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CONTENTS

THE MERIT OF CREDIT: EXPLORING THE FACTORS THAT MAKE RETAIL CREDIT CONSUMERS LOYAL

M. N. Du Toit*, R. Machado*

Abstract

Loyal consumers are often regarded as the ultimate goal of any retail business, with the definition of loyalty incorporating many aspects of consumer behaviour and attitudes, the most prominent of which is return purchase behaviour. Credit consumers tend to display consistent repurchase behaviour, thereby appearing loyal. The aim of the current study was to investigate credit consumers of a retail clothing store and to identify factors that influence their loyalty towards the store. In order to achieve this objective, a comparison was made between a sample of account holders (credit consumers) and a similar sized sample of consumers who paid for their purchases in cash. Respondents were surveyed about their attitudes towards the retailer's merchandise, service and pricing, their perceived commitment to the retailer, their current purchase behaviour and their anticipated future behaviour regarding long-term loyalty towards the retailer. The study showed that account holders' loyalty towards the retailer was mostly influenced by the merchandise selection followed closely by the service received. Price had a negligible influence on account holders' loyalty towards the retailer. The findings of the study serve to guide retailers' strategies in terms of the provision of credit as a means to encourage loyalty amongst their consumers and resource allocation when considering competitive differentiation.

Keywords: Consumer Loyalty, Credit, Commitment, Retail, Retail Loyalty

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1. Introduction

For the past forty years, brand loyalty has become a focal point in marketing research and literature (Nawaz and Usman 2011:213) where it is often brandished as a panacea for all of a business's woes (Griffin 2002:5; Hallberg 2004:232; Reichheld 2006:18). In the retail sector, strategic loyalty programmes have become critical tools in an industry that is prone to intense competition and consumer promiscuity (Meyer-Waarden and Benavent 2009:345; Cant and Meyer 2012:198) where it is hoped that retaining consumers will drive profitability and sustainability (Reichheld 2006:18). Retailers aim to create and keep loyal consumers for three main reasons. Firstly, loyal consumers are more profitable than disloyal consumers (Reichheld 2006:18). Increased profitability can be due to the decreased cost of consumer acquisition, the tendency of loyal consumers to be less price-sensitive or the decreased cost of each transaction (Allaway, Gooner, Berkowitz and Davis 2005:1318; Griffin 2002:12; Reichheld 2006:19; Wisskirchen, Vater, Wright, De Backer and Detrick 2006:10). Secondly, having loyal consumers creates a competitive advantage that is both sustainable and difficult to copy. Loyal consumers are less likely to be attracted by competitive offerings but at the same time they are more likely to forgive service delivery or product failures (Bhatty, Skinkle and Spalding 2001:13; Budhwani 2002:13; Marney 2001:33). Thirdly, loyal consumers are advocates of the organisation. Consumer advocacy is understood to be the public support given by a loyal consumer to the organisation (Oxford Dictionaries online, 2012, sv. advocacy; Reichheld 2006:19) and exists when consumers are so loyal to the organisation that they actively promote the organisation to friends and colleagues.

Many methods have been proposed to create and retain loyal consumers, with loyalty programmes based on purchase-rewards schemes being one of the most popular (Meyer-Waarden and Benavent 2009:345). An alternative means of encouraging consumers to return to a retailer is to tie such consumers in on a contractual basis. This is most often achieved by offering consumers the option of purchasing on credit terms. Credit purchase is a concept implying that a purchase is made but the actual payment only occurs at a later stage based on a legally binding contractual relationship between the retailer and the consumer (Elliot and Wei 2010:88). The problem is that the increased use of credit has a subsequent economic effect of increased indebtedness and bankruptcy (Kamleitner and Kirchler 2006:267), which should force the marketing strategist to re-evaluate the extension of credit with the sole aim of tying consumers into long-term relationships.

The marketing literature is replete with authors attempting to define the concept of consumer loyalty and specifically to explain the reasons that consumers are loyal to a specific retailer. Very few articles however address the factors that influence consumer loyalty especially amongst consumers who purchase on credit. In the study on which this article is based, the existing literature of consumer loyalty and credit-based purchasing was reviewed with the specific focus of identifying the factors that influence consumer loyalty. A sample of each of two consumer groups, distinguished by their purchase payment behaviour at a single clothing retailer in Gauteng, was surveyed to identify the factors that influenced their loyalty towards the retailer. It was proposed that marketers should be aware of the factors that influence consumers who purchase on credit terms to be loyal to the retailer in order to drive strategy formulation and resource allocation. The research being reported here took the form of an exploratory, quantitative study to explore the factors that influence consumer loyalty towards a clothing retailer in Gauteng. In the section that follows, the literature on consumer loyalty and credit purchasing behaviour is reviewed. Research methodology and findings are discussed in sections 3 and 4 followed by the conclusions and managerial implications.

