitudes of college sophomores are valuable though not exclusive resources for research.

Results

We first report and discuss our findings in each of the four areas, then present cross-tabulation data on personal values. We add a layer of analysis by presenting results by gender and testing for gender differences.

Theory X/Y Findings, by Gender

Respondents answered "YES" or "NO" to twelve questions, with six each measuring their Theory X and Theory Y tendencies. One point was assigned to each YES answer, so each respondent has two scores. Theoretically a higher score indicates a stronger tendency, particularly if one score is significantly different than the other. The mean scores range from 1 to 5 with 5 representing the stronger value attitude. Table 1 reports the mean scores.

Table 1. ***Theory X/Y Scores, by Gender***

	All Students	**Female Students**	**Male Students**	**Testing for Mean Difference (Significant differences in bold)**	
	Mean	Mean	Mean	t	Sig. (2-tailed)
Theory X	3.22	3.17	3.35	-1.79	0.07
Theory Y	4.06	4.10	3.98	1.48	0.14

Overall, the students are more predisposed to self-reporting higher Theory Y values, with no significant differences between male and female respondents. The results suggest that the respondents have the potential to adopt Theory Y values in their management style.

Personal Value Scores by Gender

Respondents were asked to assign a score from 0 – 100, indicating how important to them were 16 beliefs, conditions or activities. This instrument measured eight different values, with the scores from two randomly distributed questions combining to give a total for each value. Thus, the theoretical minimum and maximum score for each value is zero and 200, respectively. Table 2 details the average scores from highest to lowest, with statistically significant differences between males and females highlighted in bold:

Table 2. ***Mean Scores for Personal Values, by Gender***

	All Students	Female Students	Male Students	Testing for Mean Difference (Significant differences in bold)	
	Mean	Mean	Mean	t	Sig. (2-tailed)
Family	176.52	178.52	173.27	**3.14**	**Less than 0.01**
Social	164.09	163.35	165.28	-1.23	0.22
Professional	163.05	162.77	163.50	-0.46	0.65
Financial	151.96	152.41	151.24	0.61	0.55
Intellectual	150.99	150.12	152.40	-1.14	0.26
Physical	143.31	140.86	147.29	**-2.82**	**0.01**
Community	129.97	131.51	127.46	1.61	0.11
Spiritual	103.85	103.77	103.97	-0.07	0.95

We note that with one minor exception, males and females rank order the eight values identically. The traditional Confucian value of Family ranks first among our respondents, although we see a statistically significant disparity with females ranking this value higher than males. It is also consistent with Confucian values that the Community value is ranked fifth. This is consistent with the Chinese value for family and for social relationships. These social relationships, known as the complex concept of "guanxi" are the center of Chinese dealings, with little traditional Chinese recognition to any community outside of this circle of family and social relations. Only Family and Physical values showed statistically significant differences by gender, with females valuing Family higher and males valuing Physical higher.

Machiavellianism Scores, by Gender

Respondents were asked to indicate the extent to which they agree or disagree with ten statements by indicating a value from 1 – 5. Thus, the lowest and highest possible scores are 10 and 50, with a higher number indicating greater tendencies towards Mach. The statements were worded in a manner that required the scores for one-half to be inverted, and then added to the scores of the other five statements. Table 3 reports the means and standard deviations.

Table 3. ***Machiavellianism Scores, by Gender***

	All Students	Female Students	Male Students	Testing for Mean Difference (Significant differences in bold)	
	Mean	Mean	Mean	t	Sig. (2-tailed)
Mach Scores	27.46	**26.96**	**28.26**	**-3.67**	**Less than 0.01**

The mean for all respondents is consistent with research from many North American studies, where average scores are close to the numerical average of 25.0, and "students in business and management typically score higher." Chinese male students demonstrate a stronger tendency toward higher Mach scores.

Conflict Management Styles, by Gender

Table 4 lists the five conflict resolution styles from highest to lowest preference scores. Fifteen statements described a different type of behavior, and each was assigned a score from 1-4. A higher score indicated a greater likelihood that the respondent would choose that response in that situation. Each of the styles in Table 4 was represented by three randomly placed statements, thus the lowest and highest possible scores are 3 and 12, respectively.

Table 4. ***Conflict Resolution Styles, by Gender***

	All Students	**Female Students**	**Male Students**	**Testing for Mean Difference (Significant differences in bold)**	
	Mean	Mean	Mean	t	Sig. (2-tailed)
Accommodating	10.06	10.09	9.99	1.02	0.31
Competing	9.93	9.83	10.03	-1.90	0.06
Compromising	9.46	**9.55**	**9.29**	**2.44**	**0.02**
Avoiding	9.18	9.19	9.11	0.71	0.48
Collaborating	8.68	8.73	8.59	1.11	0.27

The highest overall mean is for Accommodating conduct, which is consistent with the Chinese Confucian value of the importance of "face" ("mianzi") where direct disagreement is not considered harmonious conduct. It also is consistent with Song's findings (Song, 2005). Even in today's dynamic China, harmony is considered an important and overriding social value. Statistically, however, we also note that Competing and Accommodating are essentially scored equally. This also is consistent with Song's earlier research indicating that Chinese students report a high competing style, even higher than that reported for American students.

We find it interesting that the lowest mean score is for collaborating as this skill is often considered key to effective conflict resolution using an interest based negotiations or problem solving style. When comparing male and female results only Compromising reveals a statistically significant difference, with Competing data close enough to warrant attention. Females display greater preference for a Compromising style, and seem less likely to prefer Competing.

Machiavellianism and Personal Values

Respondents were ranked as having LOW, AVERAGE or HIGH Mach tendencies, with LOW and HIGH classifications assigned to those whose respective scores were more than one standard deviation below or above the overall mean of 27.46. This classification allowed us to statistically compare personal values with Mach tendencies (see Table 5).

