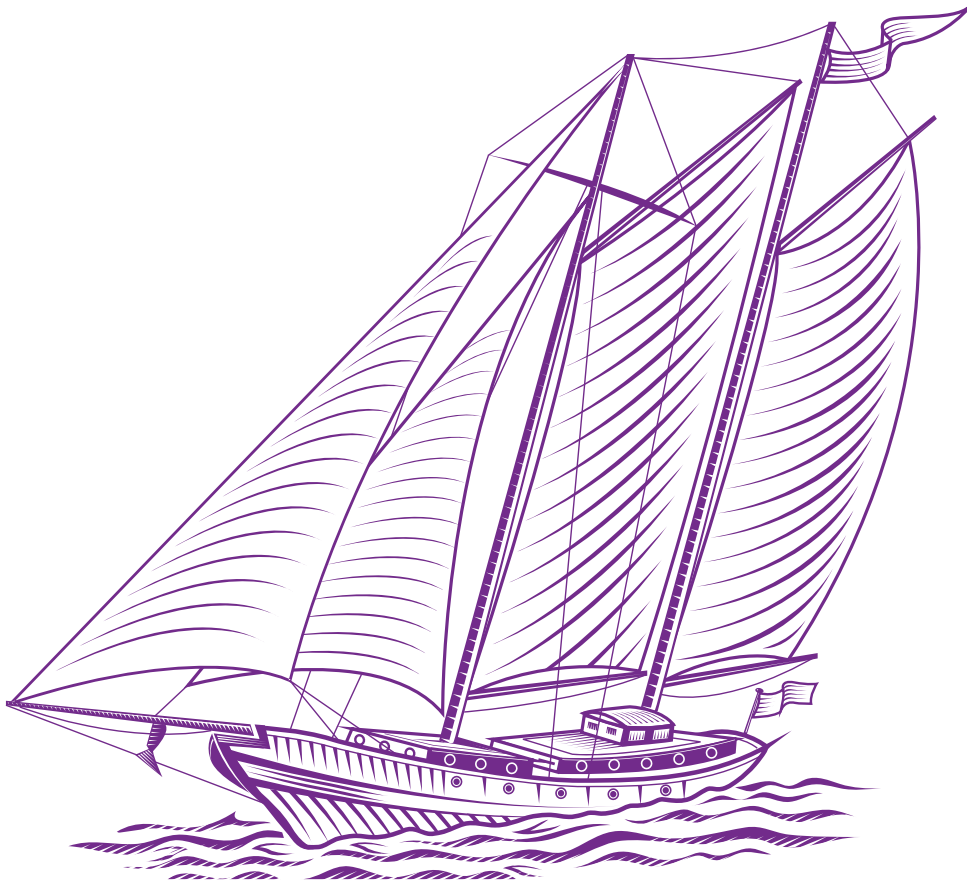




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## **FROM NETWORK ADVANTAGE TO BOP NETWORK ADVANTAGE: PATH TO SUSTAINABLE VALUE CREATION AND INTERNATIONALIZATION**

**SULAMAN HAFEEZ SIDDIQUI<sup>1</sup>, ISMAIL BIN LEBAI OTHMAN<sup>2</sup>**

**ABSTRACT.** Recent developments in theories of Base of Pyramid (BoP) focus on engaging low-income population as business affiliates in developing countries. Theories of BoP cluster linkages and firms' internationalization are well established in the literature yet there is scarcity of theoretical postulations which may connect the two. This study, using inductive qualitative methods, aims to extend network theory of internationalization by identifying linkage between inclusive supply chain cluster linkages with BoP firms and internationalization strategy of MNEs in developing host markets. This study focuses on the social sustainability of MNEs operations in host markets. Proposed model postulates sustainable/inclusive supply chain linkages with BoP enterprises as an exogenous variable that generates sustainable value creation process i.e. inclusive innovation and inclusive entrepreneurship. These sustainable/inclusive supply chain linkages, moreover, influence key determinants of MNEs' internationalization strategy such as market knowledge competence, cooperative capability and native capability/local embeddedness. The proposed model offers significant addition to the literature on internationalization of and shared value creation in MNEs.

**Key Words:** Shared value, Base of Pyramid (BoP) firms, sustainable supply chain, internationalization, economies of networking

**JEL Classification:** M14, F23, O24, O25

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## 1. Introduction

Sustainability of MNEs' operations in host markets has been gaining attention by theorists and practitioners along the triple tier approach i.e. economic, social and environmental. A number of studies have reflected upon need and dynamics of sustainable supply chain management i.e. inclusive and green supply chain strategies by MNEs in host markets. After advent of the concepts of Base of Pyramid (BoP) market (Prahalad & Hart, 2002) and blue ocean strategy (Kim & Mauborgne, 2004), MNEs are aspiring to enter developing and emerging economies as potential blue ocean markets. MNEs tend to play central role in the management of global supply chains through inter-firm linkages. Sustainable supply chain strategy of MNEs aims at developing cluster linkages with the micro and small enterprises (MSEs) through inter-firm horizontal and vertical (backward and forward) linkages (Gold, Hahn & Seuring, 2013). Inter-firm linkages between MNEs and indigenous firms have been found to have impact on various sustainable business and development outcomes (Gold, Hahn & Seuring, 2013; Cook & Pandit, 2012; Huang & Xue, 2012; Barrios, Görg & Strobl, 2011; Irawati, 2007). Shareholders and managers of MNEs are interested in sustainable business outcomes of their FDI decision along three tiers of sustainability i.e. economic, social and environmental. Emerging studies in the area of BoP 2.0 and 3.0 strategy also suggest supply chain partnerships with the micro and small enterprises (MSEs) for sustainable outreach of MNE activity in developing and emerging economies (Schuster & Holtbrügge, 2012; Cañeque & Hart, 2015; Follman, 2012; Burki & Khan, 2011; Habib & Zurawicki, 2010; London, 2007; Arnould & Mohr, 2005).

On the other hand, policy makers in emerging and developing economies are facing challenges of ensuring sustainable development outcomes such as competitiveness, poverty alleviation and natural resource preservation. MNEs with their large scale output and resources are being looked at to contribute to national objectives in a meaningful way in addition to philanthropic and charity activities. MNEs are facing greater pressures for sustainability initiatives i.e. environmental and social in their respective home and host markets (Rugman et al, 2012; Kolk and Van Tudler, 2010; Levy et al. 2012; Rodriguez, Siegel, Hillman, and Eden, 2006). The rising focus on MNE activity in emerging and developing

economies has added to the debate along the tier of social responsibility i.e. MNEs' contribution to host markets for inclusive growth and innovation. Theories of internationalization are also under revision to incorporate the sustainability dynamics into MNEs international expansion strategies. Outreach to business opportunities at the Base of the Pyramid (BoP) markets has been increasingly necessitating the need for MNEs to involve poor communities in production processes including management of their supply chains. Network theory of internationalization sheds light on how inter-firm linkages in industrial districts, supply chain cluster and affiliate relationship influence firm competitiveness and internationalization performance. Recently extensions of learning and network theories have focused on BoP market to include it into explanations of network perspective (Vahlne & Johanson, 2013; Tasavori, Ghauri & Zaefarian, 2014).

The literature on second and third generation of BoP is based on producer and supply chain partner view of BoP market (Gold et al, 2013; Simanis & Hart, 2008, 2009; London & Hart, 2010; Rangan et al. 2011; Hart & London, 2004; Hart & Enk, 2006; Rashid & Rahman, 2009). Along with concept of shared value by Porter & Kramer (2011), literature on BoP 3.0 offers rich insights on nature and dynamics of inclusive entrepreneurship and innovation through MNE activity (Cañeque & Hart, 2015).

However, current research on the interplay between these distinct yet closely related streams of research namely internationalization, sustainable supply chain and BoP business operation is lacking in a coherent manner in the available literature. There is much little conceptual and empirical evidence of the differential impact of supply chain linkages of MNEs with BoP enterprises on shared competitiveness of MNEs and various sustainable development outcomes in host markets. This necessitates investigation into theoretically grounded and empirically informed models that may align internationalization decisions of MNEs in ways to simultaneously achieve sustainable business and development outcomes. Sustainable/inclusive supply chain strategy offers matching point of 'profit with purpose' between the purpose-seeking behavior of policy makers in developing countries and profit-seeking behavior of managers in MNEs.

Against this backdrop, this study seeks to investigate the relationship between supply chain linkages with BoP enterprises and MNEs' sustainable internationalization process. The study postulates a



sustainable model of internationalization based on shared value creation and BoP network advantage (market knowledge competence, cooperative capability, native capability/local embeddedness) of MNEs through BoP supply chain linkages in host markets. Sustainability of value creation is examined along the social dimension i.e. inclusive innovation and inclusive entrepreneurship. Sustainable internationalization is postulated to be influenced by MNEs' inclusive supply chain linkages with BoP ventures in emerging and developing markets. The role of MNEs and their subsidiaries in developing host markets as the 'BoP Hub' of their respective BoP supply chain clusters offers rich insights into how MNEs can enhance social sustainability of value creation process and contribute to inclusive entrepreneurship and inclusive innovation. This sustainable value creation is postulated to be translated into BoP network advantage i.e. market knowledge competence, native capability, cooperative capability which in turn influence the internationalization performance of MNEs in host market termed here as sustainable internationalization. This paper aims:

- To review, reconcile and synthesize the literature in IB on internationalization; socially sustainable/inclusive supply chain linkages in context of developing economies;
- To identify theoretical gaps and develop propositions about key relationships between BoP supply chain cluster linkages, socially sustainable value creation and firms internationalization strategy to postulate a coherent model;
- To discuss the theoretical and policy implications of the proposed model;

This analytical construct presented in the proposed model is meant to offer sustainable value creation process along social tier of sustainability i.e. inclusive entrepreneurship and innovation based on MNEs supply chain linkages with BoP enterprises. The linkage of inclusive value creation process with MNEs' internationalization strategy would thus offer a sustainable model of MNEs internationalization. On the strategy front, managers in MNEs would get rationale for engaging micro and small firms in supply chain networks in host economies. On the policy making front, the study would encourage economic managers in emerging and developing economies to devise appropriate policy response for the integration of BoP ventures in the international supply chain of home and foreign MNEs.

## **2. Literature Review**

### ***2.1. MNEs' Internationalization Strategy***

Literature in international marketing and international business has had observed both growth and innovation in the studies pertaining to MNEs' business activities in international markets which is also termed as firms' internationalization. According to Galan et al. (1999) the MNEs' decision making related to internationalization strategy involves three dimensions: decision to go abroad; choice of location of foreign activities; and mode of entry into those locations. The study by Hafeez Siddiqui et al (2014) has summarised the literature on firms' internationalization strategy and its measures surveyed from available literature. Various other studies have also provided a synthesis of the internationalization literature, including Johanson and Vahlne (2009), Buckley and Hashai (2009), Buckley and Ghauri (2004) and Dunning (2001). The premiere work of on the topic is of Johanson and Vahlne (1977) from Uppsala school in the context of export development to explain the process approach of internationalization. Whitlelock (2002) has summarized the literature on internationalization in terms of four approaches namely Uppsala model; the eclectic paradigm; transaction cost analysis; and the network approach.

Given the focus of the study to analyze the impact of supply chain linkages with BoP firms in host market on MNEs internationalization, this study will use network theory of internationalization to explain the rationale underlying the variables and their relationships. Network linkages of foreign firms in the host market significantly improve their internationalization strategy and performance by increasing market knowledge, reducing the psychic distance, enhancing access to local resources and better in-roads into host market (Johanson and Vahlne, 2009; Vahlne & Johanson, 2013). The study by Bruneel, Yli-Renko & Clarysse (2010) elaborates importance of learning in networks that is translated into better internationalization performance.

## **3. Methodology**

This study has made use of qualitative inductive methods to postulate the theoretical model and key relationships/propositions

therein. The grounded theory research method is employed to make postulation about the hypothesized relationships grounded into literature and secondary data. The study begins by presenting an analytical framework derived from extensive review of literature on internationalization theories of MNEs, theories of firms' sustainability and theories of BoP market. Critical review and reconciliation of literature has made possible to draw the implications of sustainable supply chain linkages of MNEs with BoP enterprises in host market for variables related to MNEs' internationalization strategy.

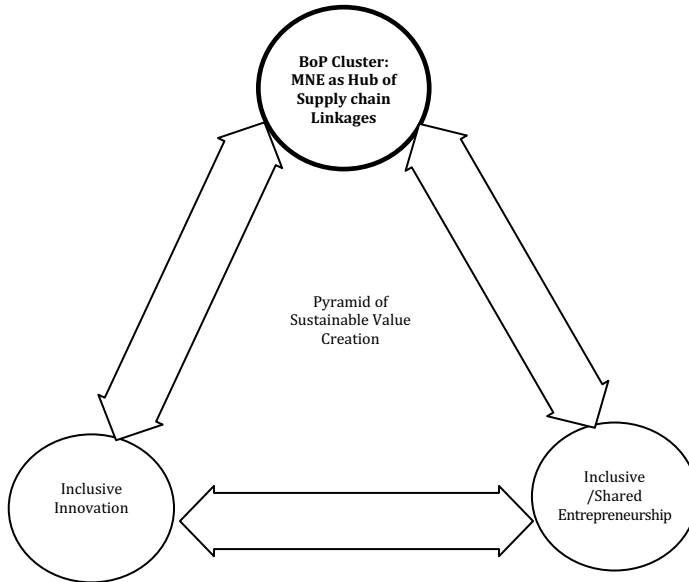
#### **4. Proposed Model: BoP Network Advantage for Sustainable Internationalization Strategy**

Figure 1 and 2 depict the process of sustainable value creation through network linkages in BoP supply chain cluster. The proposed model is extension of network theory of internationalization (Vahlne & Johanson, 2013; Bacchiocchi, Florio & Giunta, 2014; Hohenthal, Johanson, & Johanson, 2014) and theory of industrial districts/cluster. By engaging with BoP firms in their supply chain network, managers in MNEs reap benefits of BoP network advantage. BoP firms have experience and expertise of working in BoP market and thus possess important knowledge assets that MNEs may need to thrive in host markets.

##### ***4.1. Dynamics of MNEs' Supply Chain Linkages with BoP Firms for Sustainable/Shared Value Creation: Inclusive Innovation and Inclusive Entrepreneurship***

Adding BoP cluster in the supply chain strategy of MNEs has implications for sustainable value creation. Social sustainability is the hall mark of BoP firms, which can be linked with the global value creation process through supply chain linkages of MNEs (Figure 1). BoP suppliers and resellers share the opportunity of innovation and entrepreneurship with MNEs through exchange of information through supply chain network. BoP firms share their social and knowledge capital with MNEs due to their experience and expertise of doing business at BoP. The MNEs in turn also add to the competitiveness of these small and micro firms by sharing their surplus knowledge assets

with them. Participation of MNEs in global value chains and their knowledge assets encourage and enable these firms to remain internationally competitive in terms of products and processes. BoP clusters link micro and SMEs to global markets and thereby keep these firm internationally competitive and abreast with global trends. Cluster linkages with BoP supply chain partners offer MNEs significant cost advantage in labor intensive operational activities. This results into a two way flow of competitiveness in the value creation process between MNE and BoP firms through dynamics of BoP cluster.



**Figure 1.** Innovation and Inclusive Entrepreneurship in BoP Supply Chain Cluster: Pyramid of Sustainable Value Creation

#### 4.1.1. Economies of Networking

Savings in average cost and gains in quality associated with spread of activities across the value chain network through vertical and horizontal linkages is hereby termed as economies of networking. This concept is clearly different from economies of scope, which encouraged firms to agglomerate the backward and forward activities under one

management. Economies of scope thereby resulted in increased firm size and reduced responsiveness at high bureaucratic costs. Theory of industrial clusters established by Marshall (1907) has already gained further theoretical advancement elaborating its implications for growth, employment, productivity and innovation. Successful empirical results from the industrial and technology clusters in developed countries have further strengthened the theoretical construct of industrial clusters. Economies of networking have their roots in the theory of industrial clusters and theory of strategic alliances, which elaborate the role of supply chain/ value chain linkages capitalized through strategic alliances within the cluster. Network theory of organizational structures and strategic alliances has given these firms an opportunity to shed the load of these non-core activities and not only become smart and responsive but also more competitive by spreading their activities across the global value chains. Arnould & Mohr (2005) have coined the theory of BoP clusters to expand the horizon of economic activity to BoP markets through business partnerships and alliances using country level analysis. MNEs are increasingly interested in outsourcing the weight of activities/processes accumulated during race for economies of scope. BoP clusters can be vital mechanism for MNEs to capitalize on economies of networking without compromising economies of scale. Quest for economies of networking can be important incentive for the formation and success of BoP cluster by MNEs to capitalize on labor cost advantages of family-run BoP businesses.

#### *4.1.2. Locally Inclusive and Globally Competitive SME sector at BoP*

Taking MNE as the hub of BoP cluster enables the supply chain to create inclusive entrepreneurial ventures. These BoP ventures also contribute to the international competitiveness of hub MNE through their cost advantage arising out of family labor and social capital at BoP. MNEs have surplus knowledge assets (K), which is complemented with BoP supply chain ventures through forward and backward linkages to improve quality of supplier and reseller activities. Global character of MNE enables participation of these BoP firms in international markets and keeps them updated with global tastes and trends. Transfer of learning from MNE to these ventures significantly improves the competitive ability of BoP ventures. Inclusive character of BoP cluster creates and enables shared

international competitiveness with varying sections and subsections of market in developing countries. The cost advantages (C) of these small ventures add to the international competitiveness of MNEs in the area of operational activities.

#### ***4.2. Dynamics of BoP Supply Chain Cluster for Sustainable Internationalization Strategy: BoP Network Advantage***

Figure 2 depicts the proposed model of sustainable internationalization strategy stemming from MNEs' supply chain linkages with BoP enterprises in host markets. Simanis and Hart (2008) have coined the concept of embedded innovation through *Business model intimacy* which entails an interdependence and sense of shared identity in the business model innovations wherein the company and community are committed to each other's long term well-being and success. Their study emphasizes a strategy combining the resources and capabilities possessed by MNEs and income-poor communities. A strategy that brings corporations together in deep partnership with BoP communities to build a locally-embedded business and it requires that companies must *become native* to the community and is termed as native capability. Here comes the point of interplay between firms' internationalization theory and the theory of BoP cluster or supply chains linkages.

Myer, Mudami and Narula (2011) have discussed the role of local embeddedness of MNEs in their international expansion strategies. Their categorization of local context into institutional frameworks and resource endowments and their relationship to MNEs strategy has important implications for linking BoP ventures with MNEs' supply chain networks in host markets. Their study reveals that MNEs meet the challenge of local embeddedness through network with local subsidiaries. Yet their study focuses only the MNEs central role in knowledge clusters and knowledge spillovers management across borders through subsidiary linkages and does not shed any light on the BoP clusters in the host markets that can be equally, and in some cases more effectively, helpful to meet the challenge of local embeddedness. The supply chain linkage with BoP cluster can help MNEs bridge important host market variables like psychic distance (Johansen & Vahlne, 1977), cultural distance (Kogut & Singh, 1988) and institutional distance (Kostova, 1999; Estrin, Baghdasaryan & Meher,

2009), while also responding to transaction cost of production and innovation in host markets (Rodrik, Subramaniam & Trebbi, 2004). These BoP linkages translate into native capability of MNEs (Simanis & Hart, 2008) and become important determinant of their success in emerging and developing markets. In their efforts to be locally embedded through BoP supply chain linkages, MNEs tend to contribute to entrepreneurship and innovation especially in emerging and developing economies, which is inclusive in its nature and dynamics.

This inclusive entrepreneurship and inclusive innovation through BoP supply chain linkages also influence the social tier of sustainability of MNEs operations in host market and thus lead to sustainable internationalization of MNEs. The concept of sustainable supply chain management through MNEs' supply chain linkages with BoP ventures is also elaborated by Gold, Hahn and Seuring (2013) yet their study does not relate these BoP supply chain linkages to MNEs' internationalization strategy or process.

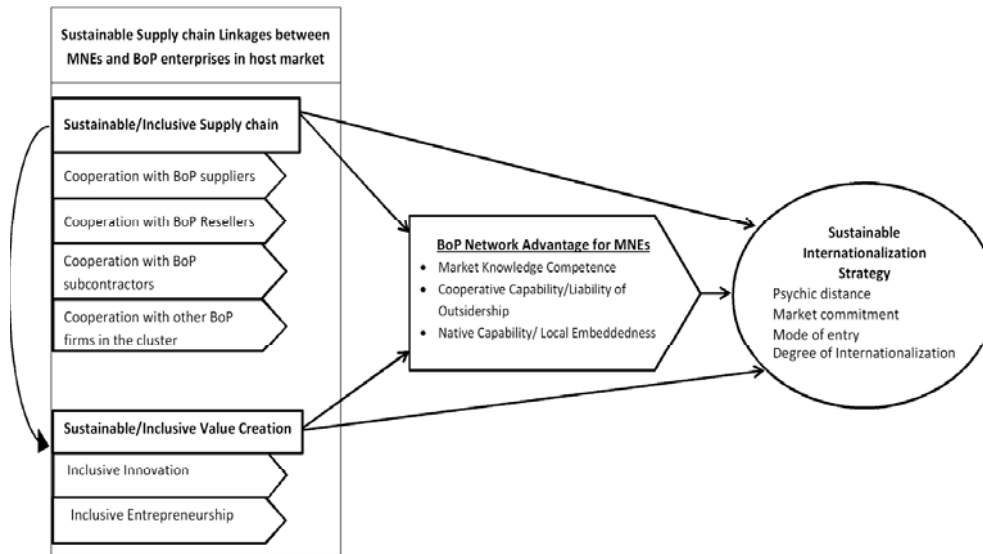
The concept of sustainable internationalization based on BoP linkages framed in this study also takes its roots from theory of cooperative internationalization, which focuses on the cooperative capability of MNEs i.e. strategic alliances, joint ventures, export consortiums and agreements with host market firms as the determinant of international expansion and success of MNEs (César Camisón, Ana Villar, 2009; Robson & Katsikeas, 2005; Narula & Duysters, 2004; Nielsen, 2010; Sarkar et al., 1999; Glaister & Buckley, 1999). Bringing BoP ventures into value creation process of MNEs tends to enhance the cooperative capability of MNEs and thereby enhances their internationalization through cooperative arrangements.

Study by Camison & Villar (2008) explains the cooperative internationalization strategy of MNEs. Their study measures the impact of MNEs' cooperative capability on internationalization. Cooperative capability refers to the tacit knowledge of managers at MNEs to build and manage cooperative alliances arising from their experience of network membership. MNEs participation in the BoP supply chain cluster enables their managers to accumulate specialised knowledge related to alliance management in the host market. This in turn lowers the perceived psychic distance leading to higher degree of MNEs internationalization.

Hart & London (2005) have coined the term native capability that refers to local knowledge and expertise to operate in host market, which results from engaging BoP suppliers in the MNEs supply chain. According to Meyer et al (2011), MNEs tend to develop local embeddedness leading to lower perceived psychic distance through their alliances with the indigenous firms in host market. The concept of local embeddedness is closely related to the cooperative capability of managers at MNEs in terms of operational outcome. The study by Santangelo & Meyer (2011) elaborates the role of inter-firm networks on market commitment decisions of MNEs. To sum up the model and explanation of key relationships, following propositions have been made.

- P1 Supply chain linkages with BoP enterprises in host market positively influences MNEs internationalization strategy.
- P2 Supply chain linkages with BoP enterprises in host market lead to inclusive innovation in MNEs and BoP firms.
- P3 Supply chain linkages with BoP enterprises in host market lead to more and better entrepreneurial activities in MNEs and BoP firms.
- P4 Supply chain linkages with BoP enterprises in host market improve market knowledge competence of managers of MNEs.
- P5 Supply chain linkages with BoP enterprises in host market improve native capability of managers of MNEs.
- P6 Supply chain linkages with BoP enterprises in host market improve cooperative capability of managers of MNEs.
- P7 Market knowledge competence of managers working in BoP supply chain cluster significantly reduces their perceived psychic distance about host market.
- P8 Native capability of managers working in BoP supply chain cluster significantly reduces their perceived psychic distance about host market.
- P9 Cooperative capability of managers working in BoP supply chain cluster significantly reduces their perceived psychic distance about host market.
- P10 Impact of supply chain linkages with BoP firms on BoP network advantage and internationalization differs across backward and forward and horizontal linkages.