2. Literature Review

Consumer loyalty is widely accepted to comprise two separate facets: positive behavioural intentions towards a brand or retailer and a positive attitude towards the same (Demoulin and Zidda 2008:386). Articles that focus on consumer loyalty primarily explore the antecedents of consumer loyalty (Boora and Singh 2011:151; Garland and Gendall 2004:81; Oliver 1999:23) or evaluate the effectiveness of loyalty programmes in creating loyal consumers (Demoulin and Zidda 2008:386; Meyer-Waarden and Benavent 2009:345; O'Malley 1998:47; Wu, Hai-Chen and Chung-Yu 2012:B1). The debate surrounding the effectiveness of loyalty programmes is beyond the scope of this article, but the definition of consumer loyalty, the antecedents thereof and the factors that may influence a credit consumer to be more loyal to a brand or retailer are important.

2.1 Consumer loyalty

A broad definition of loyalty that can be applied to spousal relationships, brands, retailers and even restaurants is taken from the Oxford dictionary: "Loyalty is the quality of being faithful [act] in your support of somebody or something [object]" (Oxford Dictionaries online, 2012, sv. Loyalty). The act of being faithful as indicated in the definition can be interpreted in a marketing context as the positive behavioural intentions or repurchase behaviour by a consumer toward an object, which could be a product, brand or retailer. The benefits of having consumers who demonstrate positive repurchase behaviour from a retailer are discussed next.

2.2 The benefits of having loyal consumers

The benefits of having loyal consumers are extensively discussed in the literature and can be grouped into three categories, namely increased profitability, competitive advantage and consumer advocacy.

2.2.1 Increased profitability

Consumers contribute to the profitability of the organisation by the immediate value generated from an individual sale and also through their potential future spend (Peppers and Rogers 2005:8). Loyal consumers who intend to return to the organisation again will have a higher future spend value and can therefore be regarded as more profitable to the organisation than non-loyal consumers (Kumar 2006:10).

2.2.2 Competitive advantage

Consumers who actively select an organisation even when competitive options are available and cheaper are an asset to the organisation and can be regarded as a competitive advantage (Allaway et al. 2006:1318; Griffin 2002:12; Kumar 2006:10; Yi and Jeon 2003:230).

2.2.3 Consumer advocacy

Loyal consumers are believed to actively advocate the organisation to which they are loyal to their friends, colleagues and families, thereby giving the organisation free advertising (Reichheld 2006:19). The value of consumer advocacy across industries and products has been debated (Keiningham, Vavra, Aksoy and Wallard 2005:98), but is still widely regarded as a benefit of consumer loyalty (Blasberg, Vishwanath and Allen 2008:16). These potential benefits of having loyal consumers form the basis of strategies employed to engender loyal consumers.

2.3 Strategies to engender loyal consumers

Loyalty programmes are presented as an effective method of encouraging loyalty in consumers (Gomez, Arranz and Cillan 2006:388; Meyer-Waarden 2008:89) and are most often rewards-based schemes that incentivise consumers to return (Hallberg 2004: 231; Lara and Madariaga 2007:37). Another method of encouraging consumers to return to a specific organisation is to offer them credit terms allowing them to pay later for purchases that are made at the present moment. The convenience of not having to pay cash or carry cash with them motivates consumers to return to the organisation. Depending on the period of payment and the specific terms, an additional amount of interest is often charged on the original purchase amount (Elliot and Wei 2010:88). Retailers make use of so-called “store cards” to offer credit terms to their consumers (Erasmus and Lebani 2008:212), where store cards are understood to be credit cards valid only at the specific retailer (Lee and Kwon 2002:240). Criticisms against store cards include the fact that they are issued to consumers with little creditworthiness who are being allowed to extend their credit beyond their ability to make repayments (Erasmus and Lebani 2008:212; Lee and Kwon 2002:240); however, the fact remains that store cards represent a convenient payment option for consumers. Marketers need to understand the reasons (beyond financial indebtedness) why credit consumers are loyal to their organisations. The research on which this article is based explored the factors that influence credit consumers to be loyal to a retail clothing organisation.