Table 5. ***Personal Value Scores by Machiavellianism Level, All Respondents***

	All Students	Machiavellianism Score			ANOVA F-stat	Significance Value
		LOW	AVERAGE	HIGH		
	n =764	n=100	n=550	n=114		
Family	176.52	182.36	176.40	171.87	**5.92**	**Less than 0.01**
Social	164.09	170.62	163.18	162.60	**5.80**	**Less than 0.01**
Professional	163.05	166.47	163.56	157.54	**5.28**	**0.01**
Financial	151.96	146.81	151.59	158.36	**5.65**	**Less than 0.01**
Intellectual	150.99	155.13	151.27	145.97	**3.25**	**0.04**
Physical	143.31	147.60	143.93	136.49	**3.92**	**0.02**
Community	129.97	139.73	131.12	115.66	**16.66**	**Less than 0.01**
Spiritual	103.85	107.87	105.00	94.69	**3.76**	**0.02**

These results are remarkably consistent in revealing significant differences between ALL personal value measures and Mach scores! Stated simply, students with high Mach scores report lower interest in all personal values, except financial values where the trend is the opposite. We also note a continuum showing less concern for each particular value as the Mach score rises – except Financial where value increases as Mach tendencies rise.

These results are consistent with Mudrack's finding that those with high Mach scores reported lower job involvement and Siu and Tam's finding that Hong Kong bankers with lower Machiavellian scores were more likely to attain higher job titles (Mudrack, 1999; Siu & Tam 1995). It can be posited that those who do not care about much else than themselves have a character flaw that will be exposed in the workplace. It could also be argued that Mach may be a useful "backdoor measure" of emotional intelligence. Tables 6 and 7 compare personal values and Mach scores for, respectively, females and males.

Table 6. ***Personal Value Scores by Machiavellianism Level, Females Only***

	Female Students	Machiavellianism Score			ANOVA F-stat	Sig. Value
		LOW	AVERAGE	HIGH		
	n=473	n=77	n=342	n=54		
Family	178.52	184.08	177.66	175.89	3.50	**0.03**
Social	163.35	170.74	161.90	161.87	5.68	**Less than 0.01**
Professional	162.77	164.62	162.82	159.82	0.83	0.44
Financial	152.41	147.44	152.16	161.17	4.80	**0.01**
Intellectual	150.12	153.12	150.16	145.56	1.38	0.25
Physical	140.86	145.19	141.24	132.22	2.86	0.06
Community	131.51	140.54	131.40	119.17	8.20	**Less than 0.01**
Spiritual	103.77	106.13	103.82	100.00	0.43	0.65

Females demonstrated statistically significant correlations between Mach levels and the four values of Financial, Family, Social and Community. The continuum is also the same with a direct correlation between Financial and Mach and an inverse relationship between Mach and all other personal values. These two distinct trends also are found in the four categories that are not statistically significant. For males (Table 7 below), there are significant differences in only three value measures: Professional, Community, and Spiritual. The inverse trend for all personal values, along with a direct correlation between Financial and Mach, is found again.

Table 7. ***Personal Value Scores by Machiavellianism Level, Males Only***

	Male Students	Machiavellianism Score			ANOVA F-stat	Sig. Value
		LOW	AVERAGE	HIGH		
	n=291	n=23	n=208	n=60		
Family	173.27	176.79	174.31	168.25	1.68	0.19
Social	165.28	170.21	165.29	163.25	1.01	0.37
Professional	163.50	172.50	164.77	155.50	6.53	**Less than 0.01**
Intellectual	152.40	161.67	153.08	146.33	2.71	0.07
Financial	151.24	144.79	150.66	155.83	1.67	0.19
Physical	147.29	155.42	148.36	140.33	2.71	0.07
Community	127.46	137.08	130.66	112.50	7.27	**Less than 0.01**
Spiritual	103.97	113.54	106.92	89.92	4.25	**0.02**

Theory X/Y and Personal Values

As with the Mach classifications, respondents were classified as LOW, AVERAGE or HIGH on the Theory X and Y scales depending on their scores falling within or beyond one standard deviation from the mean. Tables 8 and 9 report the results for the X and Y measures, respectively.

Table 9. ***Personal Value Scores by Theory Y Classification***

	All Students	Theory X Classifications			ANOVA F-stat	Sig. Value
		LOW	AVERAGE	HIGH		
	n=764	n=91	n=526	n=147		
Family	176.47	176.92	176.39	176.48	.022	.98
Social	164.03	164.45	164.14	163.37	.097	.91
Professional	162.98	168.74	162.77	160.17	4.624	**.01**
Financial	151.98	147.58	152.20	153.92	1.766	.17
Intellectual	150.89	155.88	151.25	146.52	3.598	.03
Physical	143.23	147.64	143.67	138.95	2.418	.09
Community	129.92	133.57	131.74	121.14	6.867	**Less than 0.01**
Spiritual	103.79	108.24	104.19	99.61	1.393	.25

Table 8. ***Personal Value Scores by Theory X Classification***

	All Students	Theory Y Classifications			ANOVA F-stat	Sig. Value
		LOW	AVERAGE	HIGH		
	n=764	n=91	n=526	n=147		
Family	176.47	165.58	177.38	177.52	7.698	**Less than 0.01**
Social	164.03	156.50	164.51	166.24	4.437	**.01**
Professional	162.98	153.17	163.39	167.95	8.360	**Less than 0.01**
Financial	151.98	154.08	151.50	154.76	.696	.50
Intellectual	150.89	143.67	150.92	157.17	4.014	**.02**
Physical	143.23	128.83	144.03	148.56	7.909	**Less than 0.01**
Community	129.92	110.67	131.46	132.58	11.770	**Less than 0.01**
Spiritual	103.79	89.92	104.84	106.29	3.988	**.02**

It is intriguing to note where trends and consistencies exist and do not exist in the above two tables. Theory Y results mirrored the direct correlation results from comparing personal values and Mach scores, with the same direct trends noted in the same seven values. However, there clearly is absolutely no correlation between Theory Y and Financial values. Theory X results are remarkable for their divergence of trends. Here we note only two significant correlations – both inverse trends with Professional and Community values.

Conclusion

Our findings offer solid support for the notion that traditional Confucian values remain an important part of the value attitudes of younger Chinese. Family and guanxi remain core values. These findings support the existing research identifying the resiliency of certain traditional Confucian values (Wang & Hu, 2009; Ip, 2009). The results also suggest the "Chinese Me" generation is a reality with more respondents with HIGH Mach tendencies than LOW Mach predispositions. Moreover, the overall Mach scores are similar to those found among North American business students. These findings support Fauvre's theory of crossvergence over convergence or divergence.