**Figure 2.** Proposed Model: Role of Sustainable Supply chain Linkages with BoP firms on MNEs Internationalization Capability

## 5. Limitations and Conclusions

The study identifies MNEs supply chain linkages with BoP firms (BoP cluster) as exogenous variable to influence sustainable value creation and sustainable internationalization in MNEs. BoP clusters are powerful tools available to MNEs to not only make their value creation processes socially sustainable but also further their internationalization performance in the host markets. Backward and forward linkages of the BoP clusters are found to be important for enhancing productivity and thereby international competitiveness of MNEs. These linkages with local BoP producers in host market also improve the local embeddedness of MNEs and reduce psychic distance and liability of foreignness in the host market. Improved international competitiveness and local embeddedness is found to enhance the internationalization of MNEs in host markets by way of deeper market penetration. Another implication of BoP cluster is for inclusive innovation and entrepreneurship in the host market through supply chain linkages of MNEs with the local vendors and resellers. The sharing of knowledge assets between BoP

firms and MNEs together with entrepreneurial innovation at BoP spiral up the innovation and entrepreneurial activity and transform into more sustainable value chain. Further studies based on empirical data about supply chain linkages data of MNEs can enhance validity of the proposed model and contribute new insights. The postulated model nevertheless offers new theoretical insights with implications for MNEs sustainable internationalization and supply chain strategies.

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## CATALYSING GROWTH THROUGH BOARD MEMBERS ENGAGEMENT IN STRATEGY EXECUTION

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**ABSTRACT.** Strategy Management, a widely spoken attribute among organizations, exhibits their repute on a global platform. Employing strategy to shape the organizational growth is an approach which demands significant research, experience, intelligence and foresight to ensure its success at each level within the organization. The traditional perception of strategy designing reflects the board as the sole responsible authority, with keen awareness of organizational aspects, which include resources, finances, limitations and challenges. Later, when the strategy is rolled out to management and executive levels; many of the strategies lead to a messy, disorderly and disjointed process. Reason behind poor strategy management in the execution phase is the lack of leadership initiatives by board members after strategy planning. This study reviews the role of board members in strategy formulation and challenges faced at Malaysian Government Link Companies (GLCs) particularly in the service sector. It is also looking at minimizing the strategy failure by enhancing the role of board members at deep-rooted levels of strategy execution. In order to capture the rich data from GLCs, this research adopts qualitative approach in its efforts to explore a new dimension in strategy execution. Often challenged by the human perspectives at different levels, the higher lever board tends to limit their scope towards visualizing and rolling out a strategy. This paper addresses the conventional strategy management

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archetype and introducing the board room engagement at multiple levels, to make certain the organizational growth not for a short span but in a long run, hence ensuring organization sustainability.

**Keywords:** Strategy Management; Board Members; Strategy Execution; Engagement; Strategy Success

**JEL Code:** L1, G34

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## Introduction

Organizational growth in terms of business expansion, profit maximization, competence employees and management members followed by employee training retention, reward and performance management and minimization of risks involved while making a new change or initiating a new project is crucially determined by the effectiveness of any strategy employed to achieve it. The traditional perception of strategy designing reflects the board as the sole responsible authority, with keen awareness of organizational aspects which include resources, finances, limitations and challenges. Strategies proposed by the top management are deliberated and approved by the Board. Later, when the strategy is rolled out to management and executive levels; many of the strategies lead to a messy, disorderly and disjointed process (Bordean & Maier, 2011). Reason behind poor strategy management in the execution phase is the lack of leadership initiatives by board members after strategy planning (Project Management World Library, 2013).

Being the third largest exporter of service and second largest contributor to economy, the Malaysian service sector received maximum attention from the government since 9<sup>th</sup> Malaysian Plan (EPU, 2005). The dream of making Malaysia a “global service hub”, as reported in government documents, can only be realized if Malaysia achieves superior

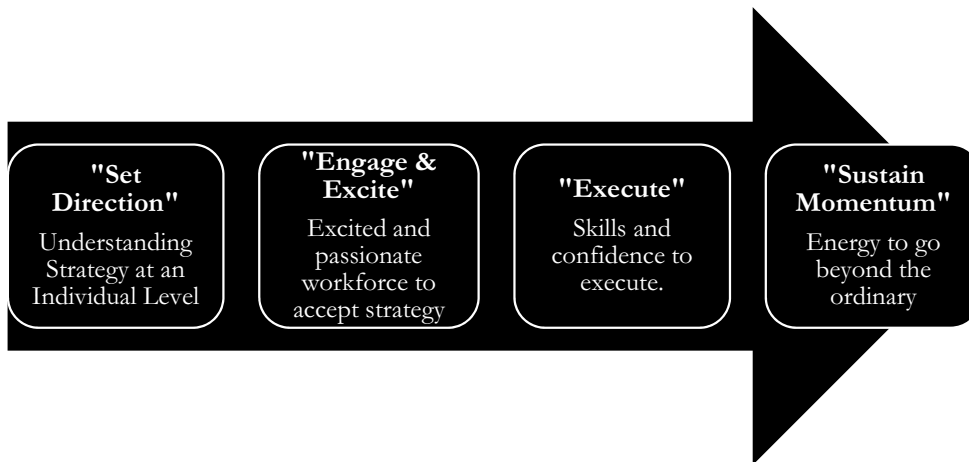
performance in a cost-effective manner. To realize this challenging task, focus has been shifted to strategic-fit framework in relation to service innovation and execution management especially within the Government-Link Companies (GLCs) and Government-Link Investment Companies (GLICs).

This paper reviews the role of board members in strategy formulation and challenges faced while implementing it. Also, minimizing the strategy failure by enhancing the role of board members at deep-rooted levels of strategy execution is emphasized by overcoming challenges and board audit measures.

## Literature Review

### *Overview of Strategy Execution in the Organization*

Strategy execution is commonly defined as the practice of bringing a strategy to fruition. As defined by RogenSi's Strategic Leadership Execution Framework, four critical forces that drive strategy execution at an exceptional level are:- Set Direction, Engage & Excite, Execute and Sustain Momentum (RogenSi, 2012).



**Figure 1.** Critical Forces of Strategy Execution  
(Source: Adapted from RogenSi, 2012)



Strategic execution relies on unambiguous leaders and good leadership. An efficient and updated management model, supporting the strategy is required. A review of changes in work processes, functions and operations incorporated by the execution of strategy is required to evaluate the modification in their scope (Mayer, 2011). Martinelli (Martinelli, 2010) says strategy identification and formulation is the domain of business owners and top-level managers, often comprising a board. The activities of board serve as a guideline to all decisions taken at managerial level and below. Strategy's effectiveness is determined by the integrity of short-term goals cohesively accelerating the organization to achieve its long term goal. Strategy execution gradually becomes a culture when mentored by a strong board (Mayer, 2011).

Several challenges are observed during the process of strategy execution, irrespective of the strategy's efficiency to let organization growth. These challenges arise due to complexity during strategy execution for organizations with several functional and operational business units geographically (Johnson-Cramer & Cross, 2007). Also, strategy formulation demands intrinsic involvement of board members, managers and team leads across all functions during early stages of strategy execution. Whereas, management involved at early stages often cite the experience as bureaucratic, unnecessary and slow in action (Balogun, 2006; Burgelman & Grove, 1996; Line, 2004).

### ***Role of Board Members Engagement in Strategy Execution***

Addressing challenges in making strategy an accepted move to boost growth, following measures can be taken. Areas where board members can participate and create awareness are creating a common sense of purpose and enhancing shared commitment, to make strategy a success. It is up to the Board members to initiate the pre-implementation steps for formulating a strategy, by involving team members from each level to participate in designing short-term goals. These short term goals, when aligned with long-terms goals of board members, will lead organization to adapt a culture favoring the changes incorporated in new strategy (Martinelli, 2010). Board members also make use of risk analysis tool, precisely at the beginning, to allow them to revise the objectives if required.

Risk evaluation even helps to back-out a strategy by unleashing the hidden perilous factors in the beginning or even before roll out (Siciliano, 2002).

Strategic execution in the organization is influenced by the capabilities depicted by strong Boards and limitations of a weak board. Mayer's (Mayer, 2011) observations about strong and weak boards outline the organization behavior associated with them. A strong board understands its role, connected to the community and strongly believes in their self-assessment, evaluation and continual improvement as a team. Mature organizations remain clear about the roles played by board members in leading successfully, and tend to invest months in planning a board and cultivating potential board members. It is characterized by precise in job description of board individuals. Also, it is led by a leader council, which motivates debates and discussions, and prevents arguments turning into conflicts. On the other hand, a weak board has poor job definitions, lack of appropriate communication with staff, and limiting the potential of strong individuals to perform as a unit. A weak board may become its own liability if not assessed righteously.

Board members also often play the important function of evaluating the effectiveness of strategy. The successful execution is determined or audited before strategy planning and rollout. The board's evaluation helps an organization to determine the following (Cropp, 1996):

1. Membership accountability and governance
2. Board operations and their worthiness
3. Legal responsibilities
4. Financial overview
5. Planning procedures adapted by board
6. Board-management relations

### ***Inter-relationship between Board Members Engagement and Growth***

Growth of an organization by strategy management is classified into two dimensions (CFERF, 2012): Financial measures of growth like revenue and profitability; and Secondly, elements of growth like customer satisfaction, development of the human resources, cost efficiency & market image makeover. Growth measurement criteria vary from business to

business and tend to be domain specific. Board members usually approved planning for a strategy within these two dimensions thus need different measures to evaluate growth. Expansion of business by new acquisitions and mergers, introducing or launching a new service/ product, closing the non-profitable ventures to improve sustainability are financial measures to ascertain growth, but they are spear-headed by the Board members of the organisation. Furthermore, digging the core practices followed in the company through strategy formulation, and targeting growth at a granular level (Fortna, 2012) from the perspective of strategy change management leading to internal growth is also initiated at the Board level.

### **Methodology**

The impact of engagement directly affects the growth of an organization. Also, the current practices followed by boards of various organizations in strategy visualization, devising methodology to incorporate people, strategy and operations in a calibrated way with available resources, was reviewed. Process of strategy planning incorporates 10% of talent & resources, and strategy execution incorporates 90% of it. Still, merely 5% of the organizations implement the visualized strategy successfully (Ottinger, 2012).

The proposed study aims to review, analyze and understand a scenario of strategy visualization and role of board members till its execution phase. The methodology adopted in this research is based on qualitative research design, which allows the researcher to explore, analyze and evaluate the data obtained with respect to the research topic (Seglen, 1994). It is based on content analysis strategy by which the various selected articles and case studies have been analyzed independently on the basis of main topic of research, setting of research, sources of data collection and definition of the concept (Karin Klenke, 2008).

The objectives of the study are:

1. Mining the factors which can capitalize the participation of board members in leading strategy to success.
2. Understanding the process of strategic execution, and mining the factors which can capitalize the participation of board members in leading strategy to success.

3. Reviewing the role of board members, their limitations, strategy's performance and overall organizational growth by engagement of board members.

### **Findings / Discussion**

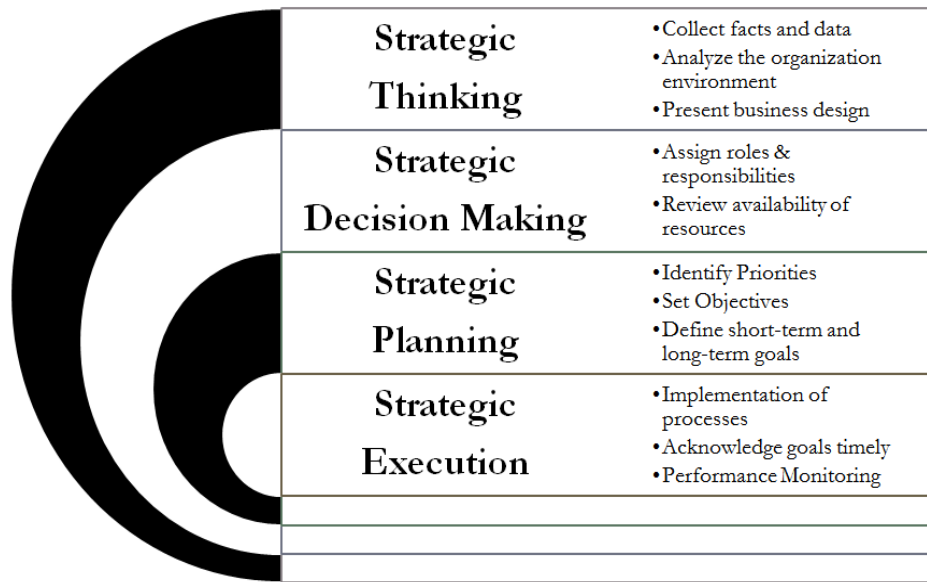
The role of board members is not limited to strategy visualization and formulation by evaluating the competitive factors (Ferkins, Shilbury, & McDonald, 2009). The role further extends to ensuring the right guideline being followed in organization at each level of strategy execution. This section analyzes the engagement aspects of board members in planning a strategy.

The strategy management approach as a step-by-step paradigm consists of following activities (Arnoud Franken, Chris Edwards, & Lambert R., 2009):

1. Visualize Strategy
2. Measured Accordingly
3. Report Progress
4. Make Sound Decisions
5. Identify Strategic Projects
6. Manage the Projects
7. Align Individual Roles
8. Reward Performance

The above points are deemed critical to majority of Malaysian Government-Link Companies especially those under tutelage of Khazanah Nasional and Permodalan Nasional Berhad (PNB) group of companies (Zeti Akhtar, 2008). Furthermore, the inter-connectivity between leadership and decision makings are quite abroad and required a strong mandate from the board / stakeholders.

Nadler (Nadler, 2004) reframed Strategy Management processes into the following 4 categories which are; Strategic Thinking, Strategic Decision Making, Strategic Planning and Strategic Execution. Details of the activities correspond to each category are shown below:



**Figure 2.** Activities of Corporate Strategy  
 (Source: Adapted from Nadler, 2004)

Based on the above figure (Figure 2), it is quite common that Strategic Decision Making are made by Board Members whereas the remaining three components are cascaded to Top Management Team (C-Level) and Middle Management Team (Senior Managers and Executives). Due to internal policies; most Malaysian GLCs having a non-flat structure for their operation (Putrajaya Committee on GLC High Performance, 2015). These will eventually widen the gap especially in terms of understanding the central ideas for any strategy to execute due to differences in information received.

Top management, business owners and stakeholders across the globe are in the process of analyzing the reasons behind failure of strategy execution processes even for simple strategies within the organization. The assumption that firms will change their current processes and methods according to new strategy often remains unaddressed by the challenges and complexities of the strategy execution phase. Researches on the issue of strategy execution and the role of Board members in it are scarce and

very few frameworks incorporate the methods to address these issues. A successful strategy is the outcome of engagement of effective board members from its initiation phase, till it becomes a practice by all elements of the organization.

The outcomes of a document analysis conducted throughout selected seven Khazanah Nasional companies (Khazanah Nasional, 2015) reveals the following characteristics for an engaged and effective boards:

1. Clear Expectation – Make everybody aware and fully understood what should be delivered. Individual contributions and progress are tracked accordingly. Improvement and alignment could be done ahead of time shall there is a needs for it.
2. Accessible Information – Board members and their top management team are given the information they need to perform their tasks. Resources, materials, equipments and other requirements easily accessible thus encouraging transparency while eliminating bureaucracy and administrative inefficiencies.
3. Two-ways Communication – Each and every personnel are encourage to share their views with respect to their routine jobs. This is to ensure blind spots are eliminated and weaknesses in board management identified.
4. Utilization of Talents – Board members traditionally were chosen due to their strengths on certain area. A composition of strong board members will lead towards business continuity and sustainability to an organization.

The literature about aligning board members in strategy execution phases emphasizes on harnessing the powers and capabilities of individuals as a team. Performance of board members unit often demands audit, to maintain the organizations repute on a wide platform, among stakeholders, clients and business owners. Board members' performance audit process is an assessment process comprising evaluation of board in terms of, board's self-evaluation, a separate committee evaluating the board, a non-board committee evaluation as well as incorporating an external consultant or audit team to provide an unbiased, independent view on board's performance as a team of leaders. Overcoming the challenges of strategy execution, exuding potential and exceptionally strategic strong board exacts and strengthens organizational growth not for a short span but in a long run.

## **Conclusion / Implications**

Many companies that start well find it difficult to sustain high performance after few years. Ineffective governance appears to be one of the contributing factors (Schmidt & Brauer, 2006). Apart from defining the firm's strategies, the role of board's engagement from a legal perspective is to include the review and monitoring of strategy (Taylor & Stiles, 2002). In a wider perspective, board's engagement is expected at different stages of strategic planning processes, such as defining the business, outlining mission and vision, understanding the environment followed by selecting and implementing a set of strategies (Hilmer, 1998; Tricker, 1994; Zahra & Pearce, 1989)

With focus on the growth of the organization, Board members are responsible to engage in decision making to empower the organization to adapt itself to changes required by a strategy (Goodstein, Gautam, & Boeker, 1994). Long term performance of an organization is also governed by organization-wide resource management & allocation (Judge & Zietahl, 1992). Significant debates and researches have been conducted to define the strategy visualization and similar responsibilities of the Board, but lack of proven framework often instigates management to explore how Boards fulfill this responsibility (Taylor & Stiles, 2002). Engagement of Board members post strategy analysis and formulation in the process of decision making at different levels is a continual process / activity (Mcnulty, 1995; Zahra & Pearce, 1989). Thus although there exist researches that highlight the need for Board members to engage in strategy execution process, there lacks consensus on present trends about the same, and methods and ways in which members can participate in execution of strategy.

It is expected that the researcher will get to understand critical success factors for strategy execution for the benefit of both Malaysian academia and industry. This will also give the opportunity to understand how underlying elements are affecting critical success factors at the time of strategy execution management. The potential role of the Board in the success of strategy execution will be revealed. These study will eventually formulate a successful strategy execution management methodology or system in the Malaysian service sector is crucial to ensure competitive advantage in the global service network and to realize targets set by the Malaysian government for 2020.

Execution is the result of thousands of decisions made every day. There are four fundamental building blocks management can consider influencing those actions - clarifying decision rights, designing information flows, aligning motivators, and making changes to structure. In efforts to improve performance, most organizations opt for structural changes. Structural change could help organization to improve execution. In fact, quantitative analysis shows that actions related to right decision and information are far more important, about twice more effective than the other two building blocks.

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## THE EVOLUTION OF E-MARKETING IN BUSINESS-TO-BUSINESS (B2B) ENVIRONMENT AND ITS IMPACT ON FIRM PERFORMANCE

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**ABSTRACT.** Now a day, E-Marketing has become an essential factor in the development of business-to-business relationship for many organizations. The increasing trend of digital marketing and the role of Millennials generation in buying decision has made a great impact on enterprise sales. Most of the firms are facing the high cost of business and unable to reach to their buyers around the world, this research will be focused on the organizations to check the E-Marketing use. The main purpose of this study is to examine the use of E-Marketing as a mediating on the firm performance. Technology adoption such as E-Marketing and its utilization is increasing with the passage of time, but still this technology is new for many emerging economies who are unaware of the proper implementation of E-Marketing. However, E-commerce, E-Marketing or e-Business has always played a significant role in business-to-business communication process and give support to the firms in order to compete with their regional buyers. In the meantime, E-Marketing (EM) has appeared to be one of the essential factors in achieving the competitive advantage for any firm. Furthermore, in this study TOE (Technology-Organization-Environment) model in linkage with RBV theory has been established to make a strong base of overall conceptual framework. Moreover, this framework can be enhanced by adding other variables and to check firm performance not only by means firm performance, but also for the marketing performance of the particular industry. Further, the researcher will empirically validate this research by administering a survey questionnaire among Firms in a number of developing countries. So that, the research could conclude with several findings, gaps and contributions.

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Nevertheless, this paper will contribute to the existing knowledge and help the firms to work globally and to overcome both internal and external issues which are becoming barriers in their business performance.

**Keywords:** E-Marketing, Globally, B2B, Firm, Performance, Emerging Economies

**JEL Code:** M31, M15

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## **1. Introduction**

E-Marketing is considered as a new concept and has bring an easy way of communication between the firms. Likewise, delivering a right and consistent message by the suppliers to the buyers through the help of digital marketing is the most significant thing to attain enterprise sales and also for long term relationship, no matter, whether the business is based on manufacturing products or delivering the services (Rahim, Bakar, & Ahmed, 2015). Moreover, it is clarified that, e-marketing technology is starting to come of age, and leading corporations are adopting e-marketing in order to achieve competitive advantage through digital marketing activities. But still, in-spite of rapid developments in new technologies, organizations adopt them at slightly slower degree (Barwise & Farley, 2005; Chen & Lien, 2013). Consistent with this argument, e-marketing technology is still a relatively new idea, specifically for corporations serving in under-developed countries, normally such firms are already facing a lack of resources and high competition (El Gohary, 2012).

### **1.1. Evolution of E-Marketing**

It is stated that, managerial and academic interests in E-Marketing has been growing from last many years. Some researcher mentioned it as new paradigms. Recently, many publishers have shown huge interest

in publishing articles on Electronic Marketing and this concept of EM could be applied in any context, but Still very few empirical studies have been done to support E-Marketing in different contexts and a huge number of companies have applied E-Marketing tools to keep in communication with their trading partners and buyers to grow their businesses for long term basis (Eid & El-Gohary, 2013; Sheikh, Shahzad, & Ishak, 2016). Globally, industry in developing countries are striving for market share and to increase products sales, where E-Marketing has become essential strategy for every firm to become more customer oriented rather sales oriented. Although, digital marketing is becoming more popular for the firms to satisfy their customer needs and expectations because in today's era, ICT and its uses made a lot of changes in social and economic processes like, many previous old processes have totally obsolete or replaced by third world approaches or virtual methods (Taleghani, Akhlagh, Akbar, & Sani, 2013).

### ***1.2. Role of E-Marketing in growth of Business-to-Business industry***

For the last 2 years, there is an interesting shift in the B2B markets and this is a wakeup call for all the firms working in business-to-business environment. Additionally, this is not a secret anymore, that 90% of the b2b researchers are now online and making a buying decision on the basis of digital research techniques because, people who lies in age between 18 to 34 are playing a role of 50% in a buying decision, this generation is also known as a millennial, who was born in early 1980's to 2000. Now, the trend is changing as marketing the products to top management through physical meeting or by simply through a phone call is not enough for the suppliers because the new generation is influencing the decision on a very serious note. In line with the previous discussion, now B2B selling and buying has been strongly influenced by the young generation and the firms must make it sure that, they are reaching to this generation on a continuous basis and providing them their required contents and message. So the easy and cost effective way to reach B2B buyers nowadays is through E-Marketing particularly with the help of videos and mobile phone technology. As it will help the suppliers to present their product and services properly in front of the buyers (Dai & Kauffman, 2002; Snyder & Hilal, 2015).

Moreover, few studies clearly highlights that, a very positive advancements has been incurred in internet access and usage since last decade, it helped the firms to increase their market reach, operational effectiveness, developing the new buyers, vendor contacts, trading partners access and opened up new horizons to sell products that ultimately helped the firms to achieve competitive advantage in local and export markets (Ahmad, Bakar, Mohamed, Faziharudean, & Zaki, 2014; Rahayu & Day, 2015). Further, in line with previous argument by Dai & Kauffman, (2015) express that, E-business, internet marketing and other interlinked technologies have established to be transformational, although these technologies had a great impact on the overall effectiveness of the firms specifically to the marketing functions because today, E-Marketing has become a significant indicator for marketing of global corporation's products. As internet and web access took a huge interest of the businesses and the scope of E-Marketing at international level has been increased drastically.

Furthermore, a study conducted by (Mull, 2013) indicated that, today, potential buyers are using digital communication channels to make any buying decision. Further illustrate that, today's buyers do not contact with their suppliers until they complete 57% of their research through e-marketing, it concludes that, Formation of opinions, learning about technical Specifications, developing requirements lists, and further narrowing down their final options, these are the activities of its own with the help of digital channels and with very little influence from the suppliers. Also a survey conducted by google in 2011 & 2012 on 1500 leaders who were deeply involved in the buying the products for 22 B2B organizations also found that, a new marketing paradigm has taken the place that is digital marketing. So why the suppliers are facing issues in reaching to these global buyers? Because few of them are providing ineffective content, improper digital integration and poorly optimization of their communication channel. On the other hand, still in today's era, top management is giving preference to traditional marketing over e-marketing or digital marketing. But apparently, this approach is no more workable as customers are learning on a continuous basis and are more aware due to high saturation in the markets. All of this, leads to B2B digital communication problem, as the firms which are doing is e-marketing is not providing the right content to the buyers as such content will make hurdle in their buying decision. However, it is better to get digital integration with

the proper mix like to communicate the right message, chose a right format to communicate those messages only then a firm can be on a right track of digital marketing (Ahmad et al., 2014; Mosawi, Shahzad, Golamdin, Pasha, & Sheikh, 2016; Rahayu & Day, 2015).