3. Research Methodology

In 2011, the clothing industry in South Africa, comprising the sales of both clothing and footwear, reported sales of R151 454.8 million (Anon 2012:1), of which 38.5% was generated by the five biggest clothing retailers. This article reports on research that focused on one particular clothing retailer in Gauteng, which on its own represented 20.3% of the market, making it the largest clothing retailer in South Africa at that stage. The retailer was selected as the focus of the study for two reasons: firstly, its status as the largest clothing retailer in South Africa and secondly, due to the unique nature of its consumer base, which consisted of three distinct groups of consumers, namely ‘cash-only’ consumers, loyalty programme members who also pay cash, and account holders who purchase on credit terms. For reasons of confidentiality, the retailer will be referred to as Retailer X in this article.

An exploratory, quantitative survey was conducted at various shopping malls in the Gauteng province in South Africa to survey 308 consumers selected at the convenience of the researcher (Hair, Bush and Ortinau 2003:359). Shopping malls were selected based on their availability for research (not all shopping malls allow research to be conducted on their premises), their geographic location in Gauteng and the demographic composition of their consumers. Individual respondents were selected by the fieldworkers who conducted mall-intercept interviews.

The 308 respondents represented each of the three consumer groups relevant to Retailer X as follows: cash-only consumers (n=101), account holders (n=104) and loyalty programme members (n=103). Loyalty programme members were not included in this analysis as their purchasing habits and attitudes could have been influenced by programme membership and the associated rewards. Loyalty programme members could be included in future research that compares all three consumer groups.

The focus of the study was on account holders, so the cash-only group was considered as a control sample and served as a point of comparison for the factors that influence consumer loyalty towards the clothing retailer. The survey instrument was a structured questionnaire consisting of 18 individual questions with subsections. The questionnaire was formulated based on the literature study, and included elements designed to measure the respondents’ attitudinal loyalty to the retailer and their current and future behavioural intentions. The questionnaire elements were categorised according to factors identified from the literature study that were believed to contribute towards consumer satisfaction or emotional commitment to a retailer. The element categories were store atmosphere, consumer service, price and product-related issues.

3.1 Questionnaire design elements

Each of the questionnaire elements and the measurement instrument are indicated below.

3.1.1 Store atmosphere, consumer service, pricing and product elements

Consumer attitudes towards the store atmosphere, consumer service, pricing and products were measured by asking respondents to indicate the extent to which they agreed or disagreed with the derived statements on a standard five-point Likert scale. The individual statements and categories are indicated in Table 1 below.

Table 1. Store atmosphere, consumer service, pricing and product elements of questionnaire instrument

1.1	I enjoy the atmosphere in Retailer X stores
1.2	I like the music that Retailer X play in their stores
1.3	I like the design of the store, the way things are arranged
2..1	I get good service at Retailer X
2.2	I do not wait long when paying at the tills at Retailer X
2.3	There is sufficient help available when I need it
2.4	Retailer X staff are very friendly
3.1	Retailer X products are reasonably priced
3.2	The prices at Retailer X are competitive
4.1	I always get the products that I want from Retailer X
4.2	Retailer X has a good selection of products
4.3	Retailer X's products are fashionable and up to date
4.4	Retailer X has quality products

3.1.2 Emotional attachment to the organisation

Emotional attachment to the retailer was measured using a five point-Likert scale. Respondents were asked to indicate if they strongly agreed, agreed, neither agreed nor disagreed, disagreed or strongly disagreed with the statements as indicated in Table 2.

Table 2. Emotional attachment elements of questionnaire instrument

5.1	I am very committed to Retailer X
5.2	It would matter a lot to me if I could not buy from Retailer X

3.1.3 Current and future behavioural intentions

Responses were recorded using a five-point Likert scale in order to indicate the degree of agreement with the statements depicted in Table 3.

Table 3. Current and future behavioural elements of questionnaire instrument

6.1	I buy most of my clothes from Retailer X
6.2	I would recommend Retailer X to my friends
6.3	I am likely to buy even more of my clothes from Retailer X in the future

The responses to the questionnaires were collated into a single dataset and factor analysis was conducted to identify the factors that influenced consumer loyalty towards the retailer. The main findings of the research are outlined in section 4.

4. Research Findings

The descriptive statistics of the findings are firstly discussed and then the results of the factor analysis are presented.

4.1 Descriptive statistics

Descriptive statistics are those analyses of data that describe, show or summarise the data in a meaningful way (Anon1 2012:1). The descriptive statistical results of the study are represented in Table 4.