Our data extend beyond merely supporting existing research. Our major finding establishes that a higher Mach predisposition among Chinese business students appears incompatible with most personal values, except the value placed on money. This finding both buttresses and advances earlier research suggesting that HIGH Mach scores may not be advantageous (Mudrack, 1999; Siu & Tam 1995). These data help better explain the disconnection between personal values and the value placed on financial success.

We also find that the Confucian value of harmony seeking is reflected in the dominant conflict resolution style of Accommodating, which supports Song's earlier findings (2005). However, we also suggest that the competitive nature of the Chinese supports the concept of a duality of negotiation styles, as would be expected with crossvergence. Thus a savvy Western negotiator would seek to build strong bargaining relationships even in the face of competitive conduct, rather than consider competitiveness and relationships as opposing forces.

We also find that the Chinese students are not as strong in the self-assessment of Theory X values that one would expect in a culture of centralized management and limited involvement of employees in decision making. Given that Theory X/Y is about one's beliefs about the attitudes of others, it is not surprising that correlating personal values against Theory Y would show near identical results as for LOW Mach respondents. More intriguing is that HIGH Mach respondents do not show similar tendencies as Theory X proponents.

This values attitude research is important because multinationals and others doing business in China need to understand culturally based differences. While the young people of the world share Facebook, McDonald's and many areas of global cultural convergence one must recognize underlying differences in value attitudes based on culture. Our contemporary reporting of durable Chinese values impacts every area of business, from marketing to financial management to employee motivation and reward systems. These values also need to be understood to ensure the development of an appropriate negotiation strategy and other management issues with our Chinese counterparts.

We suggest that business curricula continue to develop cross-cultural ethical courses and related curricula that prepare students for global business, with all the attendant complexities of crossvergence, convergence and divergence in a country where today's cultural values and behaviors are the product of thousands of years of development.

Limitations and Future Research

There is sample selection bias to the extent that the Chinese student sample represents students who have registered in programs from which they will get a western degree, either in the west or in China with significant exposure to western professors and classroom styles. The authors acknowledge the effect on the results from including a group who have or are becoming significantly "westernized"; however, as we have seen, their degree of western orientation appears not to have completely overcome 4,000 years of culture and tradition. 82% of the respondents have never traveled abroad so remain significantly shaped by traditional Chinese national values.

Our sample also is limited to business school sophomores. As noted by Greenburg (1987) and others, the value attitudes of college sophomores are valuable though not exclusive resources for research. We do not propose that our sample is representative of all Chinese, or even of all Chinese students.

Some questionnaires are 20+ years old, and newer approaches may offer more precise insights. That said, we note that these questionnaires have the value of having been used by others so that one can compare the same questionnaire results against other findings in the past and across other cultures. This comparability feature assists one in measuring the pace of certain value attitude changes as well as resistance to change. We also note that, in research, instruments that reach 20+ years of age and are still in use have stood the test of time in considering their validity.

Future research needs to move beyond the surveys used herein to include more focused questions and vignettes to further understand Chinese value attitudes. One fruitful area would be to combine questionnaires and focus groups with vignettes, perhaps supplemented with anonymous interactive data gathering through use of clickers (i.e., Turningpoint). This multifaceted approach will facilitate probing deeper into the relationships between values and behavior.

Exhibit I. **Conflict Styles, their Definitions, Objectives and Behaviors**

Conflict Style	Definition	Objective	Behavior
Avoidance	Withdrawal	lose-lose	Physically absent or silent
Accommodate	Acquiescence	lose-win	Give in; Do not "make waves"
Competition	Aggression	win-lose	Selfish, argumentative
Compromise	Trade-offs	win & lose	"Wheeler-dealer"
Collaboration	Mutual Satisfaction	win-win	Supportive of self and other

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CAPITALISM'S GLOBAL FINANCIAL CRISIS: RE-VISITING THE STATE AND INDUSTRIAL POLICY

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Abstract: The bankruptcy and merger of three major American investment banks, Bear Stearns, Lehmann Brothers, and Merrill Lynch, in 2008 have shocked the United States government to undertake dramatic market intervention and a $700 billion U.S. dollar bailout that resembles "industrial policy" in many other countries. Many global policymakers have discussed the end of laissez faire capitalism in the 21st century; others will blame investment bankers and financial institutions for their greed and lack of ethics as the root causes of the first global financial crisis of the 21st century.

Critics of market intervention, often called industrial policy in many countries, point out to two potential weaknesses: governments may have less knowledge than markets on how to pick winners, and industrial policy creates possibilities of corruption and rent seeking. Our conceptual paper introduces the idea that industrial policy helps to overcome three key aspects of "institutional infrastructure" in all countries of the world. These three institutional infrastructures are financial, knowledge, and physical.

Keywords: Capitalism; corporate governance; institutions; industrial policy; social learning; institutional infrastructure

Introduction

The bankruptcy and merger of three major American investment banks in 2008, Bear Stearns, Lehmann Brothers and Merrill Lynch have forced the United States to undertake a $700 billion dollar bailout. This type of dramatic market intervention and regulation has often been categorized as industrial policy in many countries of the world. There is a growing consensus among social science researchers, that institutions are the foundations of economic development and growth (North, 1990, 2005; Ostrom, 2005). How did global financial institutions fail in the 21st century?

The purpose of this conceptual paper is to advocate a greater integration among the more institutional and microeconomic levels of the firm and industrial policy, which tend to be analyzed at more macroeconomic levels. We believe that three types of institutional infrastructure are fundamental to national economic success: financial infrastructure, physical infrastructure, knowledge and internet infrastructure. These three types of institutional infrastructure, financial, physical and knowledge infrastructures at a global level seem to be inadequately integrated to face the globalization of financial capital and internet communication of the 21st century.

In this paper, we advocate that a country's industrial policy can help to develop these institutional infrastructures which are fundamental to economic development and growth in any country in the 21st century. Multinational corporations and financial organizations can, in turn, contribute to the development of such institutional infrastructure. To do so, multinational corporations and financial organizations must invest not just in a specific product or sector but in several sectors that help to accelerate agglomeration economies (Rodriguez-Clare, 2004; Haussmann & Rodrik, 2004; Sabel, 2004). For example, a new technology or a new type of service can help to create such agglomeration economies (Krugman, 1991) in a national economy.