### ***1.3. E-Marketing trends and comparison among emerging economies***

Several findings and literatures have revealed that, there is still a communication gap between the firms and their customers. Likewise, negative market trends, growing global competition and staff, insufficient ICT skills are another reasons, which companies gives for not adopting the E-Marketing and this non adopting behavior of the firms is effecting the internal and external performance (Morais, 2006; Tandon & Reddy, 2013). On the other side, E-marketing is growing rapidly to cater maximum global market shares, for example in china there is a 120% increase in e-commerce business (Fredriksson, 2013) and India has also progressed in ICT from last few years but on the other hand, businesses in Pakistan, Srilanka and Bangladesh are still reluctant to properly implement e-marketing as it is a cost effective way to do the business in this global era. In line with this statement, cost of doing business in these emerging economies is increasing day by day and firms has limited their thinking on local operations rather approaching to global buyers. So, this is a serious situation, firms must think globally and adopt the digital way of marketing to communicate with their buyers and find a new markets worldwide to compete with their regional competitors to make sure that, they are striving for excellence. Unfortunately, the severe impact will always be faced by SME's or small firms but another hidden fact is that, even large firms has also started the downsizing to cover their costs, which is directly increasing the unemployment in countries and leading the emerging economies towards demolition with an increase in crime rates as well (Mottaleb & Sonobe, 2009; Saeed, 2014).

## **2. Literature Review**

A literature has been established for the use of E-Marketing by firms in both under-developed and in western countries. Even, it was accepted to review commonly used theories and frameworks on E-Marketing adoption

by countries to identify their scope and limitations (Alzougool & Kurnia, 2008). The literature review on E-Marketing is very wide in nature and helps in identifying the right theory and model that has worked out and implemented in number of researches to identify the reason to use E-Marketing technology by corporations. However, the current study has employed TOE (Technology-Organization-Environment) framework (Tornatzky & Fleischer, 1990) linked with RBV theory by (Wernerfelt, 1984) to completely justify the impact of innovative technological factors on performance of the firms.

### ***2.1. Use of E-Marketing in Era of Globalization***

Electronic Marketing or digital marketing has been observed as a modern business practice, which is linked with the buying and selling of goods, information, ideas and services through the internet and other electronic means (Stokes, 2011). In addition to this, a review of the relevant literatures and published research works has revealed that, the definitions of E-Marketing varies according to each researcher's point of view, also background and specialization in the field. The E-Marketing is defined by Chaffey and Smith (2013) as "E-marketing, Internet marketing or digital marketing is at the heart of e-business – getting closer to customers and understanding them better, adding value to products, widening distribution channels and boosting sales through running e-marketing campaigns using digital media channels such as search marketing, online advertising and affiliate marketing". Currently, business practices are more related with marketing products, services, facts and concepts by the use of internet and other additional electronic processes like mobile phones, intranets as well as extranets. A firm who is implementing e-marketing technology can adapt the shape and nature of their business worldwide. However, the increased usage of the internet not only increase the opportunities for the firms, but has also eliminated various threats. Considering all these facts, explained the distribution (from 2003 to 2010) of E-Marketing related published articles in the context of different countries. Great Britain had more than 59 studies, Australia 16 studies and South Africa had 3 studies related to electronic marketing. Clearly, these figures highlight an opportunity to build on this foundation of knowledge. Based on the literature researched within the field of e-marketing and performance, there are clear research

opportunities to be examined in developing countries, which will contribute in the development of digital marketing environment between the firms (El-Gohary, 2010; El Gohary, 2012).

### ***2.2. Technological Orientation relationship with EM and FP***

Technological oriented firms are more focused to use new technologies like E-Marketing to enhance firm performance in terms of customer loyalty, market growth and financial gain, on the other hand, such technology motivation will push the firms to move towards international market in order to avail maximum prevailing opportunities around the world. Apart from this side, a study conducted by (Mutlu & Sürer, 2015) found that, technology orientation has a significant effect on the innovativeness of the firm. Moreover, the usage and implementation of E-Marketing technologies by diversified firms is to interact with their customers and to make a sound dialog with them in order to generate revenue. Therefore, numerous set of technologies plays a vital role in building a strong communication between the firms such as: e-commerce websites that offers customer relationship management systems, sales transactions & extranets, intranets and sales force mechanisms. Moreover, e-business adoption described a firm implementation of such kind of technologies to have a significant impact on the sales performance, profitability of the firm, competitive edge, export firm performance, customer satisfaction and development of relationships with buyers and trade partners as well Further, technology orientation has a positive significant effect the firm performance particularly in manufacturing sector of emerging country (Do Hyung & Dedahanov, 2014; Trainor et al., 2011).

### ***2.3. Market Orientation relationship with EM and FP***

There is evidence that, firm capabilities influence the innovation adoption (Hult, Hurley, & Knight, 2004). There is also indication that, market orientation positively influence the innovation adoption. For example, (Narver, Slater, & MacLachlan, 2000) argues that, there is a positive relationship between innovation and Market orientation. The current study conceptualizes the E-business adoption or E-Marketing adoption as an innovation. Moreover, Wu, Mahajan and Balasubramanian (2003) define market orientation as “the use of internet technologies that link customers, suppliers, business partners and employees by adopting at



least one of the following activities: (i) websites that offer sales transactions; (ii) customer service websites; (iii) intranets; (iv) extranets; and (v) IP electronic data interchange". Few studies also revealed that, market orientation plays a vital role in making the customer closer to the firm with the help of digital marketing and also helps analyzing the competitor orientation and it was found that, market orientation has a significant positive correlation with E-Business adoption and has a positive impact on the performance of the firm (Mutlu & Sürer, 2015; Voola, Casimir, Carlson, & Anushree Agnihotri, 2012).

#### ***2.4. Competitive pressure relationship with EM and FP***

Several studies explained that, the relationships among players within the same industry also affect the overall industry structure. These relationships determine the extent of competition and rivalry within the industry and play a vital role in e-commerce adoption. Therefore, a company may feel pressure when it sees more and more companies in the industry are adopting e-business and therefore feels the need to adopt it as well, in order to remain competitive (Ahmad et al., 2014; Kuan & Chau, 2001). Furthermore, the influence of key players in the firm's external technological environment such as government, competitors as well as a firm's trading partners have a significant impact on Internet usage and also on the marketing performance of the firm. Therefore, it implies that, competitors continuously affect the operations of its rivals, in order to cater maximum market shares and to increase global reach, firms have to analyze the industry practices on a continuous basis and will look into other firm's to make a comparison regarding their performance. Other than that, digital marketing has pushed the businesses to access their buyers in a more reasonable way rather trying to meet them at their offices because millennial generation has much awareness about the global trends and they normally make online research before buying or making any decision (Djermani, Shahzad, Sheikh, Mohammed, & Alekam, 2016; Snyder & Hilal, 2015).

#### ***2.5. Mediating role of E-Marketing (EM) with Firm Performance (FP)***

Organizations that adopt E-Marketing in their businesses have a view that, implementation of E-Marketing is not an expensive procedure and it helps to communicate with buyers in all around the world to

maintain good business relationships (Mzee, Ogweno, & Irene, 2015). Moreover few studies highlighted that, e-marketing technology adoption and use continues to vary, despite widespread acceptance of the Internet in corporate environments. Additionally, digital marketing or E-Marketing is a recent technology that has received substantial attention in the industry. This argument echoes El-Gohary (2012) who stated that, e-marketing technology is still a relatively new concept, particularly for organizations operating in developing countries that have limited resources and strong competition. Therefore, companies could not afford to make unwise investments or wrong decisions, which resulted in the poor uptake of e-marketing technology among firms and might affect the marketing performance of the firm.

Based on the literature, technology adoption by firms in addition to any new strategic issues is a time anticipated by decision initiators to see a possible impact on the forthcoming organization effectiveness. For instance, corporations only adopt new technology if its existing technology got lapse or new technology has much more benefit likewise new technology resolve existing problems so effectively that, it helps the corporations to be more motivated in order to invest in acquiring the latest technology. Similarly, it has been proved that, each motivation gives organization an opportunity as a driver for success likewise problem for getting internationalization is a basic necessity for every firm irrespective of its size, now an E- technology has developed an awareness among all buyers and trading partners that, they can do electronic business in order to grasp maximum international market share with very low cost. Therefore, it is highlighted that, firms perceived benefits, helps them to adopt new technology without any unnecessary delay (Eid & El-Gohary, 2013; Rahim et al., 2015)

Those companies, which are focusing more on marketing activities must focus on the digital way of doing marketing in order to increase their performance, trend is now changing in all over the world, firms are adopting E-Marketing tools and using them to have a competitive advantage over the other rivals. Further, the use of e-marketing will help in cost reduction of distribution, increase supply chain efficiency, close interaction with buyers and to perform market research for product development purpose or in order to find new customers and also in maintaining the existing buyers as well. Similarly, results highlighted

that, internet marketing is essential for achieving comparative advantage and to reduce the cost of international marketing or commerce. So it is proved by the researcher that, there is a positive relationship with technology adoption and use of internet marketing and export performance of the firm (Taleghani et al., 2013).

The importance of electronic way of doing business was further examined by Voola et al. (2012) that, understanding the effective adoption of technological innovations, such as e-business, is arguably one of the key challenges faced by organizations. The literature indicates that, the relationship between firm capabilities to use resources and firm performance is mediated by the effects of the adopted innovation (e.g., e-business). Additionally, another study of Smits and Mogos (2013) found that, the use of social media (E-Marketing Tool) enhances business capabilities and business performance. So, it implies that, digital marketing or e-marketing is bringing a new business era of communication between the firms, who are ready to accept innovation in their businesses and want to diversify them according to ongoing trends and market requirements.

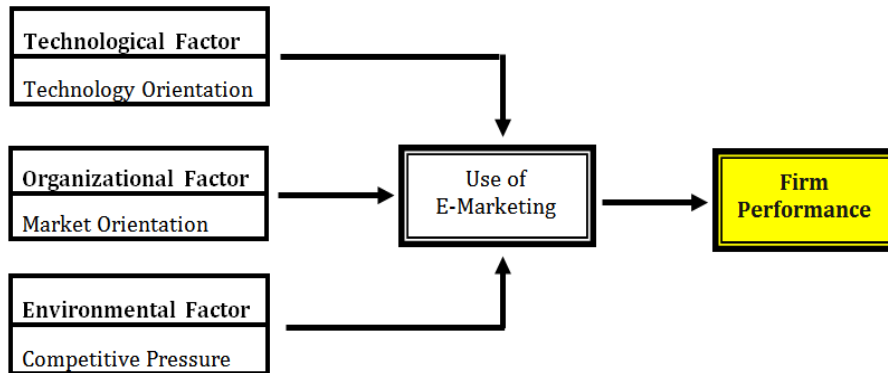
### **3. Methodology**

This paper highlights the important technological related factors that execute from the mediating factor of e-marketing adoption and its influences on firm performance of developing countries. To highlight these variables, the researchers have gone through from different databases, reports, books, thesis, empirical and conceptual papers etc. The literature clearly highlights that, the role of technological orientation, Market orientation, Competitive pressure and use of E-Marketing influence the performance of the firms in developing countries. Using TOE model and Resource based-View theory, this paper explained the importance of these variables in predicting the firm performance operating in emerging economies.

#### ***3.1. Framework Development***

Based on the literature review, a framework has been developed to give a broad view of E-Marketing technology acceptance and its ultimate impact on firm performance as a guide in this research and in later studies as well. After identifying the discussed gaps, this study will contribute to the knowledge of existing literature and give benefits to the overall industry looking for increase performance and innovation.

The conceptual model of this study is drawn on the basis of TOE framework and RBV theory to justify and explain the role of variables in resolving the major problem of performance in developing countries with the adoption of E-marketing and with the help of predictors such as technological, organizational and environmental factors. The conceptual framework for current study has been mentioned below;



**Conceptual Framework:** The Evolution of E-Marketing in Business-to-Business (B2B) Environment and its impact on Business Performance of Emerging Economies

#### 4. Discussions and implications

The research discussed that, the firm’s willingness to adopt the technology positively influences e-marketing adoption; thus, the higher the firm’s willingness to adopt the technology, the higher will be the probability that the firm would adopt the technology of e-marketing. E-Marketing technology promises that, any firm who will adopt this technology can attain several benefits. E-Marketing provides operational measures to the firms through which they can establish strategies in order to make market expansion and to improve their competitiveness. Several qualitative outcomes revealed that firms normally adopt the technology like E-Marketing in order to minimize the mistakes and to improve their effectiveness through cost reduction and to improve their corporate image through market expansion (Rahim et al., 2015).

Besides, it is evident that, digital way of marketing has become an essential business tool which is growing very rapidly with the passage of time and this paper has tried to examine the connection between internet

marketing usage and firm performance in under-developed countries, research in the area of underdeveloped countries are very limited. The investigation further reveals that E-Marketing adoption to achieve firm performance among developing countries is still on its infancy stage and factors such as technological resources, top management support and pressure from trading partners have yet to be exploited. However, current IT infrastructure is not supportive in developing countries to improve marketing performance, so at the early stage adoption of technology is very important (Mehmood et al., 2013).

The uniqueness of this study is to examine the mediating role of e-marketing uses in the relationship between each variable of technological factors, organizational factors and environmental factors. The reason behind conducting this research is that, technological, organizational and environment related factors doesn't usually affect the firm performance directly, they influence more through innovation or new technology and as suggested by Baker (2011) that, if TOE model is tested with firm performance through innovation process and with the help of RBV theory, it will be a contribution to the existing knowledge of the literatures. So, there is a missing link between independent variables and firm performance that has been explained in this current study. Hence, this study will also provide the evidence regarding the mediating role of e-marketing uses in the relationship between technological factors, organizational factors, environmental factors and firm performance.

Finally, on the practical aspect, this study will provide some insights about some of the technological, organizational and environmental factors, which are vital to increase the use of e-marketing that will eventually lead to increased performance of the firms in developing countries. As such these help the leaders (e.g. Top management, directors, general manager and marketing managers) in the implementation of e-marketing technology and to resolve these prevailing independent factors issues from their organizations in order increase their organizational performance and to reach global markets or export buyers through easy and cost effective way with a long vision of relationship management. Furthermore, this study provides an insight for entrepreneurs, policymakers, practitioners, researchers and educators by providing a clearer view and deep understanding of the issues related to E-Marketing practices and its impact on the firm performance of developing countries with the help of key predictors.

## 5. Future Research and Conclusion

The direction for future research, which emerged from our findings, is to examine the mediating role of E-Marketing uses in the performance of the firms in developing countries by different sizes of companies specifically like micro firms, medium sized firms and large corporations as well. Depending on the same proposed factors generated within this study. Future research may indicate to examine the E-Marketing use and export performance of all types of Firms in other countries depending on the same proposed factors generated within this study. Finally, different predictors could be used to measure the export performance of the Firm likewise perceived usefulness, top management support, government support and trading partners etc. Future research should be simulated to examine whether the relations between variables still hold true on an industry by industry basis because some sectors have more communicating websites than others. So another area for future research is to more focus on export of services rather than products, which can considerably improve the body of information.

This article tried to fill the gap by using the E-Marketing in order to improve firm performance in terms of (global reach, competitive advantage, customer orientation and in making technological infrastructure for the firms) and also enables the suppliers to communicate with their millennial buyers with the help of videos, search engines, mobile phones, electronic advertisement, social media networks etc. As primarily, organizations are only using email technology for correspondence, but in order to explore new markets such technologies should be acknowledged and implemented for long term benefits. Whereas prevailing clarifications have focused on firms in developing countries and also give a comparison to better understand the relationship and impact of rivals. Our research provides significant findings, particularly in the use of e-marketing technology. Our research revealed that understanding the range of technology adoption that affect firm performance is dominant to conduct the adoption procedure.

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## **THE POWER OF INNOVATION, DISTRIBUTION AND SUPERVISION FACTOR IN IMPROVING PERFORMANCE OF SUPPLY CHAIN MANAGEMENT OF SUBSIDIZED FERTILIZER IN INDONESIA**

**ASWIN NALDI SAHIM<sup>1</sup>, NIK KAMARIAH NIKMAT<sup>2</sup>**

**ABSTRACT.** Supply chain (SC) is increasingly recognized as an important factor for improving business performance. Because of that, the SC activities need to be optimized and this can be done through the supply chain management (SCM). This study has three key objectives: to reveal the influence of government policy in terms of supervision, to check the reliability of distribution and innovation factors on the execution of the SCM of subsidized fertilizer in Indonesia. A sum of 800 questionnaire have been spread to the test site and a number of 587 or 73% successfully returned. Furthermore, the data from 513 respondents, or 64% of the spread, was analyzed by statistical software Structural Equation Modeling (SEM). The findings from this study shows that the government policy in terms of supervision and the reliability of the appropriation has immediate and critical impact on execution SCM of subsidized fertilizer. However although there is no immediate impact on the execution of SCM, factor of innovation plays a significant role because it determines the success of supervision and reliability of the distribution. Moreover, this supervision factor and the reliability of the distribution act as a mediator between the factors of innovation with the full performance of SCM. To improve the performance of SCM of subsidized fertilizer in Indonesia, this research suggests that the government pays attention to supervision, the reliability of the distribution as well as innovation factors. Due to that, the distribution of fertilizer will be more suited to its purpose at the right time with the appropriate location, type, quantity and the right quality, and at an appropriate price. In future research, the same study could be utilized for other subsidized commodities.

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**JEL Codes:** O14, O31, Q35

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## INTRODUCTION

Supply chain (SC) increasingly recognized as a key factor for improving business performance. Companies that implement efficient and effective SC will be a success. Because of that, the activities of the SC needs to be optimized with the process of supply chain management (SCM) (Janvier-James, 2012).

According to Finch (2006) SCM is the management of some companies from upstream to downstream; suppliers, manufacturers, distributors, retailers, logistics, transportation, warehousing, information and others involved in supplying goods to the end customer (user). The basic aim of SCM is to associate all of chain of the supply to cooperate to expanding the efficiency, including esteem, decreasing the cost, expanding consumer loyalty, along these lines expanding the intensity of undertakings.

Measurement of performance of SCM is needed to survey whether the SCM is already running at its ideal or not. By measuring the SCM, it can be seen the achievement that has been accomplished, client needs are met, a superior comprehension of the procedure, discover the mistakes and pointless things, comprehend the issues and open doors for development, give choice truthful to get advance, encourage the work equivalent and open correspondence and better (Gunasekaran & Kobu, 2007)

This research will conduct an assessment and performance measurement of SCM in subsidized fertilizer, because fertilizer is one of the creation offices to expand the generation and efficiency of agricultural land. So fertilizer got an enormous consideration from the legislature for accomplishing national sustenance security.

As a strategic production facility, the government has made two (2) fundamental strategies on fertilizer. To start with, give compost subsidy to

ranchers, and second assign SCM of fertilizer. The distribution of compost from the production line to the farmers was completed by the Government through the State Owned Enterprises, which is PT. Pupuk Indonesia (Holding) alongside distributor and trader through the SCM framework oversight products. With fertilizer is relied upon to be accessible to farmers in 6 right; right amount, sort, time, area, cost and quality. Moreover, land profitability and production of rice is required to be enhanced and increment farmers' payment and the accessibility of rice across the nation.

Some phenomena happen in the performance of SCM subsidized fertilizer: 1) Data from BPS (2013) states that there is no increase in rice production significantly in the last five years, because the productivity of rice plants is still low and even decreased in the year 2011. 2) Statistical data of PT. Pupuk Indonesia, shows a gap between the allocation of subsidized fertilizer set by the Ministry of Agriculture to the market needs. Additionally there is a broad refinement between the distributions of subsidized chemical fertilizer to the acknowledgment of the distribution. Furthermore, 3) According to Philip Kotler (2003) if the companies do not innovate they will die. And if they innovate - then they do not succeed, they will die too, but it's better than just silence. Government innovation in SCM subsidized muck. Study Pattiro-USAID (2011) stated that there had been several improvements in subsidized fertilizer's regulations. However, the phenomenon is often the case up until now is a scarcity of fertilizers, especially during the harvest season.

From the above issues may happen due to the things that are less great at innovation factors, supervision and management factor in the distribution of subsidized fertilizer SC.

### **Research Objectives**

In respect of issues raised, the primary purpose of this study is to empirically proving the power of innovation, supervision and distribution of impact on the performance of SCM in subsidized fertilizer.

The more specific targets of this exploration are:

- a) To determine whether the distribution has a significant influence on the performance of SCM.
- b) To investigate whether the supervision factor has a significant impact on the performance of SCM

- c) To determine whether the innovation factors have a significant influence on supervision factor.
- d) To see the extent of innovation factors have a significant impact on the distribution.
- e) To examine the effect of mediation supervision factor on the relationship between the factors of innovation with the performance of SCM.
- f) To empirically test the mediating effect of the distribution on the relationship between the factors of innovation with the performance of SCM.

## **LITERATURE REVIEW**

### **The Performance of SCM**

SCM involves managing demand, supply, source of raw materials, manufacture and assembly, warehouse and stock control, order management and distribution over channels, as well as delivery to customers.

### **Relationship Between Supervision and Performance of SCM**

The feedback is an important part to improve any process. Measuring systems for efficient management of the SC that enables the monitoring of compliance with business processes. Similarly Janifer-James (2012) stated that the process of SCM depends on supervision over what happens in each chain. Thus, it is hypothesized that:

*H1: Supervision positively affects on performance of SCM.*

### **Relationship Between Distribution and Performance of SCM**

Execution is controlled by the management of SC distribution exercises to give merchandise and enterprises, including request administration, transportation administration, and stockroom administration to take care of demand. This is in line with research findings Ghasemi R Mohaghar A., (2011). Hence, it is hypothesized that:

*H2: Distribution positively affects on performance of SCM*

### **Relationship Innovation`Factor and Distribution**

Leavy (2010) using innovation factor for evaluating the performance of the distribution, the view that innovation must be seen as part of a business that enable the implementation of new processes and service products for the customer's needs. Similarly, Schramm (2008) states that innovation is the model of the commerce realizing new value for customers, and directly affect the unwavering quality of the circulation. Henceforth, it is hypothesized that:

*H3: Inovation factor has a direct effect on distribution factor*

### **Relationship Between Inovation and Supervision**

Philip Kotler (2003) states that the innovation process needs to be managed carefully as a set of business process analysis. Hence, it is hypothesized that:

*H4: Inovation factor has a positive effect on supervision factor*

### **Mediation Effects of Supervision and Distribution on the Relationship between Inovation factor and Performance of SCM**

Supervision and distribution activity may mediate the success of innovation in improving SCM performance. Thus, it is hypothesized that:

*H5: Distribution as mediator the linkage between inovation factor and performance of SCM*

*H6: Supervision as mediator the linkage between inovation factor and performance of SCM*

### **The Conceptual Model**

A structural equation model is used in this study to analyze the influence of the factor structure of supervision, distribution and innovation factors on the performance of SCM.

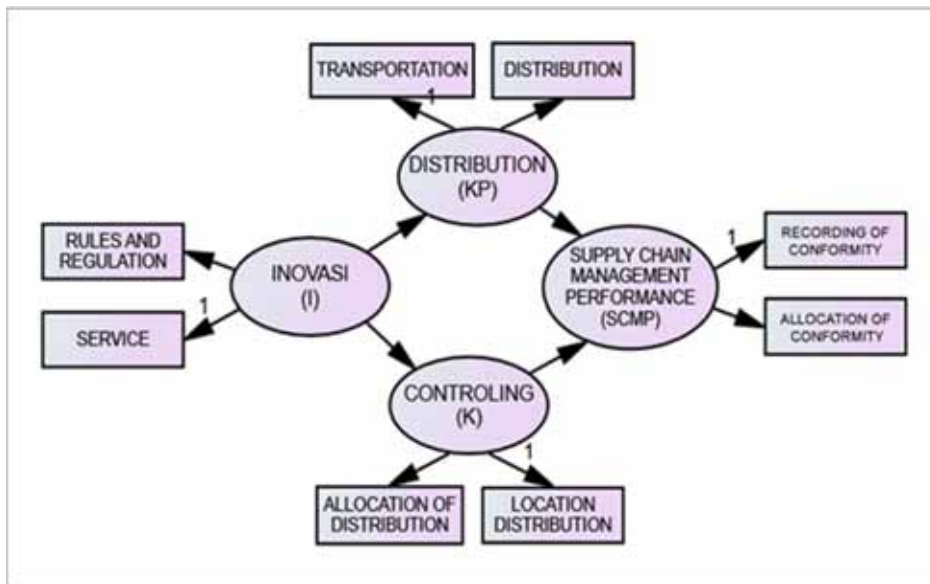
Therefore, this flowchart provides causality variables testing. In accordance with the theory, the the performance of SCM is the dependent variable, while the reliability of the supervision (K), the reability of the

distribution (KP) and innovation factor (I) are independent variable. Besides, K and KP are mediator variables between I and the performance of SCM.