Table 4. Descriptive statistics for account holders and cash-only consumers for attitude-related measurements

Statement	Consumer group	N	Did not answer	Mean	Std deviation
I enjoy the atmosphere in Retailer X Stores	Account	104	0	4.08	0.91
	Cash	101	0	4.18	0.684
I like the music that Retailer X play in their stores	Account	103	1	3.49	1.056
	Cash	100	1	3.67	0.975
I like the design of the store, the way things are arranged	Account	104	0	4.13	0.733
	Cash	100	1	4.00	0.752
I get good service at Retailer X	Account	104	0	3.87	0.976
	Cash	101	0	4.00	0.917
I do not wait long when paying at the tills at Retailer X	Account	104	0	3.59	1.171
	Cash	101	0	3.49	0.966
There is sufficient help available when I need it	Account	104	0	3.79	1.067
	Cash	101	0	3.78	1.006
Retailer X staff are very friendly	Account	104	0	3.88	0.921
	Cash	101	0	3.96	0.799
Retailer X products are reasonably priced	Account	104	0	3.42	1.094
	Cash	101	0	3.38	1.094
The prices at Retailer X are competitive	Account	104	0	3.88	0.889
	Cash	101	0	3.65	1.004
I always get the products that I want from Retailer X	Account	104	0	3.74	1.024
	Cash	101	0	3.68	0.948
Retailer X has a good selection of products	Account	104	0	4.15	0.694
	Cash	101	0	4.19	0.644
Retailer X products are fashionable and up to date	Account	103	1	4.24	0.76
	Cash	101	0	4.30	0.656
Retailer X has quality products	Account	103	1	4.14	0.755
	Cash	101	0	4.23	0.691

When comparing means, the two consumer groups appeared to be very similar in their attitudes towards the atmosphere, service, prices and merchandise at Retailer X, with account holders having higher means in 6 out of the 13 categories with cash-only consumers having higher means in the remaining 7. Descriptive statistics for the commitment and behavioural questions are presented in Table 5.

Table 5. Descriptive statistics for account holders and cash-only consumers for commitment and behavioural measurements

Statement	Consumer group	N	Did not answer	Mean	Std deviation
I am very committed to Retailer X	Account	104	0	3.98	1.115
	Cash	101	0	3.42	1.160
It would matter a lot to me if I could not buy from Retailer X	Account	104	0	3.59	1.179
	Cash	101	0	3.43	1.195
I buy most of my clothes from Retailer X	Account	104	0	3.75	1.086
	Cash	101	0	3.18	1.108
I would recommend Retailer X to my friends	Account	104	0	4.17	.806
	Cash	101	0	4.10	.742
I am likely to buy even more of my clothes from Retailer X in the future	Account	103	1	3.92	1.036
	Cash	101	0	3.84	.924

The descriptive results presented in Table 4 and Table 5 indicate that, while both consumer groups appeared to have similar attitudes towards the retailer, the account holders were more positive in terms of their commitment, current behaviour and future behavioural intentions. The descriptive results do not however, indicate with any statistical significance whether there is a difference between the factors that influence consumer loyalty for cash-only consumers and for account holders. Factor analysis was conducted in order to identify the factors that influence consumer loyalty towards the retailer.

4.2 Factor analysis results

Generic factor analysis statistics to indicate the applicability of factor analysis for the cash-only consumer sample are presented in Table 6.

Table 6. Factor analysis statistics for cash-only consumers

Kaiser-Meyer-Olkin measure of sampling adequacy	.819
Sig.	.000

The Kaiser-Meyer-Olkin (KMO) statistic of 0.819 shown in Table 6 indicates that factor analysis was an appropriate test for this sample (KMO>0.5 and Sig. <0.01). Table 7 shows the rotated factor matrix for the cash-only consumers.

Table 7. Rotated factor matrix for cash-only consumers

	Factor		
	1	2	3
1.1 Enjoy atmosphere in Retailer X	<u>.787</u>	.031	.167
1.2 Like music played in store	.112	-.196	<u>.637</u>
1.3 Like design of store, way things are arranged	<u>.698</u>	.216	-.032
2.1 Get good service at Retailer X	<u>.760</u>	.071	.243
2.2 Do not wait long when paying at Retailer X tills	<u>.665</u>	.101	.090
2.3 Sufficient help is available when needed	<u>.711</u>	.137	.203
2.4 Retailer X staff are very friendly	<u>.630</u>	.118	.305
3.1 Products are reasonably priced	.244	.153	<u>.769</u>
3.2 Retailer X' prices are competitive	.206	.352	<u>.699</u>
4.1 Always get products I want from Retailer X	<u>.513</u>	.138	.344
4.2 Retailer X has good selection of products	.474	<u>.487</u>	.344
4.3 Retailer X' products are fashionable and up to date	.461	<u>.502</u>	.136
4.4 Retailer X has quality products	.464	<u>.564</u>	.086
Extraction method: principal component analysis. Rotation method: Varimax with Kaiser normalisation.			
a. Rotation converged in 5 iterations.			