This conceptual paper is set out as follows. First, we analyze the recent history of industrial policy in different regions of the world and the implications for global economic welfare. Second, we define the three types of institutional infrastructure that are fundamental to economic development and growth: financial, knowledge and physical infrastructure. Third, we analyze the potential collaboration among foreign multinational corporations, local multinational corporations, and national governments in developing such institutional infrastructure, and we analyze the implications for analyzing the global financial crisis of the 21st century.

Institutions and Industrial Policy

The term "industrial policy" has both negative and positive connotations (Lall, 2002, 2004). Critics of industrial policy have two major objections. First, governments do not have more knowledge than businesses or financial markets, and, thus, government cannot pick winners or losers effectively in a national economy. Second, industrial policy breeds corruption and rent seeking through cronyism--relations between government, financial markets, and business. The critics, thus, see industrial policy as being against market forces, liberalization, and free trade, all factors that are seen to be fundamental to economic and business success. Neoclassical economics and market forces and free trade are seen as being superior to such collaboration among government, business, and other actors in a national economy.

Supporters of industrial policy tend to focus on the experiences of East Asia since the 1960's, especially today's developed economies such as Japan, Korea, Taiwan, Singapore (Amsden, 1989; Wade, 1990). In these countries, a long-term collaboration among government, business, and banking has produced high levels of economic development and global competitiveness (Lall, 2002; Mathews, 2003); in some sense, these economic models relied less on global stock markets. Other regions,, such as South America, appear to not have followed such overall or extensive industrial policies as East Asia. However, in-depth analysis of Latin America's globally successful industries, such as steel and aircraft in Brazil, salmon and forestry in Chile, and motor vehicles and computers in Mexico, all seem to point out to successful industrial policy and the picking of winners in particular industries (Ferranti, 2002; Agosin, 1999; Bardhan & Roemer, 1992; Jarvis, 1994).

First, nongovernmental organizations (Teegen, Doh & Vachani, 2004; Teegen & Doh, 2003) are seen increasingly as an institutional and fundamental actor in traditional relations between government and business and in global governance in the 21st century. The importance of such collaboration at a local level in developing countries, has also been extensively researched in numerous works by, Ostrom (2005). Second, the literature on institutional innovation in developed economies has shown the importance of institutional and social learning (Sabel, 2004; Henisz, 2000). New emerging industries in developed economy settings, such as biotechnology and nanotechnology, benefit from interactive and social learning and collaboration among government, business and associations within a national economy.

Both these strands of recent literature on nongovernmental organizations and on institutional innovation in developed economies show the importance of knowledge infrastructure (Sabel, 2004; Moran & Ghoshal, 1999), global business ethics, and global governance in today's business environment. Emerging and developing countries, in turn, need to develop institutional infrastructures not only in knowledge sharing, but also in financial and physical infrastructures. The importance of social learning, and knowledge infrastructure for global competitiveness in the 21st century has added an additional constraint or urgent need for emerging and developing countries (Khanna & Rivkin, 2001; Hoskisson, et al., 2000; Lyles, et al., 2004).

The Washington Consensus Versus Industrial Policy

By the late 1980's, there was a convergence of views by the United States government, the World Bank, and the IMF towards the nature of economic development and growth. This was termed by John Williamson (1990) the "Washington Consensus." There were three key components of this approach very much in line with traditional static, neoclassical economics (Murrell, 1991): market forces as allocators of economic resources, openness to foreign direct investment, and free trade liberalization. Institutions were not a part of this economic paradigm, which was seen to suit all countries – the Washington Consensus also believed that emerging or developing countries would also benefit from economic and business success and growth if they followed the key beliefs of the Washington Consensus (Birdsall & de la Torre, 2001). In the late 1990's, this model was enriched with various other ideas, that broadly fall under, "good governance" (Stiglitz, 1998; Kuczynski & Williamson, 2003; Easterly, 2001; Lindauer & Pritchett, 2002).

In some sense, the Washington Consensus was closely in line with the robust economic success of the United States economy in the 1990's. The belief in a single model or paradigm for economic success is not new. In the 1970's, the model that was most widely discussed was Sweden and several other continental European countries (Lindbeck, 1997). In the 1980's, the model most widely discussed by researchers and policymakers was Japan's economic paradigm. In the 1990's, it was the United States model and the broader implications of the Washington Consensus for emerging and developing countries.

Three factors in the early 21st century helped weaken if not discredit the beliefs of the Washington Consensus approach to economic development and growth. First, various leading economists, such as the Nobel Laureate, Joseph Stiglitz, who became the Chief Economist to the World Bank, advocated the problems of imperfect information, asymmetric information, and market failures in developed economies, and, of course, with much greater implications for emerging or developing economies. Other economists from the World Bank, such as William Easterly (2001), also looked at the realities of the world, and pointed out that Latin American countries, which probably followed the model of the Washington Consensus most closely had achieved economic growth rates of 2% throughout the 1990's and even lower in the 1980's. In contrast, countries such as China, which seemed to be following an industrial policy, in direct contradiction to most of the tenets of the Washington Consensus, continued to achieve economic growth rates approaching 10% throughout the 1980's, 1990's and into the 21st century.

Second, numerous corporate scandals in the United States helped raise the question of, an universal system or a particular type of capitalism that was seen as a single solution to all countries. The well-known corporate scandals in 1999, 2000 of major American corporations, such as Enron, Andersen, Worldcom, Tyco and many others, helped raise questions inside and outside the United States about the weaknesses of the U.S. governance model on which the Washington Consensus was broadly, based. These have, in turn, been complimented by the financial crisis of 2007 and 2008 and the bankruptcy and merger of three major American investment banks: Bear Stearns, Lehmann Brothers, and Merrill Lynch.

Third, researchers from other social science disciplines began to emphasize the importance of "institutions" and institutional analysis in predicting economic development and growth (Kuczynski & Williamson, 2003). Comparative research in corporate finance, international business, and corporate governance showed the importance of, perhaps, two or three models of capitalism and national business systems, which have been proven to be economically successful and resilient over the last several decades.