For the measurement the performance of SCM, it uses two indicators: conformity of recording data with fertilizer needs of farmers (SCMP1) and conformity of allocation with the fertilizer needs of farmers (SCMP2). Flow distribution of fertilizer from the factory to the area (KP3) and flow transportation of fertilizers (KP4) is an indicator of distribution factor, likewise, innovation for rules and regulation (I3) and innovation for service of officer (I4) are indicators of innovation factor. Supervision of the allocation distribution (K1) and supervision for distribution by location (K2) are indicators of Supervision.

Based on the above discussion, the conceptual framework is presented in Figure 1.

### CONCEPTUAL FRAMEWORK



**Figure 1.** Proposed Conceptual Framework  
Source: authors' work

## **RESEARCH METHODOLOGY**

### **Sample Design**

To get an item questionnaire that is valid and reliable, there is two (2) field trials and each trial using 40 respondents. Once the questionnaire items are reliable and valid, eight hundred (800) questionnaires, which twice the sample size required (450), were distributed to the respondents. This is in accordance Hair et al, (1998) which states that the number of samples using SEM to be effective on a sample size of 150 - 450. Of 73% of the questionnaires, which five hundred and eighty to be precise, were returned. After filtering, then as many as 513, or 64% of data can be used for analysis.

Sampling of the population occurred in two stages. The first stage is the selection of provincial samples with stratified random sampling method. From 33 provinces in Indonesia, it obtained five (5) provinces. However, according to the writer's observation sufficiently representative for the area generally granary with different infrastructure. In the second stage, the selection of samples number in each province hold with a random sample table and systematic review of 450 of the total plan [20].

### **Measurement and Analysis Method**

Data analysis is done by statistical analysis of SEM (Structural Equation Model) using software Amos 22, consists of three stages; model identification, the test measurement model and structural model of the test.

Measurement of the dependent variable and independent variables using a Likert scale (1 = strongly disagree and 7 = strongly agree).

## **DATA ANALYSIS**

### **Demographic Profile of the Respondents**

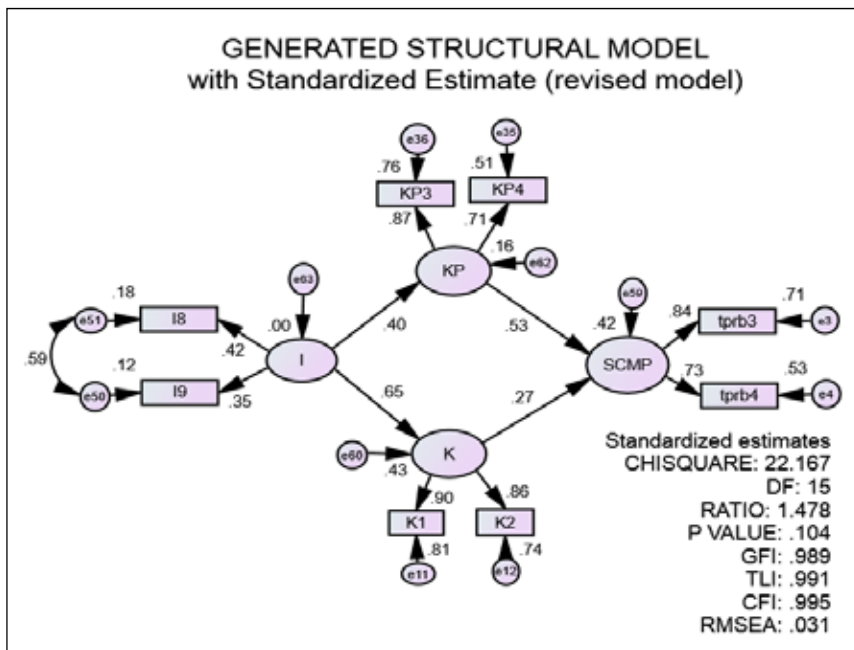
Respondents in this study is the manager authorized distributor and retailer of subsidized fertilizer, the majority of men (78.2%), average aged 31-50 years (59.3%). Being a distributor and retailer of between 5-10 years (47.8), with education background of the respondents generally



graduated from high school (60.1%). Only 72 (14%) had some training as a distributor and retailer of fertilizer, and 38 people received awards (7.4%). Total sales of subsidized fertilizer generally below 1.000 tons (85%) for each growing season. Having a fertilizer warehouse with the capacity of being, which is 500 tons (91.2%), and approximately 149 people (32.9%) had a fleet of trucks. In general, respondents in work assignments generally have three employees, and the airport is less than 10 retailers or farmers.

### Generated Structural Model (GM)

By utilizing an adjusted file, which gives the covariance relationship between E 40 and E46 research produces Structural Model Generated better and more appropriate, because the p-value of 0.104 (p-value > 0.05). Therefore, the explanation will be based on the results of the hypothesis Generated by Structural Model Revision Model (Figure 2).



**Figure 2.** Generated Structural Model  
 Source: authors' work

### The Regression Estimates

The generated structural model produces regression standardized beta estimates as in Table 1.

**Table 1.** Direct Effects Regression Estimates (Beta)

Hypo	Endo		Exo	Beta	S.E.	C.R.	P	Status
H1	SCMP	<---	K	.271	.009	5.271	***	Sig
H2	SCMP	<---	KP	.525	.024	8.990	***	Sig
H3	K	<---	I	.652	.432	3.012	.003	Sig
H4	KP	<---	I	.396	.097	3.521	***	Sig

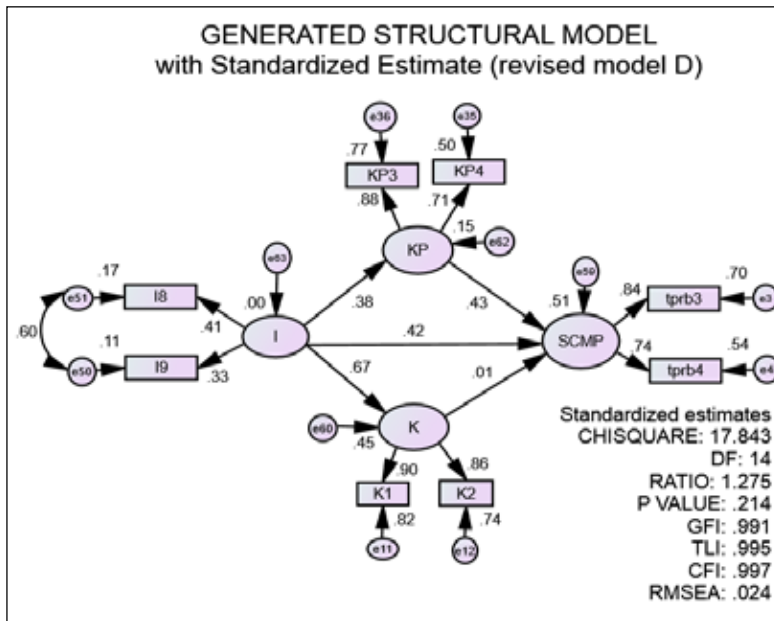
Source: authors' work

From the data shown in Table 1, it depicts supervision has a positive significant effect on SCM performance (Beta =0.271; CR = 5.271; p <0.001), or **H1 accepted**.

Secondly, distribution has a positive considerable effect on the performance of SCM (Beta=0.525; CR=8.990; p<0.05) or **H2 accepted**. Thirdly, innovation factor has a positive major effect on supervision factor (Beta=0.652; CR=3.02; p<0.05) or **H3 accepted**. Lastly, innovation factor has a major direct effect on distribution factor (Beta=0.369; CR=3.521; p<0.05) or **H4 accepted**.

### Supervision Mediation on Inovation and the performance of SCM

Furthermore, to examine the role of mediating factors between the supervision and distribution of innovation and the performance of SCM, test results will be compared to the direct and indirect relationships, once inserted Innovation factor. Model and standard regression coefficient of the estimate, such as figure 3 and table 2 below.



**Figure 3.** Generated Structural Revised Model  
 Source: authors' work

**Table 2.** Direct Effects Regression Estimates (Beta)  
 after I direct to the performance of SCM (SCMP)

Hypo	Endo		Exo	Beta	S.E.	C.R.	P	Status
H1	SCMP	<---	K	.010	.037	.049	.961	NoSig
H2	SCMP	<---	KP	.430	.032	5.546	***	Sig
H3	K	<---	I	.671	.492	2.868	.004	Sig
H4	KP	<---	I	.383	.099	3.500	***	Sig
	SCMP	<---	I	.420	.122	1.269	.204	NoSig

Source: authors' work

From the correlation of test outcomes immediate and relationships, once it inserted Innovation factors, the model does not support a finding that the supervision factor (K) mediate significant in the relationship between the I and the the performance of SCM (Table 2). It can be concluded that **H5 could not accepted.**

**Table 3.** Supervision Mediation on Inovation and SCMP

Model Element	Test Mediation in SCMP	Revised model with Direct Effect
Model Fit		
Chi-square	22.167	17.843
Df	.15	.14
P-value	.104	.214
RMSEA	.031	.024
CFI	.996	.997
Std Estimates		
I→K	.652***	.671**
K→SCMP	.271***	.010ns
I→SCMP		
-Indirect	.176	.067
-Direct	0	.420
-Total Effect	.176	.487

Source: authors' work

**Distribution Mediation on Inovation and the performance of SCM**

From the correlation of test results on the relationship of immediate and circuitous impact, having entered the Inovation (I) figure, the model bolster the finding that KP is a critical go between on the relationship amongst inovation and the performance of SCM (Table 3). It can be reasoned that the **H6 is accepted**.

**Table 4.** Distribution Mediation on Inovation and the performance of SCM

Model Element	Test Mediation in SCMP	Revised model with Direct Effect
Model Fit		
Chi-square	22.167	17.843
Df	.15	.14
P-value	.104	.214
RMSEA	.031	.024
CFI	.996	.997

Model Element	Test Mediation in SCMP	Revised model with Direct Effect
Std Estimates		
I→KP	.396***	.383***
KP→SCMP	.525***	.430***
I→SCMP		
-Indirect	.207	.164
-Direct	0	.420
-Total Effect	.207	.584

Source: authors' work

## CONCLUSION AND DISCUSSION

The conclusion of this study is the policy of the government in terms of supervision and distribution has an immediate and critical impact on the performance of the SCM of subsidized fertilizer in Indonesia.

It turns out that the distribution factor assumes a more vital part for the accomplishment of the performance of SCM. The success element will determine the distribution of the fertilizer distribution which can provide according to farmer needs in the proper amount, type, time, exact location, prices are set and appropriate quality. This is in line with the findings of the Darwis at all (2007) that the shortages of fertilizer to farmers in Indonesia are not caused by a lack of production, but due to the weakness of the system of distribution.

According to the analysis, the issue is quite often a lack of fertilizer, particularly in the growing season, since farmers need fertilizer simultaneously and required in large quantities. If there are issues in the appropriation distribution, farmers will experience difficulty in getting fertilizer, or well known as the phenomenon "the scarcity of fertilizers". Likewise, problems in terms of capacity storage and marketing are generally derived from the system of distribution that has not been adequately planned.

According to the research, there are two issues that need to be under the spotlight on the distribution. The first is the distribution of the subsidized fertilizer from the factory to the farmers (KP3), and second is to transport the fertilizer distribution from the factory to the farmers (KP5). This will improve the performance of the distribution of subsidized fertilizer from factories to wholesalers and then to retailers and to the end user, ie farmers.

The study further showed that the supervision (K) directly affects the performance of SCM subsidized fertilizer. To factor this oversight, there are two things to note for improvement, namely oversight of the allocation distribution (K1) and the monitoring of the distribution of fertilizer in a field to the desired location (K2).

According to the authors, the deviation of the distribution of subsidized fertilizer can occur due to differences in fertilizer prices in the country that are quite large which is the price of subsidized and non-subsidized. Therefore, without the necessary supervision and strict application of sanctions, there will be a permeation of fertilizer subsidized and non-subsidized in the market. This is consistent with previous studies of Sarjono (2011) that the Indonesian government must strictly implement the supervision over the SC, which means that the strict sanctions should be applied against irregularities, so as a shock therapy for other actors.

Factors innovation has an important role despite the fact that it has no immediate impact on the performance of SCM, because it determines the success factors such as supervision and distribution. In other words, the performance of SCM starting from the innovation factor, due to the achievement of the distribution and the direct supervision influenced by component of innovation. The development of constructive MSC requires innovation. Improvements in innovation could be done, especially against regulations the distribution of subsidized fertilizer (I8) and administrative redemption subsidized fertilizer (I9). With a good factor of innovation, it can affect the success and reliability of distribution and supervision, which in turn will determine the success of the performance of SCM of subsidized fertilizer in the future.

## **Conclusion**

Factors supervision and distribution factors have a huge influence on the performance of the performance of SCM of subsidized fertilizer.

In spite of the fact that the innovation factor does not directly affect the performance of the SCM of subsidized fertilizer, but its part is vital because innovation factor significantly influencing factor supervision and distribution factors.

Distribution factor being the mediator of the relationship between the factor of innovation and performance of SCM, while the supervision factor is most certainly not.

## **Managerial Implication**

This paper expresses the importance of monitoring factors, distribution and innovation factor in the performance of SCM subsidized fertilizer, so that relevant organizations can specify the pace and state of mind in settling on choices for development later on.

The study found that some important aspects of the performance of SCM subsidized fertilizer in Indonesia should be tended to in the future, so that policies can be adapted to the conditions of these factors.

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## TOWARDS UNDERSTANDING FINANCIAL BEHAVIOR OF SMEs: ROLE OF SOCIO-PSYCHOLOGICAL FACTORS OF OWNER-MANAGER

RABIA RASHEED<sup>1</sup>, MARIA ABDUL RAHMAN<sup>2</sup>,  
SYED ABID UR RAHMAN<sup>3</sup>

**ABSTRACT. Purpose** - Understanding SMEs' use/adoption of financial services is prerequisite for policy makers and managers of financial institutions interested in their growth and development. The study seeks to explore influence of personal characteristics of owner-manager on firms' financial behavior to use financial services.

**Design/Methodology/Approach** - Qualitative methodology has been employed to propose alternate model of understanding financial behavior of firms as influenced by socio-psychological factors of owner-managers. Study makes use of Theory of Planned Behavior and its variants to support the proposed model.

**Findings** - The study suggests that theories of behavior need to be applied to better understand the owner-manager's intentions to use financial services, which in turn reflect SMEs' financial behavior.

**Research limitations/implications** - The proposed model and relationships would help policy makers, managers and research scholars to better understand SMEs financial behavior. There is need for comparative empirical studies examining the propositions made by the study.

**Originality/Value** - The papers discusses the demand side issues and proposes a general model of socio-psychological factors of owner-manager that affect SMEs' decisions toward usage of financial services.

**Keywords:** SMEs, Financial Behavior, Socio-psychological Factors, Pakistan

**JEL Classification:** M1, M31, Z33

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## 1. Introduction

Small and Medium Enterprises (SMEs) are considered nursery of entrepreneurship in the economy and meeting their financial needs is vital for entrepreneurship and new venture creation. SMEs are the backbone of economies for both developed and developing countries, in terms of employment generation, sustainability, poverty alleviation and growth.

Globally, there are approximately 125 million micro, small and medium enterprises (MSMEs) in 132 covered economies, which make-up 90 to 95 percent of global entrepreneurs. Out of these, 89 million are in developing countries (Robu, 2013). Micro, small and medium firms are contributing around 43.5 percent of total employment and 57.8 percent of total new jobs created. In Pakistan, almost 90 percent of SMEs are actively working and contributing nearly 30 percent towards GDP, 25 percent towards export of manufactured goods, and 78 percent towards non-agriculture workforce employment, respectively (Chugtai, 2014).

SMEs are facing various challenges such as unpredictable legal and regulatory environments; macroeconomic instability; increased transaction costs as a result of corruption and access to finance is one of the major obstacles, which is focus of the present study. About, 45 to 55 percent of formal SMEs (11-17 million) in the emerging markets do not have access to finance from formal institutions. Moreover, about 55 to 68 percent of SMEs in developing countries are either financially underserved or not served at all, resulting in lost opportunity to realize their full potential (JWB-IDB, 2015).

International Finance Corporation (IFC) reported that, in Pakistan, 67 percent of SMEs are un-served, 22 percent under-served and only 11 percent are well served. A large proportion of SMEs are not getting any finance facilities because they are not satisfied with current financing options offered by financial institutions. However, out of 22 percent of SMEs who are able to access finance facilities, less than 20 percent are

satisfied. As a result, SMEs move towards non-financial services e.g. friends and family or personal savings. Few studies have been conducted by the scholars on the demand side of SME financing investigating the role of owner manager's behavior in financial decision making of SMEs. Within context of SMEs, most of the studies have focused on firm size, demographic and personal characteristics of owner-managers regarding their financial behavior (IFC, 2014a).

The purpose of this conceptual paper is to identify socio-psychological factors affecting SME owner-managers' behavioral intentions towards use of formal financing. The proposed model is supported by theory of planned behavior (TPB). The main objective of this study is to evaluate the extent to which SME owner-managers intend to use financial services; identify and understand socio-psychological factors that influence their intentions. Next sections define the context of study which presents a review of literature and develops the conceptual framework.

## **2. Financing for SMEs in Pakistan**

SMEs have been defined by the related institutions of Pakistan such as Federal Bureau of Statistics, Pakistan (FBSP) and Small and Medium Enterprises Development Authority (SMEDA). However, this study makes use of one stated by State Bank of Pakistan.

A small Enterprise employs not more than 50 persons with annual sales turnover up to Rs.150 million and finances can be extended up to Rs.25 Million (SBP, 2016). Whereas, a medium enterprise employs not more than 250 persons (for manufacturing and services firms) and 100 persons for trading firms. Annual sales turnover up to Rs.800 million and finances can be extended up to Rs.25 Million.

Across the world, generally three main sources of finances are used by SMEs. In Pakistan, small and medium firms have following options for financial needs.

- a) Formal sources: Banks and non-banks financial institution.
- b) Informal sources: Family and friends, advance payments from customers and credit from suppliers.
- c) Personal savings: Internal funds, retained earnings and equity.

In Pakistan, main source of financial services used by SMEs is banking sector. Several conventional and Islamic banks (both public and private) are operating to provide financial products and services to their clients. However, banks feel hesitation while offering financing services to small and medium firms. There are only 7 percent of SMEs in Pakistan who obtained formal credit from banks, compared to a much higher percentage in neighboring countries like India and Bangladesh where it stands at 33 and 32 percent respectively (Khan, 2015). Banks and other financial institutions 54 percent portfolio of total advances comprises on the corporate sector and only 19 percent of SMEs. Private and public banks are more supportive in providing finance to SMEs. Total outstanding SME financing is 69 percent in private and 25 percent in public sector banks (SBP-SME finance review, 2015).

International Finance Corporation (IFC) report highlighted that, a large proportion of SMEs (around 25 percent) are not taking any finance facilities due to religious factor or may be interested in Islamic financing. Though, Islamic banks are more careful while financing to SMEs (IFC, 2014a). Full-fledged Islamic banks share towards SME financing is only 2 percent as compare to Islamic banking divisions (IBDs) which is around 3 percent. IBDs financing ratio to SMEs increasing constantly, but full-fledged Islamic banks share is same from last three quarters. Statistics of SBP report (2014) uncovered that in Islamic banking industry most neglected sector is SMEs, as the financing share stands only 5.1 percent, though, percentage much higher towards corporate sector which is around 71.8 percent.

The reasons behind reluctant behavior of banks in providing finance is informal set up and less experience of SMEs, since most of the enterprises are quite young and unable to meet compliance requirements. Such limitations place this sector as a high risk borrower and banks show reserved behavior in lending to SMEs. Also owner-managers of SMEs do not show flexible attitude to financial institutions as they never maintain their records properly, most of the entrepreneurs are not much educated, hence they are not much aware about financial products and banking procedures. In addition, misalignment between banking products and consumers' needs as well as religious beliefs disapproving use of interest based banking. Lack of professional and management skills such as age, ownership and firm size also create problems while applying for financing from financial institutions (IFC, 2014b; Khan, 2015).

In Pakistan, SMEs prefer informal sources and personal savings to fulfill their financial needs to avoid banks lengthy procedures, non-supportive behavior and high interest rates. International Finance Corporation reported that in Pakistan 67 percent of SMEs are un-served means they are approaching non-financial services for their financial needs. Khan (2015) estimated that approximately 61 percent of informal finances are based on friends, relatives and family members followed by 30 percent landlords, professional money lenders, shopkeepers and merchants 2.12 percent. In informal financial sector small amount of credit for short period of time given by the lender without interest in case of borrowed from friends and family members. About, 90 percent of rural areas SMEs such as farmers obtain finances from informal sources or money lenders. These money lenders offer finance mostly for the rental machinery, purchase of fertilizers and working capital requirements. They never require any collateral like banks but at the time of harvesting they take share in profit and interest rate they offer is more than 5 times higher than interest rate offer by banks and other financial institutions (Khan, 2015; IFC, 2014a).

Despite, SMEs prefer informal market one of the reasons is low opportunity cost of equity as compare to formal sector financing options. Small businesses who have good business proposal they never approach financial institutions for financing purpose because of inflexible attitude and strict policies of financial institutions. Studies supported that SMEs financing demand from formal sector is low because they typically prefer to hire finance from informal sources (Kauser et al., 2012; Nkuah et al., 2013; Sherazi et al., 2012). Thus, several factors have impact on SMEs decisions towards usage of financial services such as firm size factors, personal and demographic characteristics and market factors. Next section discussion is based on these factors.

### **3. Financial decision making of SMEs**

SMEs owner/managers play a major and dominant role in firm decision making. The most preferable ownership pattern among SMEs in Pakistan is sole proprietorship, whereby owner-manager asserts key influence on all management and financial decisions of firms. According to the Neneh (2011), previously researchers have categorized the characteristics of SMEs' owner-manager into following:

- Demographic/social characteristics
- Behavioral/managerial characteristics
- Economic characteristics
- Human capital characteristics

Similarly, Islam et al. (2011) studied the almost same classification of variables for owner-manager characteristics:

- Demographic characteristic
- Individual characteristic
- Personal traits
- Entrepreneur orientation
- Entrepreneur readiness

Under these classifications the most commonly used characteristics in previous studies are age, religion affiliation ethnic group affiliation, educational level, culture, owner-manager experience and networking etc. (Ogubazghi & Muturi, 2014).

Most of the scholars in context of financial behavior and decision making of SMEs owner-manager never used any underpinning theory (Osman & Ali, 2008; Gair & Worthington, 2009; Xiang et al., 2011). Low & Mazzarol (2006) discussed owner-manager's preferences for finances by using Pecking Order Theory (POT). In this study, POT theory explained that for financing decisions there is a preferred hierarchy, in which internal finances are on the top. Few studies measure financial behavior of SMEs owner-manager by applying Theory of Planned Behavior (Brettel & Breuer, 2009; Jaffar & Musa, 2013 and Tolba et al., 2014). Thus, for better understanding of financial behavior of SMEs as influenced by socio-psychological factors of owner manager, there is need to further explore this area by using behavioral theories.

#### **4. Role of socio-psychological factors of owner-manager in financial decision making of SME's: A Critical Review**

SMEs that are individual proprietorship-based have single owner-manager. The owner manager assumes the dominant role in the firm's decision making process (Osman & Ali, 2008). Since its establishment, the most preferable ownership pattern among SMEs in Pakistan is sole

proprietorship. Therefore, it is possible that one of the key issues is lack of professionalization and formalization that may be linked with SMEs, owner-manager demographic characteristics, affecting their management and financial decisions. There is a growing concern in financial institutions for understanding factors influencing SME owner-manager's decision making regarding use/adoption of various financial products (IFC, 2014). Understanding SMEs' financial behavior towards various financial products is prerequisite for policy makers and managers of financial institutions. To understand financial behavior of SMEs, researchers (Ogarca, 2010; Gait & Worthington 2008; Abdulsaleh & Worthington, 2013; Jaffar & Musa, 2013; Low & Mazzarol, 2006; Ogubazghi & Muturi, 2014; Xiang, 2011) studied both demographic and firm level characteristics of SMEs.

Ogarca (2010) discussed that firms owners are central element of management processes. Large firms are more rationale than small and medium firms. In large firms, decision making is more formalized and less influenced by personal characteristics of owners/shareholders (Gait & Worthington, 2008). However, in small and medium firms the decision making process is opposite, whereas, small and medium firms decision affect by different factors such as firm level factors, personal and demographic characteristics of firm owner-manager as well as market elements.

Study revealed that firms who prefer profit and growth ask for additional finance as well as smaller and young enterprises face more problems while approaching for finances, because of firm size and age. Moreover, study found business objective is an important determinant which affects financial decision making of SMEs (Xiang, 2011). Along with firm characteristics demographic factors such as gender, age, education and experience of owner-manager influence SMEs financial behavior. For instance, female owner-managers used less capital than male owner-manager and face much more issues while applying for finances. Young, owner-managers are more likely to apply for finance and used own sources as well, but older one prefers their own personal savings or informal finance sources. Moreover, more educated and experienced owner-managers are more confident while dealing with bankers instead of those who have less experience and education (Abdulsaleh & Worthington, 2013; Ogubazghi & Muturi, 2014).