The rotated factor matrix outlined in Table 7 illustrates that variables 1.1, 1.3, 2.1, 2.2, 2.3, 2.4 and 4.1 (underlined) loaded heavily on factor 1. Four of the seven loaded variables relate directly to consumer service, resulting in the first factor being labelled "service".

Variables 4.2, 4.3 and 4.4 (underlined) loaded heavily on factor 2. All three of the variables relate directly to merchandise, so the second factor was labelled "merchandise".

Variables 1.2, 3.1 and 3.2 (underlined) loaded on the third factor. Variable 1.2 was the only non-price-related variable that loaded on factor three and reliability analysis indicated that if variable 1.2 was removed from the scale the reliability of the scale would increase. Factor three was therefore labelled "price" as the two remaining variables related directly to price.

Composite variables were created to represent each of the three factors as defined in Table 7, and the composite variables were tested for reliability. Cronbach's alpha scores for each of the composite variables were above 0.6 indicating reliable scales.

A fourth composite variable was created to represent the current and future loyal behaviour of the cash-only respondents. This composite variable was labelled "loyalty", and consisted of the five variables illustrated in Table 2, namely 5.1, 5.2, 6.1, 6.2 and 6.3. Reliability analysis on the loyalty variable for cash-only respondents resulted in a Cronbach's alpha score of 0.844 indicating a reliable scale.

The three factors that were identified as factors that influence loyalty towards Retailer X were service, merchandise and price.

In order to identify the factors that influence consumer loyalty amongst account holders, a similar factor analysis was performed. The generic factor analysis statistics to confirm the applicability of factor analysis on the account holder sample are displayed in Table 8.

Table 8. Factor analysis statistics for account holders

Kaiser-Meyer-Olkin measure of sampling adequacy	.811
Sig.	.000

The factor analysis statistics depicted in Table 9 confirm the appropriateness of factor analysis as a statistical analysis technique on the account holder sample (KMO >0.5 and Sig. < 0.01). The rotated factor matrix for the account holder sample is presented in Table 9.

Table 9. Rotated factor matrix for account holders

	Factor			
	1	2	3	4
1.1 Enjoy atmosphere in Retailer X	.622	.250	.122	.123
1.2 Like music played in store	.327	-.012	.577	.376
1.3 Like design of store, way things are arranged	.251	.428	.623	-.007
2.1 Get good service at Retailer X	.670	.182	.128	.324
2.2 Do not wait long when paying at Retailer X tills	.784	.011	.117	.126
2.3 Sufficient help is available when needed	.791	.294	.066	.146
2.4 Retailer X staff are very friendly	.812	.169	.144	-.040
3.1 Products are reasonably priced	.166	.137	-.009	.899
3.2 Retailer X's prices are competitive	.179	.443	.118	.731
4.1 Always get products I want from Retailer X	.301	.743	-.126	.140
4.2 Retailer X has good selection of products	.100	.731	.131	.171
4.3 Retailer X's products are fashionable and up to date	.198	.741	.370	.076
4.4 Retailer X has quality products	.283	.735	.090	.238
Extraction method: principal component analysis. Rotation method: Varimax with Kaiser normalisation.				
a. Rotation converged in 8 iterations.				

Variables 1.1, 2.1, 2.2, 2.3 and 2.4 (underlined) all loaded heavily on factor 1. Four of these variables related directly to service resulting in this variable being labelled “service”.

Variables 4.1, 4.2, 4.3 and 4.4 (underlined) all relate to merchandise and loaded on factor 2 resulting in this factor being labelled “merchandise”.

Variables 1.2 and 1.3 (underlined), both relate to store atmosphere, loaded on factor 3, leading to this factor being called “atmosphere”.

Variables 3.1 and 3.2 (underlined) both loaded heavily on factor 4 resulting in this variable being labelled “price”.

As with the cash-only consumer group, composite variables were created to represent each of the identified factors. All of the composite variables scored Cronbach’s alphas of higher than 0.6 indicating reliable scales.

The composite loyalty variable for account holders comprised the same five variables as for cash-only consumers (see Table 5) and scored a Cronbach’s alpha of 0.875 indicating a reliable scale. Factor analysis simply defined the factors that influence consumer loyalty towards Retailer X. Regression analyses were used to differentiate between the factors in terms of the strength of their influence on consumer loyalty.