The Anglo-Saxon model, on which the Washington Consensus is most closely based, was, increasingly, seen as just one type of system (Albert, 1991; Krugman, 1995) with strengths and weaknesses like other systems. Other systems with a more collective and Communitarian approach (Bowles & Gintis, 1996) were seen to be the norm in continental European countries, as well as the developed Asian economies of Japan, Korea, Taiwan, and Singapore. The contrast between the Washington Consensus and the newer lessons on institutions and economic development, are shown in the table below.

Table 1. ***Washington consensus versus Industrial Policy and Institutional infrastructure***

Washington Consensus	Institutional Infrastructure
Free markets – market forces are superior to government second guessing the market	Develop the key three institutional infrastructures: financial, physical, knowledge infrastructures
Free trade and liberalizing trade in all sectors and industries of a national economy	A new industrial policy and partnership among government, local MNCs and foreign MNCs
Foreign direct investment and the encouragement any type of foreign direct investment	Government-local MNCs-foreign MNCs select and invest in multiple, related sectors, agglomeration
Good governance, legal structures to ensure the protection of property rights, and contract enforcement	Strategy for entry into global competition can differ across countries

Re-Visiting Industrial Policy

In this paper, we advocate a conceptual model of industrial policy that requires collaboration among national governments, local multinational corporations, and foreign multinational corporations. This three-way collaboration and knowledge sharing, we believe, is fundamental in today's complex global business environment. Critics of traditional industrial policy between national governments and local multinational corporations used to point out that national governments cannot have complete knowledge or information in choosing winners or losers in complex global environments; supporters of traditional industry policy would respond that local multinational corporations, too, do not have sufficient knowledge to optimally choose the sectors and industries in which to make investments.

We believe that high uncertainty and continuous change is fundamental to today's global business environment. Thus, we believe that neither national governments, local multinational corporations, nor foreign multinational corporations acting alone have sufficient information or knowledge to choose winners or losers or to make optimal investment decisions in a complex global environment of, high uncertainty. A three-way collaborative knowledge and investment partnership among national governments, local multinational corporations, and foreign multinational corporations can help to minimize the costs of ineffective investment and business decisions. Thus, we are advocating a new industrial policy structure that involves a close partnership among national governments, local multinational corporations and foreign multinational corporations. This is shown in the Figure 1 below.

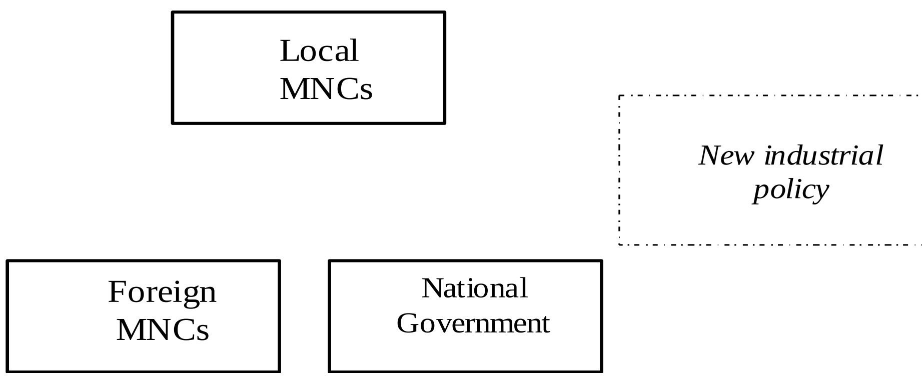

Figure 2. Three way partnership and a new industrial policy and global corporate governance: Government-Local MNCs-Foreign MNCs

Such a three-way, partnership-driven industrial policy is especially important in emerging and developing countries, where not only specific sectors, but several sectors or general industries need to be developed and sustained at the same time. Although the concept of a big push has existed in economic development at least since the 1940's based on works of researchers such as Rosenstein-Rodan (1948), Hirschmann (1958), Rostow (1965), Gerschenkron (1962), and formalized by Murphy, Shleifer and Vishny (1989), the actual international business or business level strategies of a big push national economic strategy have not been analyzed. The concept of a, big push has similarities to industrial policy within a single national setting in that governments need to work closely together with financial institutions, including, if necessary, a merger of banks, in order to jump start economic growth and overcome any financial crisis.

Three Institutional Infrastructures

In developed, large-income economies, infrastructure is largely taken for granted. In this paper, we introduce our idea of "institutional infrastructures" because they represent one of the greatest differences between developed and emerging or developing economies (Uhlenbruck, et al., 2003; Whitley & Csaban, 1998; Meyer, 2001; Lyles & Baird, 1994). We also use the term "institutional infrastructure" to describe infrastructure that is well grounded and existing in a national economy on a long-term basis, reflecting a commitment by governments and local multinational corporations. In turn, the differences in institutional infrastructures influence the attractiveness of other resources, such as talented, global managers, which, in turn, increasingly help to determine the location and joint venture decisions of multinational corporations.

We define institutional infrastructure as being comprised of financial, physical, and knowledge:

> *Institutional infrastructure is defined as a national economy's long term commitment to 3 key types of infrastructures. In turn, these three key infrastructures are embedded in local institutions – including informal traditions, norms, and social conventions especially towards the global economy, foreign direct investment and multinational corporations.*

This is shown in the figure below.