In context of Singapore, Low & Mazzarol (2006) studied socio-psychological factors and concluded that owner-managers rigid attitude affect growth of firm. Further stated that, owner-manager's personal characteristics effect their financial decision making, thus, management education and awareness of financial products/ services among owner-manager is an important issue. Study suggested that owner-managers should show flexible attitude towards financing decisions to get better financing offers from financial institutions. Similarly, in Pakistan, study examined that attitude of owner-manager considered as negative due to individual characteristics such as lack of knowledge, age and gender as well as firm level determinants have impact on SMEs owner-manager behavior (e.g. size of organization and nature of business) (Siddique et al., 2016).

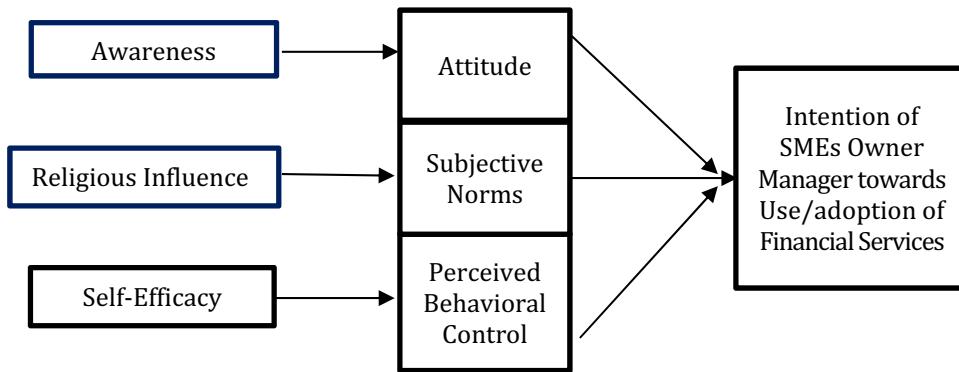
Correspondingly, scholars presented a conceptual model of SMEs owner-manager attitude towards Islamic financing. By applying, Theory of Planned Behavior (TPB) to understand the salient belief factors (e.g. awareness, religious obligations, cost benefits, business support and reputation) study supported that these attitudinal factors have strong impact on SMEs owner-manager financial decision making (Jaffar & Musa, 2013). Study by Ahad et al. (2012) explored the factors that influence SMEs intention to adopt mobile banking. Banking status, advantages for SMEs, perceived usefulness, perceived ease of use, perceived credibility, perceived risk, cost and demographic factors such as; age, gender, education, SME category, income, profession are the factors that have impact on intention of m-banking adoption. According to the findings of study banking status, perceived credibility, cost, gender, education and SME category are the significant factors.

Most of the above studies discussed about the non-supportive behavior of SMEs owner-manager and impact of their personal characteristics and socio-psychological factors. Unfortunately, there is limited studies that can clearly define attitude and behavior of SMEs owner-manager towards financial institutes. Available studies are either conceptual or providing very limited empirical evidences. Therefore, for better understanding to SMEs owner-manager behavior there is need to explain their financial behavior and socio-psychological factors affecting their attitude. This study aims to explain socio-psychological factors of SMEs owner-manager with help of underpinning Theory of Planned Behavior.

## **5. Linking Theory of Planned Behavior with SMEs' Financial Decision Making: The Proposed Model**

Ajzen & Fishbein (1975) identified some gaps during usage of Theory of Reasoned Action. Thus, in 1991, Ajzen extended Theory of Reasoned Action (TRA) into what is known as Theory of Planned behavior (TPB). Along with Ajzen, some other researchers (e.g. Godin & Kok, 1996) argued that TRA's assumption of an individual's self-control is insufficient to explain actual behavior in real life (Ajzen, 1988; 1991). Most of the behaviors lies between two extremes which are total control and lack of control totally (Godin, Valois, Lepage & Desharnais, 1992). For balancing of these observations, Ajzen (1985) added an additional determinant of intention perceived behavioral control (PBC). Spite of two different names, TPB and TRA are actually similar. TPB is a modified version of TRA in which Ajzen (1985) covered the flaws mentioned by researchers in their studies (Conner & Sparks, 2005). TPB has been also used by researchers extensively to measure behavioral intention and actual behavior as well as to find out further construct of variables.

The TPB has been extensively used by scholars to measure individuals' behavioral choices in different contexts (Souiden and Rani, 2015; Ya'gobi and Rad, 2015; Hockerts, 2015; Schlaegel and Koenig, 2013). However, there are a few studies which have applied it to understand and explain firms' behavior. To predict individual behavior, TPB is the most useable underpinning theory which makes it appropriate to explain behavioral intention of owner managers of small firms where owner manager's assert key influence in firm decision making. A meta-analysis by Southey (2011) mentioned very few studies which applied the TRA and TPB to examine the business decisions or behavior of firms towards financial, strategic and professional decision making. This study concluded that there is need to use the frameworks of these theories to design the behavioral models to explain decision making in small and medium enterprises (Southey, 2011; Jin et al., 2012). Present conceptual model is an extended model of TPB to predict SMEs owner-manager's financial behavior towards formal financing.



**Figure 1.** Conceptual Framework for Linking SMEs financial behavior with owner-manager's socio-psychological factors

### **5.1. Behavioral Intention**

Behavioral intention means persistent motivation of an individual towards performing certain behavior (Armitage & Conner, 1998). Study by Ajzen I (1991) explained that a person's intention to perform a certain behavior is the determinant of his/her actions. By understanding a person's intention it's easy to predict his/her behavior. In addition, this study explained that a person performs certain action according to his/her intention and it can be used as a proximal measure of behavior. But it doesn't mean that between intention and behavior there is always a perfect correlation as the construct of behavior also includes some other contingent factors (Francis, et al., 2004; Ajzen & Fishbein, 1980; Ajzen & Fishbein, 1977, Armitage & Conner, 1998).

### **5.2. Attitude**

Allport, (1935) defined that an attitude is a mental state of willingness to respond in a persistent manner to some situation or object. In context of SMEs financial behavior few scholars examined the influence of attitude of owner manager on financial decision of SMEs (Jaffar & Musa, 2013); Gait and Worthington (2008; 2009).

*Proposition 1: There is a positive relationship between attitude and SMEs owner-manager behavior towards usage of financial services*

### 5.2.1. Awareness

According to the Kotler & Armstrong (2001), a company needs to create customer awareness as a first step in order to influence customer preference, interest and desire towards a product. A customer with ability to recognize products brand and features has higher customer awareness. If a customer never spends time in getting information about products, he/she will have low level of awareness. People with more awareness, have strong intention towards usage of these products (Naser et al., 1999). Within context of present study, awareness is defined as knowledge and better understanding of financial products and services. Experts suggest to financial institutions that they should create better awareness techniques, which are influential in attracting customers (Haron et al., 1994; Ahmad & Haron, 2002).

*Proposition 1a: There is a positive relationship between owner-manager awareness and his/her attitude towards financial services*

### 5.3. Subjective Norms

Subjective norms are social values and their pressure which effect the customer decisions and behavioral intention (Ajzen, 1991). Subjective norm is an individual assessment regarding social and religious pressure to determine whether to perform or not perform a certain behavior (Ajzen & Fishbein, 1980). As an important factor of all intention based theories, researchers found mix results about subjective norms.

*Proposition 2: There is a positive relationship between subjective norms and SMEs owner-manager behavior towards usage of financial services*

#### 5.3.1. Religious Beliefs

Religion is a cause, principle, or a system of beliefs, practices held to with ardor and faith (Kirkpatrick, 2005). Moreover, religion is a psychological connection and dominant emotional relationship to things. Metawa & Almosawi (1998) found religion as main factor which affects

customer perception while selecting financial institution. This study further concluded that religiosity has highest rank among other factors. Similarly, Haron et al. (1994); Othmen & Owen (2001); Tara et al. (2014) found that religion is a major influential factor in adoption of financial products. Religion is an important factor which affects the consumer behavior towards banking products (Amin et al., 2011; Sun et al., 2011)

*Proposition 2a: There is a positive relationship between owner-manager's religious beliefs and his/her subjective norms towards financial services.*

#### **5.4. Perceived Behavioral Control**

The construct of Perceived Behavioral Control is exclusive as it serves in two case: 1) direct determinant of behavior and 2) predictor variable of intention (Ajzen, 1991). This construct's propositions got the higher attention from scholars such as it has been applied in the Protection Motivation Theory (Conner & Norman, 1996) and in model of Health Belief (Armitage & Conner, 2000). A study by Johan (2014), concluded that psychological factors such as attitude, subjective norms and perceived behavioral control influence consumer intention towards halal product compliance in financial service.

*Proposition 3: There is a positive relationship between perceived behavioral control and owner-manager's behavior towards financial services.*

##### **5.4.1. Self-Efficacy**

Self-efficacy or degree of confidence is the adopter's ability to make use of the initiative and innovation. Ajzen (1991) argued that it is positively related to perceived behavioral control. It is basically based on the past experience and attainment (Bandura, 1994). Self-efficacy is one of the most frequently studied characteristic of entrepreneur. Study examined that entrepreneurs and managers have higher confidence or self-efficacy as compared to non-entrepreneurs (Chen et al., 1998; Tyszka et al., 2011).

*Preposition 3a: There is a positive relationship between owner-manager's perceived behavioral control and his/her self-efficacy towards financial services.*

## **6. Significance of Study**

Theoretically, this research paper would add to the body of knowledge in the area of decision making behavior of SMEs in use/adoption of financial services. The proposed model of the study will enable better understanding of influence of socio-psychological factors of owner managers on intention to use financial services by SMEs. On the practical front, the study would be helpful to explain how these factors may affect financial decision making of SMEs' usage of financial services in Pakistan.

## **7. Conclusion**

This study integrates the socio-psychological factors with the Theory of Planned Behavior to develop a systematic approach in examining and predicting intention towards use/adoption of financial services by SMEs. The proposed model will be helpful for the governments, Central Banks and banking sector to work on new policies and procedures based on better understanding of socio-psychological factors that may constrain adoption of financial products by SMEs. The theoretical propositions need to be further scrutinized by using empirical data.

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## **BUSINESS ETHICS AND OPERATIONAL RISK MANAGEMENT IN MALAYSIAN LOCAL CONVENTIONAL BANKS**

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**ABSTRACT. Purpose:** This is a conceptual paper that discusses on the importance of business ethics and operational risk management in banks.

**Design/methodology/approach:** The paper review the literatures of business ethics and operational risk management in banks. The paper analyze the factors that lead to operational risk particularly internal frauds, operational risk management, issues related to business ethics, Machiavellianism, the relationship between business ethics and operational risk management in banks, Machiavellianism as the moderator and agency theory and Machiavellianism Intelligence theory as the underpinning theories.

**Findings:** A conceptual framework has been developed based on the literature review and the underpinning theories.

**Research limitations/implications:** The paper only concentrated in the banking industry in managing operational risk that is related to internal fraud. There are other variables that are not taken into consideration such as the quality of banks human resources and the internal control system. Future research can be done on the antecedent and outcome of operational risk management with business ethics as the antecedent of operational risk management and internal fraud as the outcome of operational risk management. Besides, future research on business ethics and operational risk management can be done in other industry such as education, manufacturing or logistic industries.

**Practical implications:** Banks could develop a robust operational risk management base on the dimensions of good business ethics. Machiavellianism variable as the moderator in the conceptual model will assists banks in identifying employees with high or low Machiavellianism personality traits.

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**Originality/value:** The proposed conceptual model helps banks to ensure the future risk of internal fraud occurrence can be eliminated. For future recruitment, banks might consider having personality test in identifying those applicants that might demonstrate high or low Machiavellianism when hired as bank employees.

**Keywords:** Operational Risk, Operational Risk Management, Business Ethics, Machiavellianism

**JEL Codes:** G30, G31

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## 1. INTRODUCTION

In the pursuit of profits and success in the business world, organizations especially banks will encounter risk in daily operations. Risk is about the ambiguity of a future result (Doerig, 2001). Vatsa (2004) defines risk as the likelihood of injury, damage, or loss and the probability that a particular unfavorable event occurs during a specified period of time, or results from a particular challenge. Even though risk is unavoidable but it can be managed. Risk management is an important practice that is needed to be implemented in banks. It helps in assuring the reliability of the operations and procedures being followed. According to Eccles et al. (2001), in the contemporary world of business, banks are exposed to a large number of risks such as:

(1) Market risk: Deals with the uncertainty of future earnings due to the changes in the value of financial instruments caused by movements in market parameters.

(2) Credit risk: Deals with the risk of loss that occur when an obligor fails to meet the terms of a financial contract or otherwise fails to perform as agreed.

(3) Operational risk: Deals with a wide-ranging of risk category pertaining to human error, management, or deficiencies in operating system.

4) Accounting risk: Related to the concerns on the using of estimates in preparing financial statements.

All these risks become the source of threat for a bank's sustainability and success (Shafiq & Nasr, 2010; Al-Tamimi & Al-Mazrooei, 2007).

Thus, one of the risks that are important and required for banks to manage is operational risk. According to Institut Bank- Bank Malaysia (IBBM) (2010), operational risk can be defined as (i) the risk that is resulted from the shortcomings in information systems and internal control system or from external events such as frauds that will lead to unanticipated losses. (ii) the risk that is related to either human errors, system failures and inefficient procedures which occur due to the breakdown in the internal control procedures either in the front, middle and or back office activities that can lead to unanticipated losses. Operational risk management is a framework that can detect the most critical operational risks to the organization in a timely manner and report effectively to all required individuals at the different levels of management with adequate information for taking necessary actions (Aung, 2008). As a result, operational risk can also be regarded as a weakness of the financial institution that can be reduced or eliminated through a proper management (Nicoletta & Cornelia, 2007).

The term operational risk surfaced in 1995 following the notorious scandalous collapse of Barings Bank, one of the U.K.'s oldest financial institutions due to the unethical behavior of Nick Leeson, a trader in the Barings Bank that committed internal fraud. Basel Committee (2003) defined internal fraud as dishonest or fraudulent acts committed by employee/s. Nick Leeson caused the bank to lose around U.S. \$1.3 billion and forced Barings into bankruptcy (Bhugaloo, 2011). In India, Satyam, a giant company that was listed among the top 13 Best-Managed companies in India, collapsed due to the management's internal fraud of the company and its stock holders financially. The management of the company displayed unethical behavior by fabricating accounts to showed large cash and fixed deposit balances in their balance sheets when in reality the company had no such balances. The financial fraud included overstating the company's cash balances by over 1 billion dollars, overstating number

of employees by more than 13,000 and withdrawal of the ghost employee salaries by the firm's top managers, inflating revenues by falsifying invoices and forging of the company's bank fixed deposit receipts (Goel and Ramanathan, 2014). In Malaysia, one of the notorious internal fraud case was done by an RHB Bank manager, Tan Khay Guan. He committed internal fraud at the Mergong branch in Kedah between April 5 and September 23 2004. Acting as the branch manager, Tan opened two current accounts without authorization and approved drafts valued at RM21 million to these accounts. RM19.3 million was transferred to a Rockwell and Bond Bank of East Asia account in Hong Kong with the intention to buy shares. He was arrested at the Bukit Kayu Hitam border checkpoint on October 31 2004 when trying to escape from the country (<http://malaysiacrimewatch.lokety.com/bank-manager-fined-record-amount-for-criminal-breach-of-trust/>).

According to KPMG (2013), the most common factors that contributed to the unethical behavior were poor communications of organization's values or codes of ethics/code of conduct (81%), poor example shown by senior management (43%) and poor ethical culture within the organization (38%). Thus, the unethical business practice of internal fraud committed by Nick Leeson and others has raised the issue on the importance of good business ethics. It deals with the morality of an organization, from top management to the employees. Business ethics can be defined as a set of moral actions of an individual, as the element of a collective, that a person conforms while performing business activities without jeopardizing the business relationships within the business system and the broader environment (Bozovic, 2007). There are three types of business ethics issues which include systemic, corporate and individuals (Velasquez, 2012).

The main motive of the perpetrators committing internal frauds is mainly driven by the desire of living beyond their means and they are good manipulators. Thus, the perpetrators demonstrate the personality traits of Machiavellianism. According to Farah Ali et al., (2009), Machiavellian individuals are successful manipulators characterized by lack of interpersonal affect in interpersonal relationships, lack of concern with conventional morality, lack of gross psychopathology, and low ideological commitment. The perpetrators do not consider their acts as against business ethics or moral standards and perceived 'the end justifies

the means'. Thus, Machiavellian individual motivation can be considered as cold selfishness or pure instrumentality. Rather than having a unique set of goals, individuals high in Machiavellianism were assumed to have typical intrinsic motives (e.g., sex, achievement, and sociality). Whatever the motives, the Machiavellians pursue them in deceitful ways.

In a previous study, case study approach has been done to study operational risk management in one of a bank in Malaysia (Abu Hassan and Abdul Aziz, 2008) The study proved that continuous monitoring and appropriate inspection and rectification should be part of the package to manage operational risks effectively. In addition, employee involvement in the bank also plays a significant role in any enforcement of risk management practice. Case study approach was also used by Chalupka and Teply (2008) to study the operational risk management implementation in of a bank in Central Europe. Their study focused on the loss distribution approach and extreme value theory and found that the bank was facing strong exposure to operational risk events. Rosman (2009) in his conceptual paper stated that future research is needed in determining the risk management practices in banks.

In one of the business ethics study, Goel and Ramanathan (2014) explored the concepts of business ethics and corporate social responsibility (CSR) with a perspective that meaningfully CSR should be seen in the context of an overall paradigm of business ethics. They studied CSR through the framework of the stakeholder theory of the firm and postulate that the current CSR practiced by organizations is a division of business ethics with other dimensions of an overall ethics framework still not discovered. Berger and Herstein (2013) implied that religion and culture can influence ethical behavior in business particularly in India.

Previous study of Machiavellianism personality traits investigated the relationships between Machiavellianism, trait emotional intelligence and empathy, using an image task that required an appropriate empathic response to the emotional displays of others (happy, sad and neutral). Results indicated that Machiavellianism were positively associated with the experience of positive affect from sad stimuli (Farah Ali et al., 2009). O' Boyle et al. (2012) found that reductions in the quality of job performance were consistently associated with increases in Machiavellianism.

To the best of the author's knowledge, no previous studies have been done looking on the relationship between business ethics and operational risk management and the moderating effect of Machiavellianism



personality traits on the relationship between business ethics and operational risk management in Malaysian conventional banking industry. Base on the above discussions on the various knowledge and theoretical gaps to be filled in the paper, the author postulated business ethics as the independent variable while operational risk management is the dependent variable and Machiavellianism personality trait as the moderating variable.

The remainder of the paper will analyze on the factors that lead to operational risk particularly internal fraud, operational risk management, issues related to business ethics, Machiavellianism, the relationship between business ethics and operational risk management in banks, moderating role of Machiavellianism, agency theory and Machiavellian Intelligence theory as the underpinning theory. A conceptual framework will be proposed based on the existing literature review.

The conceptual model presented in this paper will help organizations especially banks in incorporating business ethics as the foundation for a good operational risk management. Furthermore, this model will assists banks in identifying employees that are prone to commit frauds.

## **2. LITERATURE REVIEW**

This section will be discussing on the literature review of each variables and the underpinning theory.

### ***2.1. Operational Risk In Banks***

The Basel Committee (2003) defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events including legal risk but excluding strategic and reputational risk. On the other hand, the operational risk is a term that has a variety of meanings within the banking industry, thus for internal purposes banks may choose to adopt their own definitions (Doerig, 2001). This internal definition should take into consideration of specific situation of every bank, such as its size, and sophistication, its nature and complexity of its activities in an economic manner, considering the full range of material operational risks facing the bank and captures the most significant causes of severe operational losses (Doerig, 2001).

Other than the scandalous collapse of Barings Bank, the U.S. \$7 billion losses at Société Générale because of the unethical business practices of Jerome Kievel, demonstrates the flaw in managing operational risk (Medova & Berg-Yuen, 2008). Furthermore, the losses of \$US691.2m at the Allied Irish Banks (AIB) in 2002, and \$A360m losses at the National Australia Bank (NAB) in 2004, led to serious aftermaths for the institutions. In each of the cases, the losses are due to the actions of a single individual or groups of individuals acting in accordance with the incentives incorporated in their remuneration schemes (Ford, 2007).

Potential risks associated with the elements in operational risks are shown in Table 1.

**Table 1.** Potential Risk Associated With the Elements of Operational Risk

<b>Elements</b>	<b>Potential Risks</b>
Process	Breach of mandate Incorrect/untimely transaction capture, execution, and settlement. Loss of client assets. Mispricing. Incorrect asset allocation. Compliance issues. Corporate action errors. Stock lending errors. Accounting and taxation errors Inadequate record-keeping Subscription and redemption errors
People	Unauthorized trading Insider dealing Fraud Employee illness and injury Discrimination claims Compensation, benefit, and termination issues. Problems recruiting or retaining staff. Organized labour activity Other legal issues

<b>Elements</b>	<b>Potential Risks</b>
Systems	Hardware and/or software failure. Unavailability and questionable integrity of data. Unauthorized access to information and systems security. Telecommunications failure. Utility outage Computer hacking or viruses
External Events	Operational failure at suppliers outsource operations. Fire or natural disaster. Terrorism. Vandalism, theft, robbery.

Adapted from "Basel II: A Closer Look: Managing Operational Risk" by, KPMG, 2005, p. 7.

Moazinezhad et al., (2012) stated that risks in banking sector are different as compared to the other economic aspects, due to the following reasons; the number and variety of banking operations, different natures of banking operation, the capital position of banks and its limitation, protecting the interests of bank shareholders, status of depositors' resources and their frequency, maintaining depositors' interests and lastly variety in interests of banks and depositors. Banks are concentrating on operational risk because the exposure and effects can be fatal. Therefore, it has become one of the main risks of the financial sector (Karam & Planchet, 2012). According to Basel II (Basel Committee, 2003) there are 7 loss event types due to operational risk that can be faced by the banks. It is summarized in the following Table 2.

**Table 2.** Loss Event Types

<b>Loss Types</b>	<b>Event</b>
Internal fraud	Unauthorized activity such as fraud or theft. It involves a criminal act aimed at benefiting the perpetrator and aimed at causing a loss. At least one perpetrator is an employee. Example includes, falsifying personal details for personal gain, theft of bank assets and unauthorized use of computer systems for fraudulent activities.
External fraud	Losses due to acts that intended to defraud, and misappropriate property by a third party. It includes hacking by third party, theft of information and forgery or impersonation.

<b>Loss Types</b>	<b>Event</b>
Employment practices and workplace safety	Losses arising from acts inconsistent with employment, health or safety laws or agreement, or from payment of personal injury claims or from diversity and discrimination events. For example failure to adhere to equal opportunity policies such as religion, sex, age and race.
Client products and business practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific client, improper market practice and product flaws. It includes regulatory fines, customer complaints and breach of Anti Money Laundering Act.
Accidents and disasters	Losses arising from loss or damage to physical assets from natural disaster or accidents.
System failures	Losses arising from disruption of business or system failures such as hardware fault, telecommunication failure, and utility outage that can cause business disruption.
Execution delivery and process management	Losses from failed transaction processing or process management and involving no act aimed at benefiting or causing a loss for any party. It includes, data entry error, system errors in transaction process, ineffective documentation of processes, failure to provide accurate external reporting, failure to ensure effective contract documents, inaccurate customer records, incomplete mandatory reporting and poor management decisions or oversight.

Adapted from, "Operational Risk Transfer Across Financial Sectors", by Basel Committee, on Banking Supervision the Joint Forum, 2003, p. 31.