4.3 Regression analysis results

Regression analyses were performed on the composite variables from both consumer groups in order to determine the relative strengths of the influence of each of the factors on consumer loyalty. The results of the regression analyses are collated in Table 10.

Table 10. Regression analyses for cash-only sample and account holder sample

	Unstandardised coefficients	
	B	**Sig.**
Cash-only sample		
(Constant)	-5.705	0.013
Service	0.351	0.000
Price	0.721	0.000
Merchandise	0.304	0.013
Account holder sample		
(Constant)	-3.532	.069
Service	.512	.000
Merchandise	.666	.000
Atmosphere	.052	.667
Price	.198	.228
a. Dependent Variable: Loyalty		

Table 10 indicates that, for the cash-only sample, the price variable had the strongest influence on the loyalty variable (B=0.721). The variable which had the second strongest influence on the loyalty variable was service (B=0.352) followed by merchandise (B=0.304). The large gap between price and the other variables indicates the relative importance of price to cash-only consumers. Table 10 further illustrates that for account holders, the variable that influenced the loyalty variable most strongly was merchandise (B=0.666). Service had the second strongest influence on the loyalty variable (B=0.512). Neither of the remaining two variables, namely price and atmosphere identified for account holders had a significant impact on the loyalty variable (sig.>0.01).

5. Discussion

From Table 4 it can be seen that the two consumer groups, namely cash only and account holders were fairly equally represented in the study (n=101 and 104 respectively). While the descriptive statistics represented in Table 4 did not provide any conclusive proof of significant differences between the groups, the factor analyses performed on the two samples revealed that the two groups are significantly different when it comes to the factors that influence their consumer loyalty towards Retailer X. Table 10 revealed that cash-only consumers' loyalty towards Retailer X was most influenced by price. This is an important, albeit seemingly obvious finding which can influence retailers' marketing strategies. If price is the most important driver of consumer loyalty for cash-only consumers then retailers can utilise price promotions and special offers to encourage this consumer group to return to the store regularly. Other elements of retail marketing such as customer service and extensive product selection can be foregone to focus more closely on price-related issues.

The focus of the study reported on in this article was the account holder consumer group, and Table 10 revealed that the strongest influence on consumer loyalty for account holders was merchandise. The merchandise variable included the availability of merchandise when consumers demanded it, the breadth of the merchandise selection, the fashionability of the merchandise and the quality of the merchandise. The second strongest influence on consumer loyalty for account holders was the level of consumer service that they received. The service variable included the respondents' overall perception of the service received, their evaluation of the time spent waiting in queues, the availability of help when needed and the friendliness of the serving staff. While the strength of the influence of these two factors is interesting, the most notable result is the absence of price as an influencing factor. The implication for marketing managers of the insignificance of price to account holders is valuable in the establishment of marketing strategy. In the retail industry, most competitive strategies are based on price differentiation and special offers. The proliferation of "lowest prices every day" and "compare our price" marketing slogans are evidence of the importance of price in retail marketing. The negligible influence of price for account holder loyalty can allow Retailer X to achieve more per-unit profitability by charging higher prices than the competition with the potential of earning more interest over the repayment period.

From Table 5 it is clear that account holders across the board are more positive about continuing to purchase from Retailer X than the other consumer groups even though their perceptions about the prices being reasonable and competitive are only marginally positive (mean = 3.42 and 3.88 respectively). Marketing managers can focus more on merchandise buying and product selection than on pricing when encouraging account holders to be more loyal to the shop.

6. Conclusion and Managerial Implications

The retail industry is a very competitive one, with all role players trying to differentiate themselves from each other and attract loyal consumers. The benefits of having loyal consumers are well established in the literature and include increased profitability, consumer advocacy and sustainable competitive advantage. Many retailers offer credit terms to consumers, and at face value it appears that these consumers are loyal because they continue to purchase from the retailer. However, the reasons for their return patronage are not always clear and the study on which this article is based consequently endeavoured to identify the factors that influence the consumer loyalty of credit consumers in one clothing retailer in Gauteng.

The study found that both cash-only consumers and credit consumers were positive in their intentions to continue purchasing from the retailer, with credit consumers being more positive than other consumer groups in their perceived commitment to the retailer and their intentions to purchase even more clothing from the retailer in the future.