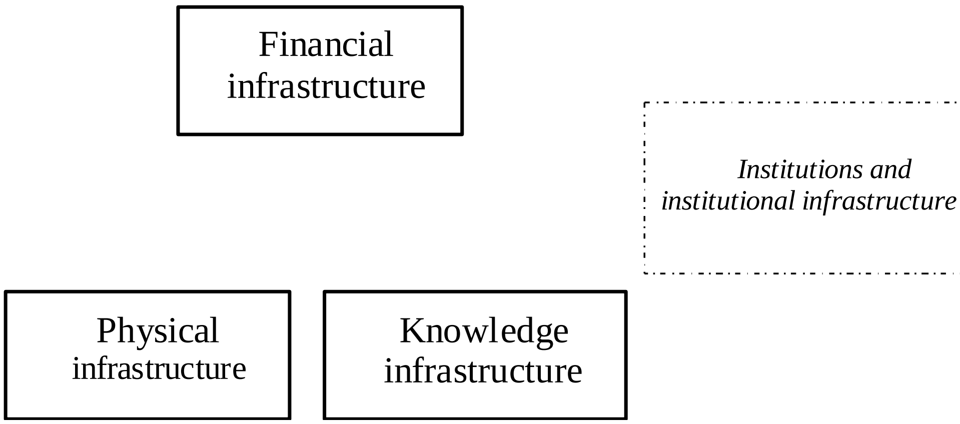

Figure 3. Industrial Policy and Institutional infrastructure–financial, physical, knowledge

Financial Infrastructure

In the growing literature on comparative corporate governance and finance, there have been extensive discussions about the differences between the more stock-market-driven financial institutions in Anglo-Saxon countries versus the more bank-driven financial institutions in continental Europe, and the developed Asian economies, such as Japan and Korea. The conclusions of this research in international business, comparative corporate governance, and corporate finance is that both financial institutions of a stock market-based business system and the financial institutions of a bank-based business system have their relative strengths and weaknesses (Beck & Levine, 2002; Levine, 2005).

A general conclusion from these various strands of research is that a national economy's financial institutions are part of a greater picture included other types of institutions (Haggard, 2003; Vamvakidis, 2002). The existing literature, however, has not sufficiently researched the interdependence between a national economy's financial institutions and other types of institutions (Trinidade, 2003). The need for a more interconnected view of financial institutions has become more evident even in developed economies, as the dramatic changes of the global internet, digital technologies and knowledge based societies, create a new type of dynamic and interdependence between financial and other types of institutions.

Thus, the academic and policy debate in developed economies is about the relative strengths of stock market versus bank-driven financial institutions and the occasional fine turning that is required between both, since in developed economies, both stock market and bank-driven financial institutions, co-exist. In emerging or developing countries, recent by various authors such as Levine (1997, 2005), Beck and Levine (2002) and LaPorta, et al (1997) have shown that there is a generally shortage of financial capital and the supporting financial institutions. Thus, emerging or developing countries will welcome, either stock market or bank driven financial institutions. We believe that in emerging or developing countries, this is a fundamental need for, "institutional infrastructure", including, financial infrastructure. In emerging or developing countries, such financial infrastructure can only be developed through a long term commitment by national government, local multinational corporations and increasingly foreign multinational corporations and global institutions, such as the World Bank and the IMF.

A clear example of developing institutional infrastructure, such as financial infrastructure in a new industrial policy context is the case of, China. China continues its liberalization of its financial services, taking a first major step with the extremely successful stock market listings done in 2005 and 2006 of its 4 largest national banks: China Construction Bank; Bank of China; Industrial and Commercial Bank of China; Bank of Communications. The strategy for this development of financial infrastructure is a three-way partnership among the Chinese government, foreign financial multinational corporations, and local multinationals, or the major Chinese banks.

Physical Infrastructure

By physical infrastructure, we include not only the creation of basic foundations in transportation industries, such as shipping ports, railways, and airports, but also the deeper institutional connections to the national economy. Physical infrastructure that is appropriate for a national economy, in turn, is interconnected (Olson, 1992) to the type of sectors or industries that are globally competitive in that national economy (Dasgupta, Marglin & Sen, 1972). In turn, this depends on the industrial policy decisions towards particular industries, sectors as decided by knowledge sharing among national governments, foreign multinational corporations and local multinational corporations.

If physical infrastructure development needs to match a national economy's focused sectors and industries, how can emerging and developing countries choose which sectors and industries to enter during various phases of national development (Olson, 1982, 1992; Nelson, 2004), as well as the complex changes in the global business environment? This is a fundamental problem for any emerging and developing country undertaking industrial policy.

Imbs and Wacziarg's (2003) large cross section of countries' data have shown regularity in terms of industry concentration or diversification during different phases of a country's national economic development. Those countries that have successfully moved from emerging or developing country levels to a more developed or OECD level of national incomes go through a more diversified process of industries and sectors, until they reach a developed economy or OECD level of national income. Once they reach this high level of developed economy income levels, their economies become more concentrated over time (Hausmann & Rodrik, 2004; Klinger & Lederman, 2004).

If we broadly divide the world's economies into developing reflecting the lowest levels of incomes, emerging as reflecting the next tier and developing as the final OECD mature economies, then there are phases and a dynamic path that a national economy must go through that requires investment into and diversification, which, in turn, may require successful industrial policy to help choose the particular target industries and sectors for such diversification in the national economy. For those national economies that have made the successful transition and taken the dynamic path from developing to emerging to developed economic levels, there is thus a "turn around" from focused or concentrated simple economies to diversified complex economies to concentrated complex economies.

> *"In fact, our result is an extremely robust feature of the data. The estimated turnaround point occurs quite late in the development process and at a surprisingly robust level of income per capita. Thus, increased sectoral specialization, although a significant development, applies only to high-income countries. Countries diversify over most of their development path." (Imbs & Wacziarg, 2003, p. 64)*

The implication of this empirical research on a wide cross section of countries is that diversification on a national economy level needs to happen for countries to achieve successful economic development. However, such diversification is a complex issue and, in turn, requires the choosing of winners and losers (Krueger, 1974) in the correct sectors and industries across a national economy.

Physical infrastructure, then, is no longer about transportation, railways, and shipping ports. Physical infrastructure must help reflect a national economy's chosen diversification strategy into various industries and sectors. Such diversification must also take into account the nature of the global business environments, which industries are most competitive, which industries are new and emerging, and the potential interaction with multinational corporations that are market leaders in their industries from various countries.

The best examples of institutional infrastructure in terms of physical infrastructure can be seen from the successful cases of Latin American industries – especially Chile, Brazil, and Mexico (Rodriguez-Clare, 2004; Agosin, 1999; Ocampo, 2003). Chile has experienced great economic and business success in the salmon and forest industries (Clapp, 1995). Brazil's greatest successes have been in steel and aircraft. Mexico has at least two global industries and multinational corporations in car components and personal computers (Melo, 2001).