Currently, the Basel Committee framework provides three approaches for the operational risk capital charge measurement. The straightforward approach is the Basic Indicator Approach (BIA), by which the capital charge is calculated as a percentage (alpha) of Gross Income (GI), a proxy for operational risk exposure. Being the most basic approach, its adoption does not require prior supervisory approval. The most advanced methodology is the advanced measurement approaches (AMA), which allows banks to use internal models to calculate their capital requirements. Adoption of the AMA requires prior supervisory approval and involves implementation of a rigorous risk management framework. The third approach, the Standardized Approach (TSA), which is positioned as an intermediate approach between the BIA and the AMA, requires banks to divide their total GI into eight business lines

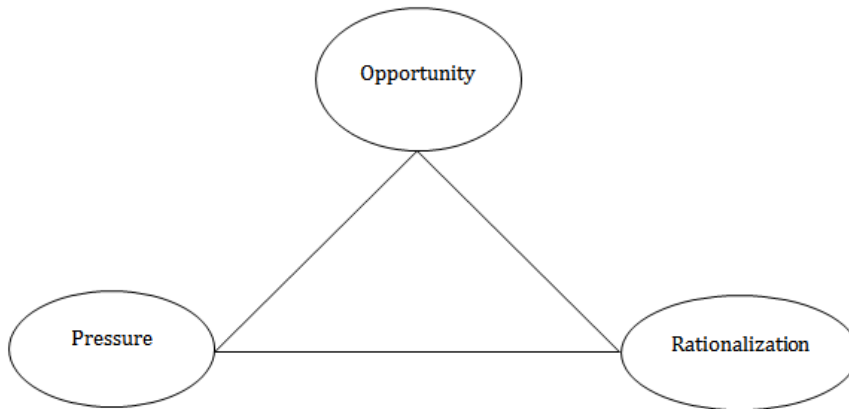
and to calculate capital requirements as a sum of the products of the GI attributed to each business line and the specific regulatory coefficients (betas) assigned to each line. Since the adoption of the TSA requires compliance with a set of qualitative criteria relating to operational risk management systems, banks are required to obtain prior approval from their supervisory authorities before moving to this approach. A variant of the TSA, the Alternative Standardized Approach (ASA), allows banks with high interest margins to calculate their operational risk capital requirements by replacing the GI for two business lines – retail banking and commercial banking – with a fixed percentage of their loans and advances. Adoption of the ASA is allowed by the respective supervisory authorities at their national discretion (Basel Committee, 2014).

### *2.1.1. Internal Fraud*

Banking industry is one of the industries that is highly expose to internal fraud (Kingsley, 2012). According to the Association of Certified Fraud Examiners (ACFE) as mentioned by DiNapoli (2008), internal fraud can be defined as the use of one's (employee) profession for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets. Internal fraud involves with a range of irregularities and unlawful acts characterized by intentional deception. The five elements of internal fraud are:

- A representation about a material fact, which is false,
- Made intentionally, knowingly, or recklessly,
- Which is believed,
- And acted upon by the victim,
- To the victim's damage.

According to Duffield and Grabowsky (2001), the act of committing internal fraud is due to the factors such as a supply of motivated offenders, the availability of suitable targets, and the absence of capable guardians or a control system to "mind the store." DiNapoli (2008) stated that there are four factors that can lead an employee to commit internal fraud which includes opportunity, low chance of getting caught, rationalization in the fraudsters mind, and justification that are resulted from the rationalization. Cressy (1953) developed "The Triangle Fraud" to describe and explain the nature of fraud. "The Fraud Triangle" is depicted in the following figure 1:



**Figure 1.** The Triangle Fraud. Adapted from “Other People’s Money: A Study in the Social Psychology of Embezzlement”, Cressey, D.R. 1953, Free Press, Glencoe, Illinois.

From figure 1, opportunity can be described as an open door for solving a non-shareable problem in secret by violating a trust. Opportunity is generally provided through weaknesses in the internal controls. Some examples include inadequate or lapses in supervision and review, separation of duties, management approval and system controls.

Pressure can be described as anything from unrealistic deadlines and performance goals to personal vices such as gambling or drugs. While rationalization is a crucial component of most frauds because most people need to align their behavior with the commonly accepted concepts of decency and trust.

In Malaysian banks, internal fraud usually involves with employee/s stealing cash or cash equivalents such as cashiers order or bank draft. Besides, internal fraud can be committed through the use of accounting entry. Employee with specific position may have privileged access to suspense accounts or accounts payable, which is temporarily function as interdepartmental transfers, cash in transit or loans in process. Internal fraud is also known as occupational fraud and insider abuse. If the types of fraud are considered, it ranges from identity theft, cheque fraud, counterfeit negotiable instruments, mortgage fraud, loan fraud, asset misappropriation, corruption, money laundering, credit card fraud and etc. (Zuraidah Mohd Sanusi et al., 2015)

## ***2.2. Operational Risk Management in Banks***

Operational Risk Management contains the mechanisms, tools, policies, procedures and processes, including management oversight, to identify, assess, monitor, report, and control operational risk. Taking into consideration the losses suffered in previous years, the banks has established operational risk management as the main objectives: a higher capital profitability, a better capital allocation, the avoidance of the unanticipated losses, the avoidance of a big number of losses of small value, the improvement of the operational efficiency; a higher attention for the operational risk during the banking management process; the increase of the services quality for the clients; an efficient information and human resources management (Nicoleta & Cornelia, 2007). However, operational risk management is not a new idea but what is new is the organization of the mechanisms of operational risk in a coherent and structured framework to accelerate the efficiency of the operational risk management (Bodla & Verma, 2008).

Moazinezhad et al, 2012, stated that the paradigm or model of risk management consist of a set of tasks which are a subsequence of chained activities throughout the lifecycle of a mission. Activities include:

- Activity 1: Identifying risks  
Investigating and detecting risks, before they turn to problems.
- Activity 2: Analysis  
The conversion of risk data into useful decision-making information. Evaluation of the impact levels, the likelihood and time limit of risk, classifying, and prioritizing them.
- Activity 3: Planning  
Compiling the risk data to decisions of current and future activities and applying them.
- Activity 4: Tracking  
Scrutiny of risk indices and reducing activities.
- Activity 5: Control  
Reform of deviations toward reducing-risk programs.
- Activity 6: Communications  
Information and feedback from external and internal risk activities provides existed and arisen risks.

Basel Committee (2014) has set expectations for the implementation of the operational risk management. All internationally active banks should implement policies, procedures and practices to manage operational risk according to their size, complexity, activities and risk exposure, and seek continuous improvement in these areas as industry practice evolves. In order to enhance operational risk management, the committee provide comprehensive guidance regarding the qualitative standards that should be observed by large internationally active banks. The Committee considers it appropriate to achieve more definitive, rigorous and comprehensive implementation of operational risk management by setting out specific guidance to be followed by large internationally active banks.

Bank Negara Malaysia (BNM) has placed great emphasis on risk management. The ultimate aims are to enable operative and effective delivery on the mandates of banks while safeguarding the assets and reputation of banks. Therefore, BNM continued to strengthen its risk management governance framework to ensure that it is adequately strong to face the challenges ahead. BNM also undertook initiatives to further enhance its risk management culture, including further embedding risk management processes into all strategic initiatives, policy making and operations of banks. The overall framework sets out the general principles and processes to ensure consistent and effective management and oversight of risks in the Bank. Operational Risk Management and Financial Risk Management frameworks are designed to provide greater transparency in managing specific risk types. Greater efforts were made towards creating increased clarity across the organization about risk events that could impact bank's reputation. This would enable banks to develop a more systematic approach in understanding the nature of the specific reputational risk event and direct resources to address the root causes. A key component in this initiative is the formulation of the Stakeholder Engagement Framework. BNM foresees greater challenges in managing the risks that are dynamic in nature as well as in building the right risk management culture. Therefore, BNM has developed an Operational Risk Reporting System to Report any operational risk event and loss reporting system, for increased surveillance capability as well as for information sharing with the industry. This system has been in operation since January 2013 and has been acknowledged by World Bank and International Monetary Fund ([www.bnm.my](http://www.bnm.my)).



### **2.3. Business Ethics in Banks**

According to Velasquez (2012), business ethics is a study of right and wrong that are applied to business policies, institutions, and behaviors. This is an important study due to the nature of business as the most influential institutions within modern society. Besides, business organizations are the primary economic institutions through which people in modern societies carry out the tasks of producing and distributing goods and services. They provide the fundamental structures within which the members of society combine their scarce resources—land, labor, capital, and technology—into usable goods, and they provide the channels through which these goods are distributed in the form of consumer products, employee salaries, investors' return, and government taxes. Though business ethics cover a variety of topics, there are three basic types of issues:

1. Systemic issues — Related to the economic, political, legal, or other social systems in which businesses operate. These include questions about the morality of capitalism or of the laws, regulations, industrial structures, and social practices within which businesses operate.

2. Corporate issues — Related to a particular company. These include questions about the morality of the activities, policies, practices, or organizational structure of a company.

3. Individual issues — Related to a particular individual within an organization and their behaviors and decisions. These include questions about the morality of the decisions, actions, or character of an individual.

Organizations and business people who thrive for sustainability must practice sound ethical decision-making. Organizations and people who behave in a socially responsible manner will enjoy the greatest success as compared to those whose actions are solely motivated by profits. Knowing the difference between right and wrong and choosing what is right is the foundation of ethical decision making in business. Thus, doing the right thing often leads to the greatest financial, social, and personal rewards in the long term (Hejase et al., 2013).

The banking industry proved that success can be achieved by incorporating high ethical standards when delivering quality services, good customer service, management duties, staff qualifications, and the staff appreciation of their work. Failure to follow ethical norms and lack of

business transparency were among the reasons that lead to the global financial crisis. Confidence in banks is the key to success. It is indeed a challenging task in ensuring the safety of the banking activities. The ongoing processes of global integration, internationalization, and continuous financial innovations directly affecting banking operations. As a result, the solution to the banks' problems rest on the attitude and confidence of the market players. Among other things, the rating of confidence in banks greatly depends on skilled supervision (Jasevičienė, 2012).

Svensson and Wood (2008) introduced business ethics dimensions that include three components: society expectation, organizational culture and society evaluations. The components contributes to the creation of a conceptual framework of business ethics. The components can be affected by people behaviors and perceptions. The outcomes of the framework are determined by the evolution of time and contexts. A few tentative conclusions may be drawn from the dimensions.

#### **2.4. Machiavellianism**

Machiavellianism personality traits are first introduced by Niccolo Machiavelli's (1532/1950), the author of *The Prince*. The book acts as a guidance for those attempting to seize and retain political power. His ideas were based on historical events rather than philosophical idea. He suggested that even a morally righteous man must make deliberate use of ruthless, amoral, and deceptive methods when dealing with unscrupulous men. The Machiavellian personality is defined by three sets of interrelated values: an avowed belief in the effectiveness of manipulative tactics in dealing with other people (e.g., "Never tell anyone the real reason you did something unless it is useful to do so"), a cynical view of human nature (e.g., "It is safest to assume that all people have a vicious streak and it will come out when they are given a chance"), and a moral outlook that puts expediency above principle (e.g., "It is hard to get ahead without cutting corners here and there") (O'Boyle et al., 2012). Machiavellians individuals are emotionless, realistic, and have skeptical perspective on life and interpersonal relationships that justified their behaviors in exploiting others and acting in immoral ways (Rauthman, 2012).

O'Boyle et al., (2012) stated that Machiavellians individuals are successful in their careers, especially when they are working in unstructured

and less organized settings. However, as the organizational structure increases, their success tends to decline. Machiavellians will be less productive and are more likely to display negative workplace behaviors no matter what their level of authority or the degree of collectivism in the organization where they worked. However, Machiavellians do not regularly engage in extremely negative forms of antisocial behavior (Jones & Paulhus, 2009).

## ***2.5. The Relationship between Business Ethics and Operational Risk Management***

Business ethics acts as a governance for a good operational risk management. The components of business ethics that include: society expects; organizational culture; and society evaluations provide the foundations in managing operational risk in banks. Thus the paper hypothesized the relationship as follow:

H1: The higher the business ethics the better the operational risk management.

### *2.5.1. Society Expectation and Operational Risk Management*

Society have high expectations towards business and the business leaders (Svennson & Wood, 2008). Thus customers expected banks to protect their deposits. Customers trust are important for banks sustainability. Banks are the custodian of customers' money and investment while employees acting on behalf of bank management in performing their services to the customers. Socially responsible managers will ensure that their actions are appropriate and truthful as expected by the society (Svennson & Wood, 2008). Thus, it is the responsibility of the banks to develop good operational risk management in mitigating risk and gain trust from customers. Besides, shareholders are also part of the society and investors of the organization. Shareholders invest in an organization they trust. Many cases involving shareholders being cheated by executives who end up collapsing the organizations and escaping with the illegal gain. Shareholders deserve organizations that protect them because they are entitled to a return on investment at the market rates or better. If such returns are not forthcoming, then open and early disclosure is required to enable shareholders to be able to assess their own positions. Good organizations do this for all shareholders

regardless of institutional shareholders or others. The welfare of all shareholders should be treated equally regardless of the size of the shares that they own (Svennson & Wood, 2008). Hence, the relationship is hypothesized as follow:

H1a: The higher the society expectation the better the operational risk management.

### *2.5.2. Organizational Culture and Operational Risk Management*

Organizational culture is very important for an organization (Svennson & Wood, 2008). It is the “set theory” of important values, beliefs, and understandings that members share in common, that provides better (or the best) ways of thinking, feeling and reacting that could help managers to make decision and arrange activities of organization. A successful organization should have strong cultures that can attract, hold, and reward people for performing roles and achieving goals. Strong cultures are usually characterized by dedication and co-operation in the name of common values in order to overcome problems or challenges in the organizations (Sun, 2009). Operational risk is therefore a major problem and threat to the banks. One of the banks objective is to manage risk. Good organizational culture is the foundation of a good operational risk management. Hence, the relationship is hypothesized as follow:

H1b: The better the organizational culture the higher the operational risk management.

### *2.5.3. Society Evaluations and Operational Risk management*

There are standards that members of society use in evaluating the performance of an organization. In many cases, this evaluation is not a conscious one, but one that develops as one is made aware of incongruities and inconsistencies in the ways in which for example the organizations profit has been achieved. The questions at the center of these issues include: What have been the economic outcomes of their actions?; Has their behavior been lawful?; Are they better corporate citizens than they were?; Have they paid the appropriate taxes?; Has the company been environmentally friendly?; Have they retained good employees?; Have services to customers been retained?; Are their products acceptable to us from a health and safety perspective? (Svennson & Wood, 2008). Therefore,

banks must prove to the customers that they are highly responsible and proactive or reactive to customers' needs and demands. Hence, the relationship is hypothesized as follow:

H1c: The higher the society evaluations the higher the operational risk management.

### ***2.6. Machiavellianism Personality Traits as a Moderator***

Previous studies have found that Machiavellianism personality traits has a moderating effect, although studies are not on the issue of banks operational risk management. In a study done by Wei and Chen (2011) among 216 middle school 7th-graders in Taipei, Taiwan on the relationships between bullying, peer acceptance, and school adjustment (rule-following behavior and academic performance), it was found that The participants were divided into two groups according to their Machiavellianism. Analysis showed that for those who were low in Machiavellianism condition, physical and verbal bullying was negatively linked to peer acceptance and academic performance while no significant association was found for the high-Machiavellianism group. Bullying was negatively, yet non-significantly, associated with rule-following behavior for both groups. The results largely supported the moderating effect of Machiavellianism on the negative outcomes of bullying. Hartog and Belschank (2012) in a study done on work engagement and Machiavellianism in the ethical leadership process also found the moderating effect of Machiavellianism. The notion that Machiavellianism as the moderator is supported because it was found that the effects of ethical behavior on engagement are less strong when ethical leaders are high as opposed to low on Machiavellianism. Based on the literature, the paper hypothesized as follow:

H2: Machiavellianism moderates the relationship between business ethics and operational risk management.

### ***2.7. Agency Theory***

In the paper, agency theory is use to explain the relationship between business ethics and operational risk management. The origin of agency theory can be traced back to its roots in information economics (Eisendhart, 1989). Agency theory is related to the universal agency relationship between one party (the principal) who delegates work to another (the agent),

who in turn performs the delegated task. Agency theory ultimate priority is to resolve problems that can occur in agency relationships. Agency problem includes; (i) the desires or goals of the principal and agent conflict and (ii) it is difficult or expensive for the principal to verify what is currently been done by the agent. The main problem is that the principal and the agent may prefer different actions because of the different risk preferences (Eisendhart, 1989). Thus business ethics act as the principal and operational risk management is the agent.

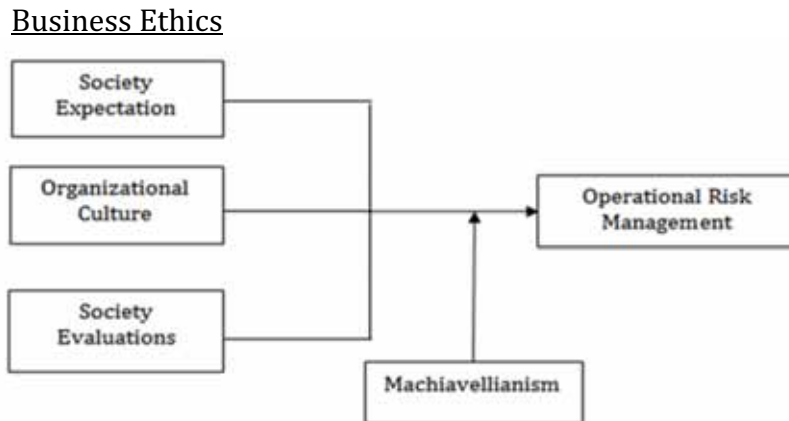
According to Sheedy (1999), agency risks are correlated with information asymmetry and agency problems mostly happen in a large public company. Failure by agents to act in accordance to the interests of principals covers a wide range of behavior which includes avoidance, carelessness, and inappropriate decisions (Sheedy, 1999). In financial institutions, operational or agency risk can be managed using an agency framework. It is because operational or agency risk is the main cause of operational losses. The risk includes breaches of company policy, incomplete information and poor management decisions (Sheedy, 1999). Therefore, agency theory not only helps to identify situations where agency risk is high but also suggests principles for the problem reduction through effective organizational structures (Sheedy, 1999).

### ***2.8. Machiavelli Intelligence Theory***

The Machiavellian intelligence theory (or the “social brain” hypothesis) postulates that large brains and unique cognitive abilities of humans have evolved via intense social competition in which social competitors developed increasingly sophisticated “Machiavellian” strategies as ways to achieve higher social and reproductive success (Gavrilets and Vose, 2006). According to this hypothesis, one of the important increasing pressures on human cognition is the risk of manipulation and deception. Manipulation and counter-measures to manipulation evolved in an “arms race” that led to greater intelligence. That is, as the social intellect in some members of a community increase, so will the application of selection pressures on others to show their social capability, thus resulting in the “arms race” of our Machiavellian intelligence over time (Santhalingham, 2009). Thus, the Machiavellianism intelligence theory clearly explained the reasons behind those internal fraud cases in banking industry as depicted by the unethical behavior of Nick Leeson and Tan Khay Guan.

### 3. Proposed Conceptual Framework

Based from the literature review and the underpinning theories, the paper proposed a conceptual framework. It is depicted in the following figure 2.



**Figure 2.** Proposed Conceptual Framework

From figure 2, business ethics dimensions (society expectation, organizational culture and society evaluations) become the independent variables while operational risk management is the dependent variable. Machiavellianism act as the moderator in the relationship between business ethics and operational risk management.

### 4. Limitation and Future Research

Like most papers, the author has found some limitations. Firstly the paper only concentrated in the banking industry. It is due to the wide range of operational risk and losses faced by the banks. Secondly, the paper concentrated on managing operational risk that is related to internal fraud because the impacts and losses can leads to high losses and even the collapse of a bank as depicted in the Baring Banks and SocieteGeneral cases. Lastly, there are other variables that are not taken into consideration such as the quality of banks human resources and the internal control system. Future research can be done on the antecedent and outcome of operational

risk management with business ethics as the antecedent of operational risk management and internal fraud as the outcome of operational risk management. Besides, future research on business ethics and operational risk management can be done in other industry such as education, manufacturing or logistic industries.

## 5. Conclusions

It is hope that the paper will shed some lights on operational risk management and business ethics. The paper also highlighted on the Machiavellianism personality traits that are behind the internal fraud cases in banks. Based from the conceptual model, it is hope that banks could develop a robust operational risk management base on the dimensions of good business ethics. By including Machiavellianism variable as the moderator in the conceptual model, it will assists banks in identifying employees with high or low Machiavellianism personality traits. This is to ensure that the future risk of internal fraud occurrence can be eliminated. Furthermore, for future recruitment, banks might consider having personality test in identifying those applicants that might demonstrate high or low Machiavellianism when hired as bank employees.

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## **SOCIAL AND INDIVIDUAL FACTORS THAT INFLUENCE BOARD PARTICIPATION BEHAVIOUR IN THE CO-OPERATIVE GOVERNANCE**

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**ABSTRACT.** This review paper expanded knowledge and improved understanding of active participation behaviour among Board of Director (BOD) in the governance of co-operative organization. To understand the role of BOD in the co-operatives' governance structure, we began this paper with the introduction of philosophy, universal values and principles of co-operatives. The formation of the co-operative organization is briefly described to illustrate the importance of member participation in the governance. Current issues related to participation based on research findings were discussed to illustrate the importance of this study. The concept of participation in previous studies was reviewed to develop an operational definition of active participation behavior in the co-operative governance. BOD is responsible for carrying out its functions on a voluntary basis and some of their roles are the attending of meetings, having open communication, giving constructive ideas and solutions, being involved in decision making and as well as performing tasks in a team. Several factors were highlighted to explain the BOD participation phenomenon in the co-operative organizations using relevant theories. The Social Capital Theory (SCT) and Mutual Incentive Theory (MIT) were described briefly in this paper to explain the social factors and individual factors in shaping active participation behaviour. Finally, this paper suggested that further studies can be conducted to explore other factors that could explain the participation behaviour especially in the governance of co-operatives that can contribute to the theory and existing knowledge.

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## 1. INTRODUCTION AND REVIEW OF LITERATURE

Studies on social capital based organizations show that public participation plays a vital role in the development of a community (Mori, 2014; Saidu, Samah, Redzuan, & Ahmad, 2014). Participation in co-operative became an important phenomenon for behavioral studies and often attract the attention from researchers (Birchall & Simmons, 2004b; Cechin, Bijman, Pascussi, Zybersztajn, & Omta, 2013; Simmons & Birchall, 2007). Participation of BOD became a vital element in the co-operative movement through the philosophy, principles and values shared by members of this organization (Choi, Choi, Jang, & Park, 2014; Neville & Neville, 2011).

This paper will explore the concept of participation in the co-operative governance, which explains the importance and benefits of participation to the members and the organization. This article will also enhance the understanding of the concept of voluntary participation in the governance of the co-operative. Numerous authors note that there has been limited empirical study of the actual behaviour of board directors performing their task (Cabrera-fernández & Martínez-jiménez, 2016; Petrovic, 2010).

## 2. THE CO-OPERATIVE PHILOSOPHY, PRINCIPLES AND STRUCTURE

A co-operative society is an organization that has played a significant role in realizing the economic prosperity of the people. As a self-help organization, participation in co-operative will optimize the utilization of the economic potential of its members. The co-operative

role is to develop and build the capacity and potential of co-operative members in particular and society in general to improve the socio-economic welfare (Md. Salleh, Arshad, Shaarani, & Kasmuri, 2008).

A co-operative member owns and controls the business democratically as a patron. Members will receive their profit in proportion to their use, or “patronage,” of the cooperative's services. In some countries, some cooperatives are treated as a type of nonprofit organization. This is because the co-operative’s primary objective is to provide goods or services at a cost to the members. However, both the profit or non-profit type co-operative is similar in the terms of statutes provided for member patron ownership, member voting rights for board of directors, profit distributions to members, and member rights to assets sold if the cooperative should dissolve (Cechin et al., 2013).

Members’ participation is a foundation in the co-operative movement. The practice of philosophy principles and values adopted by this organization is consistent with the definition of the group themselves. The co-operative society definition has been accepted all over the world through the Declaration in Co-operative Identity Statement in 1995 by the International Co-operative Alliance (ICA) as, “An autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise.” (Md. Salleh et al., 2008).

Seven principles underlying the establishment of co-operatives based on the declaration of ICA (1995) are: 1) voluntary and open membership; 2) member economic participation; 3) democratic member control; 4) autonomy and independence; 5) training, education, and information; 6) cooperation among co- operatives; and 7) concern for community. These principles could explain that the co-operative is a social organization motivated by economic cooperation that existed between groups of individuals who want to achieve the same goal (Hartley, 2014).

### ***2.1 The Importance of Participation in Co-operative Governance***

The co-operative is governed systematically through democratic control by members. Members, via its rights in the Annual General Meeting (AGM) will appoint a Board of Directors (BOD) through majority vote. The BOD is responsible for executing and implementing the effective

governance based on co-operative policy and rules approved at the AGM. The roles and responsibilities of BOD were determined in the by-laws of the co-operative, and this task is carried out involuntarily. A BOD position either as a Chairman, Secretary, Treasurer or Committee is established to develop a mechanism control on the administrative and daily operations of the cooperative (Md. Salleh et al., 2008). Therefore, BOD active participation in their role when performing a task is vital for the co-operative organization's success (Choi et al., 2014).

Hanel (1992) categorized members' participation into two: first as an investor or lender to co-operatives. Second, participation in governance and involvement in decision making related to goal setting and governance policies. The co-operative governance is controlled by its members through voluntary democratic participation (Birchall & Simmons, 2004a). Members cannot be forced to participate. The volunteerism spirit will keep the members motivated and continue to provide the best in business together (Jussila, 2013). Through their active participation and the implementation of good governance, the BOD tries to protect the interests of society as a whole based on the values and ethics of co-operatives (Bijman, Hendrikse, & Oijen, 2013).