Furthermore, the study found that credit consumers' loyalty towards the retailer in question was most strongly influenced by merchandise variables such as quality and availability. The second strongest influence on credit consumers' loyalty was the level of consumer service that they received. The absence of price as an influencing factor on loyalty was noted as important and useful as a guide to defining future marketing strategies.

Based on the findings of the study to which this article refers, it is recommended that retail marketing managers focus on merchandise and service-related issues to encourage loyal behaviour in credit consumers, in order to capitalise on their indifference to price. It appears that there may be merit to credit after all.

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NATIONAL OIL COMPANIES: BUSINESS MODELS, CHALLENGES, AND EMERGING TRENDS

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Abstract

This paper provides an assessment and a review of the national oil companies' (NOCs) business models, challenges and opportunities, their strategies and emerging trends. The role of the national oil company (NOC) continues to evolve as the global energy landscape changes to reflect variations in demand, discovery of new ultra-deep water oil deposits, and national and geopolitical developments. NOCs, traditionally viewed as the custodians of their country's natural resources, have generally owned and managed the complete national oil and gas supply chain from upstream to downstream activities. In recent years, NOCs have emerged not only as joint venture partners globally with the major oil companies, but increasingly as competitors to the International Oil Companies (IOCs). Many NOCs are now more active in mergers and acquisitions (M&A), thereby increasing the number of NOCs seeking international upstream and downstream acquisition and asset targets.

Keywords: National Oil Companies, Petroleum, Business and Operating Models

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Introduction

National oil companies (NOCs) are defined as those oil companies that have significant shares owned by their parent government, and whose missions are to work toward the interest of their country. The traditional mission of a NOC has been to allow strategic investors, as co-owners and service providers, access to its home country's hydrocarbon resources. The governance dictates that NOCs own and manage the supply chain of oil and gas in the home country from upstream to downstream. The primary driving factors of investment between NOCs and international oil companies (IOCs) are the provision of access to hydrocarbon resources, knowledge transfer of leading-edge technology, engineering expertise, and managerial and project management skills. In addition, however, as exemplified in Venezuela and Russia, NOCs may be used to promote both social and political agendas as well as economic ones. A Chinese NOC's failure to acquire a U.S. company (UNOCAL) with international assets sends a signal that NOCs must do greater political due diligence when undertaking cross-border mergers and acquisitions (M&A). M&A has always been a factor in boosting growth in the oil and gas sector. The Merger Market gives figures of $423 billion for 2010 and $408 billion for 2011 in the energy sector, out of total global M&A of $2,277 billion and $2,237 billion (Mitchel et al., 2012).

NOCs come in a variety of forms, but most have both upscale (exploration and production "E&P") and downscale operations (refining and marketing). NOCs historically have mainly operated in their home countries, although the evolving trend is that they are going international. Examples of NOCs include Saudi Aramco (the largest integrated oil and gas company in the world), Kuwait Petroleum Corporation (KPC), Petrobras, Petronas, PetroChina, Sinopec, StatOil, and Malaysian NOC.

Asian state-owned companies of NOCs, most prominently from China and India, are at the forefront of strategic cross-border investments as their governments seek to prepare for long-term energy supply challenges. At the same time, increasing oil wealth brought about by rising oil prices has encouraged governments as diverse as Russia, Venezuela, Bolivia, and Ecuador to give greater political and economic leverage to their national energy champions. This is achieved in their local market through revisions to constitutional laws, contracts, tax and royalty structures. Also, the NOCs have begun to enter the international market, engaging in strategic investment activities and acquiring full or partial control of foreign companies, in sectors of strategic interest for national development.

Within the Gulf Cooperation Council (GCC) region, there are a number of NOCs that have capabilities to expand beyond serving their domestic markets. This process is, in part, being hindered by the inadequacy of corporate structures and the lack of information in the GCC region. Globally, it is being hindered by the rise of economic nationalism and the debate around economic sovereignty, security, and ownership of assets, and the perception in the west that NOCs should not seek to acquire IOCs and assets. Undoubtedly, political considerations influence and impact the international investment policy of NOCs.

The emerging trend driven by the rise of NOCs has shifted the balance of control over most of the world's hydrocarbon resources. In the 1970s, the NOCs (super majors) controlled less than 10% of the world's hydrocarbon resources, while in 2012 they control more than 90%. This shift has enabled NOCs to increase their ability to access capital, human resources and technical services directly, and to build in-house competencies. Further, NOCs have been increasing their ability to conduct outsourcing activities for many operations through the oilfield services companies (OFSCs), thus increasing their range of competence.