These successful economics and international business cases from Latin America, of Chile, Brazil and Mexico have been based on a close three-way partnership among the government, foreign multinational corporations, and local multinational corporations. In the famous case of the salmon industry in Chile, the Fundacion Chile, a government agency, worked with major local companies in partnership with multinational corporations from Norway and Scotland. This three-way partnership adapted to the Chilean business environment a technology that had been developed by Norwegian and Scottish multinational corporations. Before this development, Chile had never exported salmon before. In 2006, Chile is one of the world's biggest exporters of salmon.

Knowledge Infrastructure

Among the three institutional infrastructure advocated in this paper, knowledge infrastructure is an issue discussed throughout the world in developed, emerging, and developing countries. Knowledge-based infrastructure is seen as being fundamental to knowledge-based societies (Steensma & Lyles, 2000; Inkpen & Beamish, 1997), especially am ambition of the world's developed, high-income countries. The commercialization of the global internet in the mid-1990's, of course, is a fundamentally new driver that has been added to the issue of knowledge infrastructure. The global internet and the emergence of digital technologies as the foundation of all technology and communications have created an urgent need to develop knowledge infrastructure in national economies. In such national development, we believe that equal if not initial development of the more rural sectors is important for the preservation of local knowledge (Ostrom, 2005) as well a more overall, balanced approach to national business and economic development.

Generally, such small, local groupings or the larger communities play a role in the creation and maintenance national norms and social conventions. Nongovernmental organizations (Teegan & Doh, 2003; Teegan, Doh & Vachani, 2004), because of the power of the global internet to connect diverse and small groupings, play an increasingly fundamental connecting role between such local groupings, national governments, and local and foreign multinational corporations. Thus, in terms of the new industrial policy, we are advocating in this paper institutional infrastructure, such as knowledge infrastructure must combine the development of national level strategies on the internet and digital technologies, such as high speed broadband, along with the smaller, local groupings that, in turn, set the informal norms and social conventions that are also part of any successful national economic change.

Two examples from Asia help illustrate the importance of institutional infrastructure creation in knowledge infrastructure. The first example is that of high speed broadband institutional infrastructure development in Korea. In 2006, Korea continued to be the world’s no. 1 broadband country, with 80% of homes in Korea’s population of 50 million people, having high speed broadband approaching 20 megabytes in speed. This, in turn, has helped create various other linked sectors, such as internet games and animation.

High-speed broadband was first developed by the Australian telecom company, Telstra, in the mid-1990’s. However, the Korean government, in collaboration with Telstra and local multinationals such as Korea Telecom and SK Telecom, were the first to commercialize the technology fully in the Korean market in the early 21st century. An interesting aspect of this three-way partnership among the Korean government, local multinational corporations, and a foreign multinational corporation was the emphasis on developing the high-speed broadband infrastructure in the relatively rural, agricultural, and lower-income regions of Korea before including the more cosmopolitan districts and major cities. We believe this approach helped to preserve the local knowledge, norms, and social conventions, in turn creating a more balanced national acceptance of the global internet and high-speed broadband technologies.

Another example in terms of local knowledge (Ostrom, 2005) development is from Taiwan. Taiwan was traditionally an exporter of sugar, but due to changing global competition and restructuring, sugar cane no longer became a viable export industry to Taiwan’s farmers (New York Times, 2004; Taipei Times, 2004). The institutional infrastructure response has been a partnership among the Taiwanese government, local multinationals, and foreign multinationals to develop a globally competitive, orchid flower industry. This three-way partnership has created the knowledge infrastructure necessary to jump start such an industry. The three-way collaboration has created a genetics laboratory, quarantine site, shipping and packing areas, new roads, and privately owned greenhouses. It is too early to know whether Taiwan’s orchid industry will be globally competitive, but by 2006, they had already achieved substantial export success; in turn, the development of such knowledge infrastructure in a rural region of Taiwan has been a positive alternative to subsidizing the depressed sugar cane export industry.

Conclusions and Future Research

The dramatic bankruptcy and merger of three major American investment banks, Bear Stearns, Lehmann Brothers and Merrill Lynch, in 2008, led to the dramatic government intervention and a $700 billion U.S. dollar bailout by the United States government. Institutions are increasingly seen as fundamental to economic development and continued national economic success (North, 2005; Nelson, 2004; Ostrom, 2005). But what went wrong with global financial institutions in 2008?

This paper provided a conceptual analysis of the role of institutions in the three key components of institutional infrastructure: financial, physical and knowledge infrastructures. We introduced the idea of our three institutional infrastructures and how a new type of industrial policy is needed to successfully create and interconnect financial, physical, and knowledge infrastructures in a national economy.

We have advocated a new industrial policy framework that requires a three-way partnership among national governments, foreign multinational corporations, and local multinational corporations. Critics of traditional industrial policy believe that industrial policy can increase political corruption, as well as the fact that government doesn't have sufficient knowledge and information to correctly choose the winners and losers in a national economy. Douglass North (1994, 2005) has emphasized that uncertainty is a continuing reality of the global economy. We believe that in the 21st century's complex, global business environment, no single groups of actors, whether they be a national government, foreign multinational corporations or local multinational corporations can overcome the complexities of uncertainty and dynamic pace of change.

At least two areas warrant further research: First, a comparison of the connection and interdependence among the three institutional infrastructures in high-income, developed economies, and emerging and developing economies. Second, an empirical comparison of the role of these three institutional infrastructures in the United States versus other countries since the 2008 global financial crisis is needed.

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BOOK REVIEW

Values and Stakeholders in the Era of Responsibility: Cut-Throat Competition?

by Paolo D'Anselmi

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Competition exists everywhere in business as well as in our daily life. The positive value of competition by which millions of people live their daily occupations is recognized as a latent energy lies at the heart of many economies of the world. Competition is a powerful driver of responsibility, and many other workers of regulated industries, monopolies and public administration, or government are less accountable to positive social or economic forces. However, Paolo D'Anselmi indicated that tapping the energy of competition is a difficult task. In fact, competition is quite often preceded by a "cut-throat", hence cut-throat competition. Thus economic units subject to competition fail to bring that value to bear in the social and political arena and thus fail to turn their weakness – being subject to competition - into an opportunity.