The study on BOD active participation in governing a co-operative is important for understanding participation behavior, especially in the context of co-operative organization.

### **3. THE PARTICIPATION ISSUES**

Active participation is very important because it gives space for members to implement control mechanisms in governance more effectively (Osterberg & Nilsson, 2009). Second, active participation will create a competitive advantage over corporations, and thus became value added to member-customer participation (Bhuyan, 2007). Third, it simplifies the process which could lead to changes to the co-operative to provide better benefits to its members and thus, increase the commitment and loyalty of members (Morfi, Ollila, Nilsson, Feng, & Karantininis, 2015).

However, the co-operative movement is constantly faced with issues of participation. One of the critical issues which has attracted the attention of many scholars is the free rider. A free rider is defined as a

member who is not active in the operation or governance of co-operatives and is only interested in the benefits derived from the co-operative. This is also known as the apathy attitude (Hooper, Kaplan, & Boone, 2010; Iliopoulos & Theodorakopoulou, 2014). Among the BOD team, free riders exist when some BOD do not play their appropriate roles and responsibilities.

What determines active participation? Recent studies showed that various factors determine participation. Researchers have thus far focused on social factors as strong determinants toward participation in co-operatives (Deng & Hendrikse, 2014) (Kasabov, 2015; Ruben & Heras, 2012). However, these are not sufficient to explain active participation behavior. Other studies have also shown that there is an individual factor that contributes to participation (Birchall & Simmons, 2004b; Tijnaitiene, Neverauskas, & Balciunas, 2009). Therefore, the author will look into all factors mentioned in the context of co-operative governance.

#### **4. THE PARTICIPATION CONCEPT**

Participation means to act or take part in an activity. In addition to the term "participation", some authors also used the term "involvement" to reflect the behavior of the subject takes part in a number of organizations (Ballard, 2014). There are also some authors who use the term "engagement" in which they described the involvement of a person to take part physically and emotionally (Barrutia, Echebarria, Hartmann, & Apaolaza-Ibáñez, 2013; Dodd, Brummette, & Hazleton, 2015). This study will use the term 'participation' as it is thought fit, where the behavior of members' participation in co-operative governance focuses on the physical act of taking part in the governance of the co-operative (Cechin et al., 2013; Liang, Huang, Lu, & Wang, 2015; Zheng, Wang, & Awokuse, 2012).

The study by Phipps, Prieto, & Ndinguri (2013) described the concept of participation as a joint construct communication, team work and participation in decision-making but this study was conducted at the corporate organization instead of co-operative organization. Verhees, Sergaki, & Van Dijk (2015) and Cechin et al. (2013) described active participation as attending meetings, communicate their views or criticism and involved in decision making. However, some literature suggest that a BOD should display a set of quality for the role - open communication, questioning and



challenging one another's assumptions and beliefs, frequent communication and regular attendance, actively participating in board discussions, giving constructive ideas and solution (Choi et al., 2014; Petrovic, 2010).

Based on the literature review and the BOD function in the co-operative organization, constructs of participation behavior in this study should include voluntary behaviour, open communication, attending of meetings, giving constructive ideas, involvement in decision making and performing tasks for teamwork.

## **5. DETERMINANTS OF ACTIVE PARTICIPATION**

### ***5.1. Social Factor***

The influence of social factors was shown as being able to increase voluntary participation in social movements. Social factors are considered as social capital stock which was determined to have a positive influence towards participation in the collective action. Social capital can increase the level of participation, productivity, and socioeconomic member and address the issue of free riders in the co-operative (Liang et al., 2015; Oh, Lee, & Bush, 2014; Ruben & Heras, 2012). In fact, the communities endowed with a diverse stock of social capital and collective associations will be in a stronger position to confront poverty and vulnerability (Woolcock & Narayan, 2000; Woolcock, 1998). The effort and focus in increasing social capital need to be addressed by the co-operative movement, to ensure that the co-operative movement continues to develop and achieve the common objectives of its members. This is because, as a co-operative association, the organization needs a high social capital in creating the unity of members, to make it successful in achieving their shared goal.

In the context of participation in the governance of co-operative society, the character of social capital is similar to the philosophy, values and principles of co-operatives. It allows participants to act together more effectively to achieve the common objectives in cooperation (Deng & Hendrikse, 2013). This is supported by other studies which show that of the organization, a combination of social and economic approach that suggests social resources (relations, norms and beliefs) can be used as a form of exchange to achieve the organization goals (Dodd et al., 2015).

According to Putnam (2001) features of social organization such as trust, norms and networks, can improve the efficiency of a society by facilitating coordinated actions. In addition, social capital can be defined as resources that exist in social relations that facilitate collective action. It exists in any group of affiliate consistently to achieve collective goals. The resources for social capital raised from the interactions within a community. This interaction, both among individuals and institutions will deliver an emotional bond of trust, reciprocal relationships and social networks, form values and norms that are useful for coordination and cooperation to achieve common goals.

#### *5.1.1. Social Network*

Network is one of the social factors that influence participation. People have the ability to get involved in a network of social relations, through a wide variety of relationships that co-exist and upon the principle of volunteerism, equality, freedom and civility. The ability of the group members or members of the public to always unite themselves in a pattern of synergistic relationship will be very influential in determining how strong the social capital of a group can be (Adler & Kwon, 2009).

In the governance context, community members who have access to co-operative representatives, and are able to use the co-operative product as well as been given information about the co-operative activity will have a higher possibility of being more active (Deng & Hendrikse, 2013; Ruben & Heras, 2012). A recent study showed that members with wider social network i.e. government official, another co-operative BOD, supplier and community leader will participate actively in co-operative (Wim, Xueqin, & Lu, 2011).

#### *5.1.2. Social Norms*

Social norm is defined as a set of rules expected to be obeyed and followed by society in a social entity. These rules are usually institutionalized, unwritten but understood as a determinant of behavior patterns in the context of social relationships and social sanctions are applied if violated. Social norms will determine the strength of the

relationship between individuals because it stimulates social cohesiveness and creates a positive impact on the development of society. Therefore, the social norm is referred to as one of the social capital (Deng & Hendrikse, 2013; Ruben & Heras, 2012).

Studies on participation in co-operative organization also described social norms as a shared value among members in the group. Values are ideas that have been hereditarily considered right and important by members of the community. Values are important and are normally dominant in certain population groups in our culture. They grow and develop as well as influence the rules by which to act and behave in society. A group of people with a set of shared values also work together easily and cooperate to achieve their goal. In the co-operative governance context, the BOD shared their norms and values by appreciating the co-operatives philosophy, values and principles and played their role and responsibility by obeying the co-operatives by-laws (Morfi et al., 2015).

### *5.1.3. Trust*

Trust is about a willingness to take risk in social relationships based on the confidence that the others will do something as expected. This feeling will always act in a pattern of action that is mutually supportive. At least, he will not harm himself and his group (Ruben & Heras, 2012). Collective action based on mutual trust will increase people's participation in various forms and dimensions, especially in the context of common progress. It allows people to unite and contribute to the improvement of social capital (Chloupkova et al., 2003; Kasabov, 2015; Ruben & Heras, 2012). People with the same language, norms and values, find it easier to build trust and take collective action. Trust is seen as having a positive relationship with participation in the co-operative governance (Barraud-Didier, Henninger, & Akremi, 2012).

## **5.2. Individual Factors**

Studies also showed that the factors that encourage participation also stem from the individual, either from the internal or external drive. The urge to act or behave is due to the motivation of the individual (Cechin et al., 2013; Whiteley & Seyd, 2002). Birchall & Simmons (2004a), in their

study, concluded that the motives of members' participation in co-operative governance were led by their interests to achieve personal and collective goals. The findings of this study eventually led to the formation of a new theory known as Mutual Incentive Theory-MIT.

#### *5.2.1. Individualistic*

According to MIT, members are driven by intrinsic and extrinsic factors to take part in the co-operative activity. The factor that concludes a positive relationship with participation is a benefit (extrinsic driven) and habit (intrinsic driven). Members are looking for the financial benefit (i.e. dividend and shares) and quality product. Those who served in the BOD, expected social recognition in the community and built better networks in business or politics. This is considered as an intangible benefit. A person who has participated in cooperative activities and has a strong social identity of co-operative, will form a habit of participation. Habit means a routine that has become part of life, which one loves and does, regardless of the benefits obtained (Birchall & Simmons, 2004a).

#### *5.2.2. Collectivistic*

Collectivistic orientation interprets individual action differently, assuming that when members decide to participate, their action are driven by three variables: (1) Shared goals: the individual expresses mutual needs that translate into common goals; (2) Shared values: the individual feels a duty to participate as an expression of common values; and 3) Sense of community: the individual identifies with and cares about the community he lives in or is like them in some respect (Birchall & Simmons, 2004a).

As described in paragraph 4.1, social factors such as social networks, social norms and trust play a significant role on the behavior of participation in the cooperative organization. These factors will lead to the formation of social identity in a person due to social influence. According to Birchall & Simmons (2004b) in the co-operative society, the committee members will actively participate in collective action because they want to get benefits for the group as a whole as opposed to individual benefits. With this reinforcement, one is able to act more actively to participate in the governance of co-operative.

## 6. THEORIES

### 6.1. *Social Capital Theory (SCT)*

Various theories have been used to explain the behavior of participation. Among them, the Social Capital Theory explained that social features in the community will lead to participation behavior and collective action (Putnam, Leonardi, & Nanetti, 1994). Features of social affiliation such as trust, norms and networks can improve the efficiency of society by facilitating coordinated actions. In other words, social capital can be defined as resources that exist in social relations that facilitate collective action. Sources of social capital include trust, norms and networks that represent a relationship of any group affiliated consistently to achieve collective goals (Putnam, 2001).

In the context of participation in the governance of the co-operative, social capital factors allow participants to act together more effectively to achieve their shared objectives (Deng & Hendrikse, 2013). This is supported by other studies where social capital is generally understood as a combination of social and economic approach that suggests social resources (network, norms and trust) and which can be used as a form of exchange to achieve the organization goals (Dodd et al., 2015).

### 6.2. *Mutual Incentive Theory (MIT)*

As explained in paragraph 2.0, the co-operative society is motivated by economic and social capital where it was founded by a group of individuals to meet common needs. Later on, MIT described that the dimensions that constitute participation in co-operatives are individualistic-collectivistic orientation. This theory explains the individual and collective factors that influence members to participate in co-operative (Birchall & Simmons, 2004a, 2004b).

According to MIT, individuals will be driven by self-interest and collective interest of the community groups when deciding whether to participate or not in a co-operative. The interests of individuals are described by two factors- benefit and habit, and these and associated positively with participation. MIT also explains that three other factors that will negatively connect with the participation are cost, opportunity cost, and satiation. Three factors that established collective orientation by individual are shared goal, shared value and concern to the community

(Birchall & Simmons, 2004a). In this study MIT will be used to establish whether collectivistic incentives or individualistic incentives predominate in members' behavior to participate actively in their role as BOD governing the co-operative.

## 7. CONCLUSION

The objective of this study is to determine whether social factors and individual factors have positive relationship with participation behavior. However, the existing variables are still not sufficient to explain what leads to active participation. Therefore, another variable needs to be identified whether a direct or indirect relationship exists with active participation behavior. We will consider another variable as mediator or moderator to test the best competent model in the explanation of active participation. The use of SCT and MIT are relevant and can be applied in the research on BOD's participation in the governance of co-operatives. The combination of these theories can better describe the encouragement of active participation of BOD governing co-operatives.

The role of co-operative members in governing co-operative at the AGM and the BOD level are equally important and should be strengthened in order to realize the benefit of the community. In addition, active participation can improve the efficiency of the governance of the co-operative. Only then, can the collective co-operative goal be achieved and hence contribute to the economic development of its members.

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## **APPLYING SERVQUAL MODEL TO MEASURE ONLINE CUSTOMER SATISFACTION IN PACKAGE DELIVERY SERVICES**

**NUSRAT HAFIZ<sup>1</sup>, A. S. A. FERDOUS ALAM<sup>2</sup>**

**ABSTRACT.** Online customer is a person or association that purchases goods from a retail store via internet. This online purchasing is facilitated by companies that deliver shipping parcels, known as package delivery companies. The service quality is measured by the difference between customers' expectations towards a service and their actual experience from that service. The objective of the study is to explore the correlation of online customer satisfaction with service quality in the package delivery industry using quality management framework SERVQUAL. Quantitative data on customer satisfaction levels divulged from questionnaires were scrutinized against service quality factors, which was later replaced in the service quality model using a five-point Likert scale and conducting simple regression. The result of the study found positive impact of reliability, assurance and empathy dimensions of service quality model on online customers' satisfaction level pertaining to package delivery companies, with overall dominance of reliability dimension. The study adds value to the untapped sector of package delivery service, a critical backbone of e-commerce. The findings can be applicable for any e-commerce entrepreneurs in order to enhance optimum customer management efficiency by focusing on imperative dimensions of service quality model and perking up customer satisfaction.

**Key words:** Customer satisfaction, Service quality, Service quality dimensions, SERVQUAL, package delivery services.

**JEL Classification:** A13, P46, C54

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## INTRODUCTION

The explosion of internet population spurred the technology in terms of speed, efficiency, versatility and dynamism in the 21<sup>st</sup> century. Since then the volume of trade conducted electronically has developed remarkably. E-commerce has turned to the major modality for prospective trades regardless of the size and type of startups (Rahman, 2014). The country focus for this study is Bangladesh, which has a promising growth of e-commerce categorically during the last few years. The impact of 'Digital Bangladesh program by the year 2021' (a2i, 2009), ease of transaction, decreased overheads, increased private sector investment (Garza, 2015 World Bank, 2014) fueled interest in many small companies to engage in e-commerce business. With nominal to zero-capital-intensive infrastructure, and just the right know-how and platform selection, the m-commerce and f-commerce dynamics have grown and revolutionized over the last few years.

The e-commerce companies are always in a pressure to build more efficient business models to satisfy and delight the fickle-minded, price sensitive, better-informed and more mobile-consumers using technology and innovative customer service as their key success factors (KSF). These key success factors eventually enable them to "beat the traditional retailers at their own game". The launching of the good number of online startups leads to newer business opportunities for the package delivery service-providers. The carriers catering to online customers, regardless of their retail-nature of being either brick-and-mortar or virtual, serve the key backstage operations to facilitate online purchasing and thereby help boost the e-commerce transactions. Hence, it is imperative to build a framework of service excellence on the ground of online customer satisfaction (Parasuraman, Zeithaml & Berry, 1985), which is the key recipe to save the service pertaining to e-commerce from being in a detrimental position (Fabien, 2005).

The objective of the study is to explore the correlation of online customer satisfaction with service quality in the package delivery industry using quality management framework named, "SERVQUAL". The framework is widely accepted for measuring service quality, which, using the dimensions of the model, effectively measures customers' expectations towards service and their perceptions of service they receive. The growth of e-commerce largely depends on the effectual coordination of the business-model components of online entrepreneurs and the most vital partnership network of the model, i.e., the package administration network. Hence, the package administration has positioned itself as the most imperative backbone of e-commerce.

Previously, the scope of parcel carriers was narrowed to the extent that it that was confined within the infrequent parcel delivery between household and corporate houses only. The system has now been broadened to cover a great range of services particularly in the past few years. The medium and small online start-ups along with f-commerce and m-commerce have positively contributed to the new growth opportunity of package delivery industry.

Unfortunately, very few studies were conducted to scrutinize the generic state of e-commerce in Bangladesh; yet the area of exploring online customers' perceptions towards receiving their ordered products has visibly remained untapped. The paper pioneers in analyzing buying behavior of online customers pertaining to the package delivery industry by focusing on the factors of satisfaction. The present implication of the study would approach the new entrepreneurs embracing new business opportunity in the package delivery sector and realign their strategy with consumer demand (Rahman, 2015). Even, international associations are also taking deep interest in Bangladeshi e-commerce and investing in order to get a sturdy grip in the niche that offers huge potential. The paper looks in to relationship between online customer satisfaction with service quality in the package delivery industry using quality management framework SERVQUAL.

## **LITERATURE REVIEW**

Customer satisfaction has always been one of the best predictors of customers' buying behavior, including their brand selection, brand loyalty and switching attitude (Oliver, 1993; McQuitty et al., 2000). Three

prominent researchers Parasuraman, Zeithaml and Berry investigated thoroughly for 13 years (1985 to 1988) and set the benchmark for customer satisfaction "gap" based on the differences between customer expectation towards a service and their actual experience.

Service excellence is assured if it marks up to the expectations of the customers (Asubonteng et al., 1996; Wisniewski and Donnelly, 1996). The SERVQUAL (service quality model) developed by Parasuraman et al. (1985) is used in this paper in order to assist in reflecting the service excellence. The model offers five dimensions, i.e., tangibles, reliability, responsiveness, assurance, and empathy; where reliability playing the key dimension and other dimensions makes most sense to consumers given reliable service is provided (Berry et al., 1994).

In order to further explore online consumers' attitudes towards service excellence in e-commerce sector; their online shopping trend needs to be taken into account. The emergence of a colossal number of online customers is the aftermath of f-commerce and m-commerce technologies, who are increasingly taking charge of their shopping experiences by proactively deciding where, how, when and what they want to buy. The nativity and attractiveness of the concept 'online shopping' are materialized due to the customer convenience. Li, N. and Zhang, P. (2002) mentioned it as purchasing of the consumers using the internet, which is positively related with the growth of the local package delivery businesses. (Kim, 2015).

Package delivery in this study refers to the delivery of parcels sent by online merchants to online customers. These carriers act as external suppliers that provide logistic management on behalf of an e-commerce start-up in order to ensure an efficient internal delivery-chain (Coyle, Bardi & Langley, 2003) of that start-up. Package delivery industry functionally bridges the online shops and consumers, and offers high potentials because of the dependability of online shops and increased customer convenience by it. In Bangladesh, the increased number of users of the social networking websites along with the easy ordering system via trendy apps of the smart-gadgets and convenient payment facilities are the key rationales behind the high growth of the sector.

The Bangladeshi package delivery services were almost annihilating even few years back until the boom of e-commerce that had to revamp the overall distribution strategy of various products including clothing, accessories, electronics and even books. The entrance of package delivery

industry that consists of traditional carriers, and online carriers, redefined the significance of e-commerce. Key traditional carriers include Sundarban Courier, Continental Courier, S.A. Paribahan Ltd, Sonar Courier etc, while kaymu.com, upoharbd.com, daraz.com, priyoshop.com, aponzone.com, eCourier.com.bd etc are the key online carriers. As the integral facilitators of e-commerce, the carriers need to create synergies with the online entrepreneurs in order to ensure online customer retention (Bowen and Chen, 2001).

An in-depth study of online customer satisfaction will enable the online start-ups determine the necessary assignments recognize their potencies and flaws relating to the delivery-system, which eventually will help them create competitive positions towards profit-orientation. The study would also reinforce the willingness of online retailers to create a complete package of “enhanced online purchasing experience” by helping to craft a synergy with delivery system in the long-run.

Based on the above discussion and literature review, the following research question is developed: *“Do the dimensions in the SERVQUAL model have impacted the satisfaction level of the online customers by the package delivery providers?”*

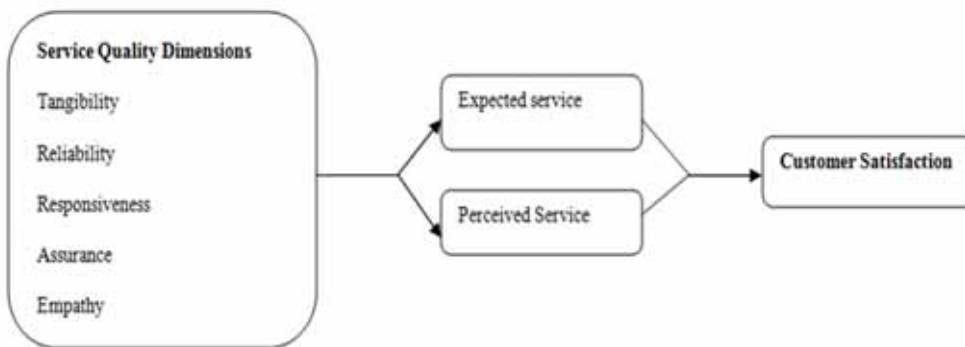
## **RESEARCH FRAMEWORK**

It is imperative for service-providers to meet customers’ expectations while providing the actual service (Parasuraman, Berry, and Zeithaml, 1991), as the customer expectation level will determine their satisfaction level (Grönroos, 1994; Parasuraman et al., 1985; Parasuraman et al., 1988; O’Connor et al., 2000; Van Pham & Simpson, 2006). The service-providers should constantly contemplate on the best possible modus operandi to meet the customer expectations (Pakdil& Aydın, 2007) and take necessary steps to improve their competence and commitment-level. Ensuring customer satisfaction through quality services is the up-to-the-minute strategy for organizations, hence conducting a research on consumer-satisfaction is crucial to retain the existing customers and attracting the prospective ones.

Despite the growing interest in e-commerce in Bangladesh, almost no empirical research has been conducted regarding online customer satisfaction focusing the package delivery providers. The pre-research feedback from

university students in late-2015 revealed that, their f-commerce experience does not meet their online shopping expectations specially from categories such as delivery charging policies, reliability and product-accuracy by the carriers, payment-related safety, timely delivery of the products, accessibility, know-how about the product-usages and courtesy-level of the online courier-representatives. The feedback leads to a logical paucity (Rahman, 2015) in the prevailing delivery system and raise the need to conduct the research for the online merchants who constantly look forward to act upon customers' expectations in order to safeguard them against early-failure and ensure ultimate survival (Fornell et al., 1996; Chan et al., 2003; Lien-TiBei & YuChingChiao, 2001).

Hence, the purpose of the study is to investigate the influential aspects of satisfaction of online customers. To gauge the level of satisfaction by online customers to package delivery companies, the SERVQUAL model (Parasuraman et al. 1985) will be used. Under the approach, the service quality dimensions would be considered as independent variables while customer satisfaction as the dependent variable, in order to correlate the package delivery with fulfilling customer expectation and ensuring customer satisfaction. SERVQUAL model is based on tangibility, reliability, responsiveness, assurance, and empathy dimensions. SERVQUAL is the most comprehensive endeavor to conceptualize service quality (Nyeck, Morales, Ladhari, and Pons 2002).



**Figure 1.** The Research Framework

Figure 1 depicts the association of service quality dimensions with customer satisfaction. According to the research framework, the correlation between online customer satisfaction and service quality by the package delivery industry has been chalked down using the five dimensions of quality management framework SERVQUAL.

Service quality (SQ) can be defined from the gap between expected service (E) and perceived service (P) by the customers; i.e.,  $SQ = P - E$ . If the gap between customer expectation and their perceptions of actual experience is low, service quality is deemed high and likewise. The equation can be interpreted by the customers' perception of service performance. If they feel that the performance is equal to or more than what is expected (confirmation), then they are satisfied. On the other hand, perceived performance falling short of their expectations (disconfirmation) leads to their dissatisfaction (Oliver, 1980). Based on the framework, the following five hypotheses have been developed:

H1: Online customer satisfaction is high when tangibility is ensured by package delivery companies.

H2: Online customer satisfaction increases when package delivery representatives are reliable.

H3: Online customer satisfaction improves with the level of responsiveness of carriers.

H4: Online customer satisfaction is high when assurance by the package delivery companies is high.

H5: Online customer satisfaction is positively related with empathy of the carrier personnel.

Here, the hypotheses i.e., H1, H2, H3, H4 and H5 represent the relationship between tangibility, reliability, responsiveness, assurance and empathy (independent variables) with customer satisfactions (dependent variables) respectively. The speedy transport, attractive packaging, accessibility to the personnel represent tangibility; while reliability is represented by providing promised products, payment security and timeliness; responsiveness are signified by promptness in service, eagerness to solve problem and delivery efficiency; whilst trust, knowledge and courtesy are demonstrated by assurance and finally empathy is denoted by the level of care, individualized attention and affinity.