The author holds that this predicament delivers a deficit of meritocracy in society, effectiveness in governments' action, lack of efficiency in protected and regulated industries. The end result is an overall weakness in the economies affected by such deficit, a competitive disadvantage. The goal of this book is to show – with cases in capsule form - the differences of accountability in the diverse sectors of the economy, quantify the potential, and identify the hindrances that prevent the coming of competition as a factor of social and political advance within each country.

Competition is lived within the narrow limits of vertical industries and international trade debate. But the author argued that competition should be brought to bear horizontally, among different economic sectors, within the boundaries of each country and nation, in order to make governments accountable for their actions and regulated industries efficient in their functioning. The logic of collective action delivers SME as a key stakeholder to embrace the value of competition and have it observed by those sectors of the economy and the institutions which today do not observe it. Through the force of competition, the representative bodies of SME have an opportunity to become a full field stakeholder in the political arena to make governments effective and regulated industries efficient.

Starting from corporate social responsibility - CSR, the author extended CSR to all organizations in the economy (private businesses and public institutions) and developed the concept of "accounting for work" as a duty for everybody in society. Such a duty brings to the political and economic foreground the struggle between work subject to competition and work performed under monopoly privilege. Once the political arena is redefined along these lines, SME become protagonist in the debate for the advancement of society and have a potential benefit here to reap. Then what they have to do is only become aware of the value of competition / accountability that they already embody. With no extra work they can get advancement in society.

In this book, Paolo D'Anselmi embarked in analyzing the CSR reports of corporations and came up with a solution that would hopefully be seen as more relevant to business: a process framework that is also compatible with issue frameworks such as the GRI guidelines. The author's proposed process framework is formed by four values: Unknown Stakeholder, Disclosure, Implementation and Micro-Ethics. This framework is about the "how" one could look at the core business of firms in order to identify CSR instances, manage them and report about them. The key element of Paolo D'Anselmi's proposed process framework is that CSR ought to look at the instances where "irresponsibility" can be identified within corporate behavior. It makes CSR germane to risk management.

The author distinguished two type of competition in the book. "Vertical competition" which accustomed to accept is a driver of accountability. It is the struggle among companies engaged within each industry and within the same economic sector. Vertical competition is central to the process of accounting for work It does guarantee society that – having the opportunity to adopt competing goods and services – it can do without the bad company. "Horizontal competition" is the struggle between different industries and sectors of society to appropriate shares of national income. Once the duty of accountability is extended to all economic sectors, horizontal competition between economic sectors becomes the crucial driver of accountability, a reverse process can take place: sectors subject to competition (i.e. private companies) could ask accountability from those sectors which are not subject to vertical competition (i.e. public sector) with the objective of reaping a benefit from a better work and more socially profitable work by the public sector.

The workforce in the economy can therefore be partitioned horizontally between that part of it which is subject to vertical competition and that part of it which is not subject to vertical competition. The notion of "competitive divide" is thus derived: the work of workers, employees and executives who are not subject to vertical competition enjoys a shelter vis-à-vis the work of those who are subject to competition, therefore those who are not subject to competition must give account of their work through the introduction of vertical competition or through pseudo-market mechanisms, such as CSR reporting and benchmarking.

From an empirical point of view, SME and the majority of workers and jobs in the economy are on the competitive side of the "competitive divide", while monopolistic sectors, such as the government sector, are on the non competitive side of the competitive divide. Paolo D'Anselmi believed that CSR appeared to be a game for large corporations who could afford CSR executives and CSR budgets; people struggled to figure out ways to "do" CSR in SME. Under the auspices of competition, SME become a key actor of social responsibility in society. They are first in CSR as they are immersed in vertical competition.

What is then the force that will move society towards accountability? The author suggested that the horizontal competition is the answer. This force will be the self-interest and the collective action of those who are subject to vertical competition vis-à-vis those who are not subject to competition. Horizontal competition is the competition between those who are in their work subject to vertical competition and those who are not subject to such vertical competition. Horizontal competition is a force more relevant to the economy than the owner-employee, public-private, left-right, labor-capital dialectic. Vertical competition exists because many want to sell to few, horizontal competition exists because social groups - differing by their position vis-à-vis competition - still compete with each other to appropriate shares of national income.

One question is always asked about CSR: "Why bother?" Paolo D'Anselmi's argument answers this question through horizontal competition: all institutions must account for their work because it is in the self-interest of those who are subject to competition that those who are not subject to competition account for their work as well.

The representatives of the associations of small and medium (and micro) enterprise, micro-enterprise being the self-employed and those small businesses with less than 10 employees will be specifically the social actor of horizontal competition The specific incentive for the small business association is tapping the reservoir of social and economic value (being subject to competition) - already embodied in their own fabric – in order to obtain political clout and to negotiate with public sector representatives and governments starting from a vantage point.

The author have therefore undertaken a project to take to the local representative bodies of nationwide SME associations, the following message: "you are the embodiment of a positive social and political value: competition; you should make that weigh in your local and national interaction with government and large businesses". SME however are not ready to receive the message. One preliminary finding is that local SME associations are immersed in vertical competition but not ready to act upon the value of horizontal competition. Nor are they very much interested in checking the reality of their own social responsibility (there being always room for improvement). They have practical needs to serve their members, the small entrepreneurs, more than listening to general statements of political intent. They are however interested in CSR and they are interested in developing a consulting formula that allows them to deliver a product or service to their members. Therefore a CSR concept for SME is being developed in partnership with some local associations.

Finally, Paolo D'Anselmi made an effort to bring the message of competition as a positive value to a supra-national and trans-national level. The author's work that competitive divide is applicable to all economies, if not to the entirety of each specific economy, our notions are in fact confined to that developed part of society which is well above the poverty line. Also the notion of SME is a global one, when taking into account the diverse structure and dimensions of SME in each economy. Therefore a move of SME towards removing the competitive divide appears to be one that all societies and all economies can entertain and profit from.

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Partner Organizations:

Founded in 1986, the Caux Round Table advocates comprehensive global ethical principles for businesses, governments, non-profits and those who own wealth. CRT management approaches bring ethics and social responsibility into focus as praxis and not just moral theory.

China Credit Research Center，Peking University（CCRC）

The China Credit Research Center was founded in October 2002 to assess public policy towards credit markets in China and provide independent support for policymakers in the development of a China's credit system.

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