## **METHODOLOGY**

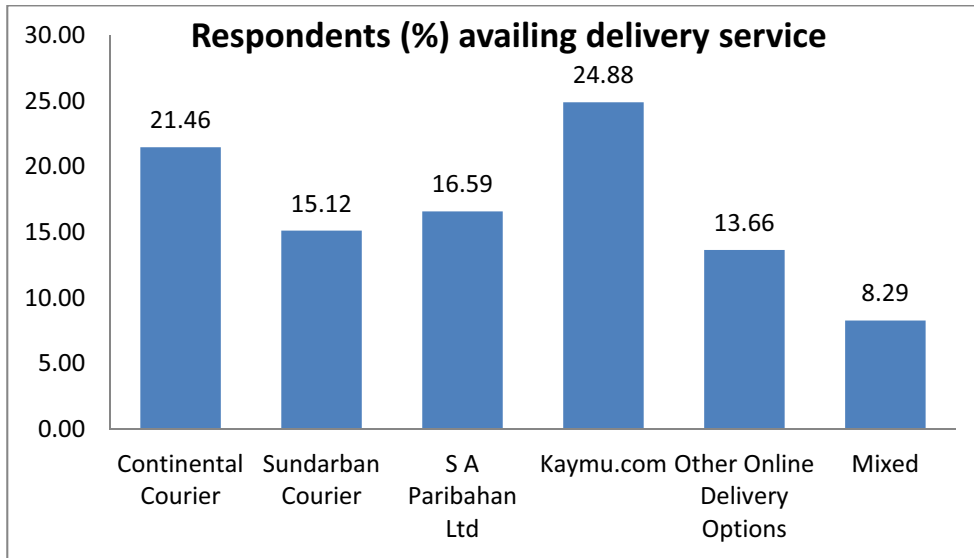
### **Sampling and Data Analysis Procedure**

This study used both primary and secondary data. The survey was conducted between October 2015 and February 2016 using a non-probability sampling technique to the online buyers, who interact with package delivery companies while receiving products. 230 questionnaires were distributed among the random population from all over Dhaka city, and 205 usable questionnaires were accepted, which yielded a response rate of 89.13 percent. The collected data used ordinal five-point Likert scale.

The respondent group consists of 116 (56.59 percent) male and 89 (43.41 percent) female respondents. More than half of the online buyers' age range is between 25 and 40 (51.22%), a majority of which belong to the working class, while 30.24% of the respondents belong to the young generation and students (age between 13 and 24), while 17.07% are middle-aged (age between 41 and 50); however only 1.46% respondents' age have crossed 50 years.

The respondents' occupations are in accord with their age grouping as well. 50.24% are either job-holders or entrepreneurs; 33.66% are students; 13.17% are home-makers and only 2.93% are in the group of retired and job-less. The majority of respondents (55.6%) have been pursuing the service for 1 to less than 2 years, while 27.32% were availing the service between 1 and 6 months, 10.73% started very recently (less than a month) and 6.34% have been using the service for the longest period (2-5 years).

As Figure 2 suggests, 44 (21.4%) respondents take service from Continental Courier, while 31 (15.12%) respondents got their products through Sundarban Courier; on the other hand, S A Paribahan Ltd facilitated transactions to 34 respondents (16.59%). Kaymu.com served 51 (24.88%) respondents and 28 (13.66%) respondents said that they were served by various online carriers, such as Upoharbd, ClickBD, Daraz.com, Rokomary.com etc. Interestingly, 17 (8.29%) respondents said they experienced a blend of online and retail delivery services. As per the respondents' profile, the presence of online delivery companies are gaining gradual strength; though the traditional retail package delivery services are still preferred by them over the online delivery.



**Figure 2.** Percentage of Respondents’ Taking Package Delivery Services from Major Companies

Quantitative data on customer satisfaction levels divulged from the questionnaires were scrutinized against various service quality factors, which have later been replaced in the service quality model. The Statistical Package for Social Science (SPSS) Version 17 was used to conduct the simple linear regression analysis to analyze the questionnaire dataset.

The secondary data was collected by reviewing various literatures from international publications of journals, case-studies, books and research papers on customer satisfaction and SERVQUAL Model but the review was not limited to package delivery services only.

**Variable Measurements**

Twenty one items were chosen to represent the service quality dimensions by Parasuraman et al. (1991) with minor modifications were made to reflect those items to show the impact on customer satisfaction from the present context of Bangladesh. The service quality dimensions i.e., tangibility (TAN), reliability (REL), assurance (ASSU), empathy (EMP) and responsiveness (RES) being the independent variables and customer

satisfaction (SAT) being the dependent variable, the following equation has been developed:

$$SAT = f(TAN, REL, ASSU, EMP, RES)$$

Out of the service quality dimensions, tangibility, reliability and empathy are based on four items; while assurance and responsiveness have three bases. The customer satisfaction also is based on three items. A Five-point Likert scale ranging from 1 = “poor” to 5 = “excellent” is used to rank the responses.

## FINDINGS

### Validity and Reliability Analyses

The questionnaire is being tested for its validity and reliability. The latent variable in this model has high Cronbach's Alpha values, such as: tangibility (.8); reliability (.87); assurance (.85); empathy (.83); responsiveness (.91) and customer satisfaction (.82). Therefore, the reliability level of the questionnaire meets the critical value of 0.7 suggested by Nunnally and Bernstein (1994).

**Table 1.** Reliability of Service Quality Dimensions and Service Satisfaction

Variable	Number of Items	Mean	SD	Cronbach's alpha
Tangibility	4	3.42	0.71	0.80
Reliability	4	3.54	0.82	0.87
Assurance	3	3.38	0.86	0.85
Empathy	4	3.35	0.91	0.83
Responsiveness	3	3.38	0.81	0.91
Customer satisfaction	3	3.42	0.68	0.82

According to table 1, the respondents' perceived reliability (M = 3.54, SD = 0.82) is the most dominating variable, which is followed by tangibility (M =3.42, SD = 0.71), responsiveness (M =3.38, SD = 0.81), assurance (M = 3.38, SD = 0.86), empathy (M = 3.35, SD = 0.91), which are all rated as “good”. Also, the customer satisfaction (M =3.42, SD =0.68) is also rated as “good” as per the likert scale categories.

### Regression Analysis

A simple regression has been conducted and analyzed to check the comparative impact of the dimensions of service quality to customer satisfaction. According to Table 2, the dimensions of SERVQUAL model (independent variables) explained 0.970 of variance (R Square) in customer satisfaction (dependent variable). The F statistic is 1290.084 for customer satisfaction at 95 percent confidence level.

**Table 2.** Result of Regression Analysis of Service Quality Dimensions and Customer Satisfaction on the dependent variable

Dependent Variable: Satisfaction					
	Sum of Squares	Df	Mean Square	F	Significance
<b>Regression</b>	90.349	5	18.070	1290.084	.000 <sup>a</sup>
<b>Residual</b>	2.787	199	.014		
<b>Total</b>	93.136	204			

R Square=.970; Adjusted R Square=.969;

a:Predictors: (Constant), EMP, TAN, RES, ASSU, REL;

The coefficient of determination (R<sup>2</sup>) means that the regression line fits the data properly and the relationship between the model and response variable is strong. Nevertheless, since the value for the F-test of overall significance test is more than the significance level, the null-hypothesis cannot be rejected.

**Table 3.** Result of Regression Analysis of Service Quality Dimensions and Customer Satisfaction on independent variables

Independent Variables	Standardized Coefficients (β)	t-stat	Significance
<b>Tangibility</b>	-.009	-.701	.484
<b>Reliability</b>	.392	25.199	.000*
<b>Assurance</b>	.431	30.980	.000*
<b>Empathy</b>	.456	32.043	.000*
<b>Responsiveness</b>	-.004	-.236	.813

Note: \* Significance @1% level

According to Table 3, the regression analysis outputs have supported H2, H4 and H5, but not H1 and H3. Hence the customer satisfaction have a positive relationship with the hypotheses mentioning about reliability, assurance and empathy (H2: β = .392, t = 25.199; H4: β = .431, t = 30.98 and H5: β = .456, t = 32.043).

## RESULTS AND DISCUSSION

The result of the study interprets that the reliability dimension is dominant, which is also consistent with the theories. As per the results pertaining to the reliability dimension, online customer satisfaction increases when the parcel carriers are able to provide them consistently the exact products as promised by the online merchants (without damaging it) and thereby enhancing accuracy, ensure safety relating to payment and the reaching products within the promised time.

Besides the reliability dimension, assurance, and empathy dimensions of SERVQUAL model play key roles to enhance online customer satisfaction. A diverse behavioral attribute that increase customer confidence including the employees' service competence and know-how, courtesy and honest behaviors cumulatively demonstrate the assurance dimension (Parasuraman et al., 1991). This holds for the online customers too, whose confidence would strengthen with the courtesy and honesty level of delivery-men and if their expectation in terms of delivery charges are met.

Providing attention at individual levels with a caring mind-set would be the most prominent feature of empathy dimension (Parasuraman et al., 1991), which is experienced by the online customers as well. As they found the delivery men to be helpful to them, their satisfaction went up.

Nevertheless, as per the results of the study, the tangibility dimension, i.e., the physical attributes associated with the actual service (Parasuraman et al., 1991) found to play no significant role in augmenting customer satisfaction. Similar result appeared for the responsiveness dimension that demonstrated the enthusiasm to insure promptness in service (Parasuraman et al., 1991) has no effect on creating customer satisfaction in the package delivery industry.

A remarkable observation throughout the demographic profile-analysis was that the majority of respondents' usually have pre-determined perceived satisfaction towards the renowned delivery companies even before experiencing the actual services. This perception might offset their focus on the tangibles associated with the package delivery, as their key expectation is that, the basic products needs to be flawless and accurate, in other words service to be reliable. They might just prefer the delivery men to be helpful and fulfilling customer expectation. Hence, the presence of assurance and empathy components in services will add to their satisfaction level.

On the other hand, promptness of performing the services might not be the key requirement by the customers; it rather should be the key requirement of the sellers who would like to recover their sales proceeds at their earliest possible time from customers with the help of the carriers. The package delivery industry being composed of both superior service-providers and the not-so-committed delivery channels might be one of the reasons for not being acknowledged by all the hypotheses based on all the dimensions of SERVQUAL Model.

### **LIMITATIONS**

The service quality model has never been tested on startups or institutions might be a major limitation to the study. Other limitations might include scarcity of funding and limited geographic coverage (Dhaka city only). Also, the noisy environment and unpredictable respondents' attitude turned out to be the constraints to accuracy of data. Finally, the data being collected within four months' time might not help any perceptual adjustments in customers' mindset to reveal. It is possible to increase the true explanatory power of the model by adding predictors. A further study should be performed to explore the association in related service industries.

### **CONCLUSION**

This paper conducts an investigative assessment of the relationship between SERVQUAL model dimensions with customer satisfaction concentrating the package delivery industry and attempts to contribute a hands-on approach to the existing literature. Throughout the study, the SERVQUAL model was proven to exert a moderate to high impact on the level of satisfaction of online customers in the package delivery industry. The study effectively adds value to the untapped sector of package delivery using the SERVQUAL model. The success of e-commerce can be ensured by the endorsement of online entrepreneurs and online package delivery industry that encourages satisfied customers to spread positive words-of-mouth to create a great deal of a business.

As the e-commerce is booming in Bangladesh, a good number of package delivery providers are entering into the business and creating more corridors to earn revenue. They may offer online tracking facilities to enhance their operational efficiency. The online startups and package delivery companies need to shake hands to provide better customer service and climb up the business ladder together to ensure a win-win situation for both. Additionally, they should conduct joint-researches and market studies mutually to reach the goal to serve the customers at the optimum manner.

The result can be particularly applicable for corporate or institutional managers to deal with customers by altering some factors of the dimensions to ensure optimum efficiency management and by emphasizing on the more imperative dimensions of the model in order to improve service excellence and thereby satisfaction level of customers.

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## DETERMINANTS OF EMPLOYEE PERFORMANCE IN EMBRYONIC ECONOMY

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**ABSTRACT. Purpose:** Since the building of a nation is the main concern of most governments worldwide, and human resources have been recognized to be one of the most important promoters in the nation's development, this paper therefore focuses on the relationship between HR practices and employee performance in the embryonic economy. Also, this work seeks to establish the relationship between selected HR practices and employee performance.

**Design/methodology/approach:** In this work, extensive literature review is the approach adopted for the development of conceptual model. Also, review of literature is used to measure and discourse the relationship between the selected HR practices (i.e., compensation, performance appraisal, and succession planning) and employee performance.

**Findings:** This paper proposes a conceptual framework that indicates direct and positive relationship between the selected HR practices and employee performance. Hence, this work serves as guide on enhancement of employee performance.

**Research limitations/implications:** This paper is a conceptual work that has its own limitation. However, the study can be improved upon through collection and analysis of related data.

**Practical implications:** The paper can guide the stakeholders in Nigeria to understand better the roles of HRM practices through which employee performance can be enhanced.

**Originality/value:** It is believed that this work is a compendium that contributes to the extant body of knowledge in the HRM-performance research field, and serves as guide for stakeholders on the enhancement of employee performance.

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## 1. INTRODUCTION

In spite of the enormous importance of human resource (HR) practices towards the realization of employees' performance, many organizations are not fascinated to emphasize its optimum. Researchers have shown that no organization can exist unless its workers are highly productive. Also, performance can be propelled by workers' evaluation of what they gain or lose by acting in a particular way (Koshy and Suguna, 2014). Obviously, the most vital factor that affects the future of any organization is its employees, as they play an integral role in achieving organizations' objective (Koshy and Suguna, 2014). Therefore, this paper focuses on reviewing literatures on human resources practices, particularly compensation, performance appraisal, and succession planning and employee's performance in embryonic economy. It will later propose the potential relationship as well as effect of human resources practices on employee performance within embryonic economy's setting. While substantial numbers of research (Delery and Doty, 1996; Huselid, 1995; Seidu, 2011) have established the link between human resource practices enhanced employee performance, this kind of research in the context of embryonic economy would solidify the existing body of knowledge in the research field.

## 2. LITERATURE REVIEW

According to Anitha (2013), employee performance refers to employee's monetary or non-monetary outcome which is absolutely connected with performance and success. According to McConnell (2003), employee performance is the achievement and contribution of an individual

in practical and quantifiable term. Moreover, employee performance is a complex concept that can be affected by many variables (Popovich, 1998). These variables can range from age, gender, employee recognition to job satisfaction, performance appraisal techniques, and task types (Rahman, & Shah, 2012). Sarmiento et al. (2007) argued that job performance is often the result of at least two aspects: the abilities and skills (natural or acquired) that an employee possesses, and his/her motivation to use them in order to perform a job better.

In addition, a number of authors believed that employees can help to improve business performance through their ability to generate ideas and use these as building blocks for new and better products, services and work processes. Recently, there has been a behavioural view which claims that performance involves the results or the outputs. However, that doesn't mean companies should ignore their goals and targets. Thus, performance comprises all the behaviours that are related to achieving the unit or department goals as well as organizational goals in which individual works on (McShane and Glinow, 2005). Hence, there are two views of performance: results/output and behaviours, and that makes it difficult to distinguish between these two aspects of performance and would be confusing to do so. Nevertheless, behaviour is viewed as the cause of output, and output is used to measure employee performance and effectiveness (Anitha, 2013). Many scholars have tried to come up with the best way to explain employee performance and some of the definitions given are organizational-related (Meyer et al., 1991). Performance is also importance for the individual, accomplishing tasks and performing at a high level can be a source of satisfaction with feeling of mastery and pride (Sonnentag, 2003). Low performance and not achieving the goals might be experienced as dissatisfying or even as a personal failure (Sonnentag, 2003). Moreover, performance, if it is recognized by other within the organization, is often rewarded by financial and other benefits. Organization wants employees with highly performance as they would expedite the accomplishment of their goals, delivery of the products and services, and finally the achievement of competitive advantage (Sonnentag, 2003).

Furthermore, resources in organizational setting are defined as anything that could be thought of as a strength or weakness of a given firm including tangible assets (Wenerself, 1984). There are main organizational resources; human resources, financial resources and technological resources. The management of human resources involves an approach that deals on

employment management in which it seeks to accomplish competitive advantage via the tactical utilization of a highly committed and capable workforce, using on array of cultural, structural and personnel techniques (Storey, 1995). The purpose of HRM is to ensure that the employees of an organization are used in such a way that the employer obtains the greatest possible benefit from their abilities and the employees obtain both material and psychological rewards from their works (Graham 1998).

Moreover, human resource management is a process, which consists of four main activities, namely, acquisition, development, motivation, as well as maintenance of human resources (Gupta and Shaw, 2014). Gupta and Shaw (2014) cited Scott, Clothier and Spriegel, (1961) that he defined Human Resource Management as that branch of management which is responsible, on a staff basis, for concentrating on those aspects of operations which are primarily concerned with the relationship of management to employees and employees to employees and with the development of the individual and the group. Also, Human Resource Management is responsible for maintaining good human relations in the organisation. It is also concerned with development of individuals and achieving integration of goals of the organisation and those of the individuals. Human resource management is also an extension of general management that is of prompting and stimulating every employee to make his fullest contribution to the purpose of a business. Human resource management is not something that could be separated from the basic managerial function. It is a major component of the broader managerial function. The next section discusses the selected HR practices.

## **2.1. HR PRACTICES**

Human resource practices have received increased attention for its impact on employees' performance. The majority of the researches in this area have focused on the degree to which the human resource practices can enhance individual and organizational performance (Joarder, Sharif and Ahmmed, 2011). There is a lack of information regarding dynamic nature of human resources in the setting of countries in an embryonic economy. Moreover, it is difficult to generalize the human resources practices of the western setting, and adopt the western model of human resources practices in the embryonic economy countries (Joarder *et al*, 2011). Therefore,

there is need for research in the embryonic economy. Budhwar and Debrah (2004) opined that there is a greater need to know how employees in various parts of the world perceive human resource practices in different environment. Thus, this paper is expected to fill the gap on human resource practices-employee performance link within the setting of embryonic economy countries. Three sets of HR practices are highlighted in this present paper which include (i) compensation, (ii) performance appraisal and (iii) succession planning.

### *2.1.1. COMPENSATION*

Compensation, as a HRM practice, deals with all type of rewards that employees receive in an exchange for what they have performed towards achieving organizational objectives (Philip, 2003). Compensation packages vary for different workers depending upon their levels and types of formal education, experience and training (Pedro and Vicente, 2007). Compensation has been considered a fundamental issue of concern on employees and a powerful utility for them to improve their performances, and pay is the most popular way of motivating employee to perform and ensures effective performance.

The rationale for employee's compensation in organization is always with a common goal to advance employee performance and overall organizational capabilities. Numerous research studies highlighted performance-based compensation as highly motivating and an influence creating HRM practice (Arthur, 1994; Huselid, 1995; MacDuffie, 1995; Delery & Doty, 1996). Bonus systems are to motivate employees to work towards the company's objectives (Pfeffer, 1994). Some researchers have concluded that the relationship between pay and performance in the past was stronger and agreed that compensation played a key role in enhancing employee effectiveness and generalized terms, it can be said that compensation is used as a motivator to enhance performance.

### *2.1.2. PERFORMANCE APPRAISAL*

The most difficult and most distasteful human resource management task for line managers to perform is the process that appraises employee performance and acts on that appraisal termed "Performance Appraisal". Performance appraisal (PA) has been and still is the most problematic HR

area and the most avoided/detested HR area for line managers and HR departments alike (Dessler, 2011). Grote et al. (2010) points out that PA has more influence on individual careers and work lives than any other management process. Performance appraisal can both make a business more efficient and help keep employees motivated. By evaluating people at regular intervals, appraisals help firms show where their employees excel, where they can improve, and how well they have followed the goals set by the firm.

However, some of the authors are in the view that better performance appraisal result in improved employee performance, Daoanis (2012) posits that performance appraisal is a vital tool to measure the frameworks set by any organization to its employees. It is utilized to track individual contribution and performance against organizational goals and to identify individual strengths and opportunities for future improvements and assessed whether organizational goals are achieved or serves as basis for the company's future planning and development.

### *2.1.3. SUCCESSION PLANNING*

McConnell (2006) defined succession planning is the process of identifying people who could presently move into key positions or could do so after specifically targeted development occurs. The process identifies the better people in the organization and takes a consistent approach to assembling, analysing, and retaining information about potential leaders and planning for their further development. Mehrabani and Mohamad (2011) opined that organization's future plans may change by some reasons such as retirements, promotions within the organization, serious illness, death or any voluntary departure from the organization to follow a career elsewhere. To cover such changes, organizations must have a key employees' replacement plan. Succession planning is considered as a suitable effort in this regards Mehrabani and Mohamad (2011) cited Sambrook, (2005) there are mainly three focal points of succession planning as pointed out by Hedum (2010). These are:

- It addresses the needs of the organization as senior leadership ages and retires.

- It helps an organization prepare for an unexpected event such as the sudden illness or death of a person in a key leadership role in the organization.
- It ensures that an organization has the right calibre of personnel in place to function at peak efficiency.

Today's dynamic environment filled with global competition and business discontinuities defines the arena in which succession planning must flourish. To do so, a much more active orientation is required; one that is better characterized by succession management and its emphasis on going and integrated processes (Bruer et al., 1996). The concept of succession planning is a positive approach to guarantee continuity in an organization by identifying how vacant positions that were created due to planned and un planned departures of employees will be filled (Schmalzried and Fallon, 2007). This implies that succession planning is both a dynamic and systematic leadership and talent development strategy embarked upon to be able to accomplish future organizational operational needs and goals. Simply put, succession planning is the life event of an organization. Consequent upon this, succession planning has been proven to be an antidote to disruption of organizational policies due to the effects of resignation and loss of talent in organization (Nayab, 2010).

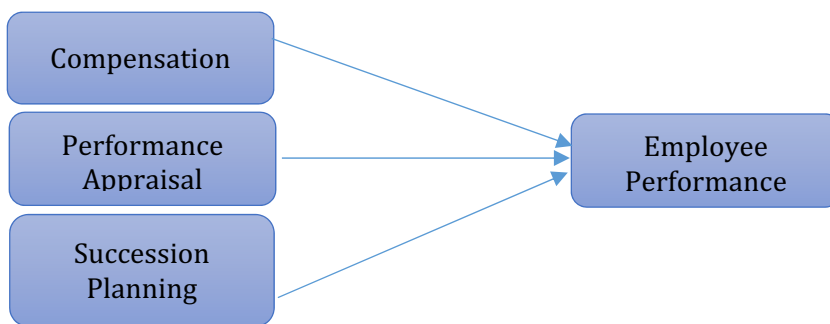
### **3. RELATIONSHIPS BETWEEN THE SELECTED HR PRACTICES AND EMPLOYEE PERFORMANCE**

It has become an empirical fact that relationship between compensation and employee performance exists, and the studies that establish this include Oluigbo and Anyiam (2014), and Rizal et al. (2014). For example, Oluigbo and Anyiam (2014) studied the relationship between compensation and employee performance. The study used a sample of 92 employees of Zinox Technologies Limited (a private company that specialized in information technology). Frequency distribution table, simple percentage and chi-square are the statistical instrument used in the analysis of data. The study revealed that compensation influence employee performance.



Regarding performance appraisal, many empirical studies have established a positive relationship between performance appraisal and employee performance in organization, the studies include Owoyemi and George (2013), Kuvaa (2011), Daoanis, (2012), Shaharyar et al. (2014). Similarly, there are some empirical studies that show the significance of succession planning in an organization, these includes Daspit et al. (2015). Sharma, Chrisman, & Gersick, (2012). Based on the observation made by Posthuma et al. (2013), there is dearth of research on the effect of succession planning. This implies that despite that succession planning is a vital HR practice that has its crucial role in the achievement of organizational success, little is known about its influence on employee performance.

Given the argument put up above, this paper proposes a conceptual model of HR-performance connection as illustrated in the figure below:



**Figure 1.** Research Framework (Source: authors' work)

Based on the evaluation of relevant literature, it is proposed that there is enough evidence to show the linkage between HR practices and employee performance, especially given the three reviewed sets of HR practices. This is illustrated in the figure above which depicts the proposed framework where HR practices are independent variables and employee performance is dependent variable. HR practices are measured through compensation, performance appraisal and succession planning. While employee performance could be measured by task and contextual performance. These are postulated to exist in an embryonic economy, in which higher and better employee performances are important in

ensuring organizational success as well as in sustaining business competitiveness. It is obvious that HR practices are probable variables that will affect employee performance.

The proposed research framework is well supported by the Ability-Motivation-Opportunity (AMO) model, AMO model posits that performance of the firm can be speed up through three factors which are ability, motivation and opportunity. The first factor can be achieved through recruiting and selecting quality personnel. Jiang Lepak, Hu and Baer (2012) emphasizes that ability of the firm's human capital can be enhanced through all-inclusive compensation, performance appraisal, and sound succession planning. AMO theory is commonly adopted at individual level. Thus, this theory ground the proposed relationships among the variables of this paper.

#### 4. CONCLUSION AND DISCUSSION

This paper surveyed the research on the relationship between HR practices, particularly compensation, performance appraisal and succession planning, and employee performance. The general information from the literature is that HR practices have impact on employees' performance. However, since this paper focuses purely on the conceptual perspective of the relationship between compensation, performance appraisal and succession planning and employee performance, the trend for future research should be empirically test to what extend and how HR practices, more specifically compensation, performance appraisal and succession planning are related and impacting employees' performance in the embryonic economy.

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