Moreover, the shift of the NOCs business models poses challenges for IOCs and independents by questioning the sustainability of their resource-ownership business model. Among these challenges are the production declines in existing oil fields, the difficulty of replacing oil and gas reserves in limited or restricted access areas, the rapid depletion of conventional or easy-to-access oil reserves, increasing production costs of unconventional resources, and the decline of their operating profit margins.

A number of key trends in NOCs' activities at the international level are emerging:

- With more access to capital and the development of in-house expertise, there has been a movement from being upstream producers to fully integrated energy companies;
- High oil prices, improved NOC management techniques, and access to capital markets mean that NOCs now have the financial resources to bid for, and complete, major international acquisitions;
- While major global oil companies may be fearful of investing in unstable areas of the world or where international sanctions have been imposed, NOCs' decision making merely has to be compatible with national policy and is unlikely to be hindered by corporate governance requirements and stakeholder action;
- NOCs are better able to mitigate overseas political risks through government-to-government relationships and negotiation strategies;
- NOCs can tolerate international political risk because domestic operations are likely to be unaffected; and
- Consortia exclusively led by NOCs are an emerging trend that will greatly impact the global oil and gas sector.

Despite these business and marketplace advantages, NOCs are not necessarily disciplined by the marketplace and, therefore, relative to IOCs, have a tendency to make economically-inefficient decisions. They also have the tendency to tolerate underproductive labor and staff bloating or, potentially, graft and other abuses on the part of national leadership. NOCs do, indeed, have many advantages relative to private corporations, most notably the political muscle of their parent government. Also, they usually at least have greater access to capital and the potential to take greater risks without fear of "betting the company."

Nevertheless, to truly be successful, NOCs should function with the discipline of a well-managed private firm and, wherever possible, segregate their national responsibilities to avoid the potential inefficiencies. If they have larger social objectives, these should be clarified and costed out so that fraud and abuse are avoided while social objectives are pursued in a cost-effective manner.

All this being said, there is indeed a rise in the NOCs, which are increasingly looking like international corporations with the full panoply of resources and with the special asset of carrying the imprimatur of their parent nation.

This paper will review and discuss the NOCs business models, challenges and opportunities, their strategies and emerging trends.

NOCs' Business Models

Business models are generally used to capture the economic logic for aligning internal decisions in view of external conditions. They are typically used by corporate executives as explanatory, but not predictive, tools for sound decisions and effective management practices.

As was noted earlier, most of the world's oil reserves are totally owned by national entities or partially owned by governments that coordinate oil exploration, development and extraction of the hydrocarbon resources in their countries, and in some cases outside their borders. NOCs differ in many respects; there are NOCs of net oil importers and exporters. They differ in their evolution, relation to their governments, accountability, efficiency, international presence, degree of integration, size, etc. The expansion of scope of business suggests that some NOCs be renamed the International-National Oil Companies (INOCs) because they may operate across the globe, and certainly beyond their national borders. INOCs also have similar functions to IOCs in terms of structural, financial and operational aspects. We will use NOC and INOC interchangeably. In recent years, INOCs have begun to bridge the gap and catch up with IOCs. This convergence is changing the landscape of the global oil and gas industry by both collaboration and competition.

NOCs have four key elements for success in the upstream oil and gas sector: access to capital, access to technology, breadth of capabilities and partnerships, and effective domestic engagement. In recent years, NOCs, relative to IOCs, have made more progress in innovative technologies. A common metric for innovation is a company's R&D expenditure. Some NOCs also are true innovators.

Saudi Aramco, Petrobras, Petronas, and the Chinese NOCs all have in-house R&D capabilities. PetroChina stands out as the top spender in absolute terms on R&D in 2012 among all oil and gas companies. Table 1 shows that IOCs historically have a competitive edge over NOCs, but the gap is now shrinking, and in some respects is reversed.

The emerging trend posed by the rise of NOCs has shifted the balance of control over most of the world's hydrocarbon resources. In the 1970s, the NOCs (super majors) controlled less than 10% of the world's hydrocarbon resources, while today (2012) they control more than 90%. This shift has enabled NOCs to increase their ability to access capital, human resources and technical services directly, and to build in-house competencies. Further, NOCs have increased the direct outsourcing of many operations through their oilfield services companies (OFSCs), rather than turning to IOC partners. As a result, IOCs and independents are facing new challenges to remain relevant to the NOCs, even in the most technologically difficult projects. Based on the growing wealth and expertise of NOCs, IOCs are increasingly focused on larger and more complex projects, such as Arctic drilling and production in unconventional oil and gas fields. The larger independents usually follow the same strategic path but with smaller scale projects.

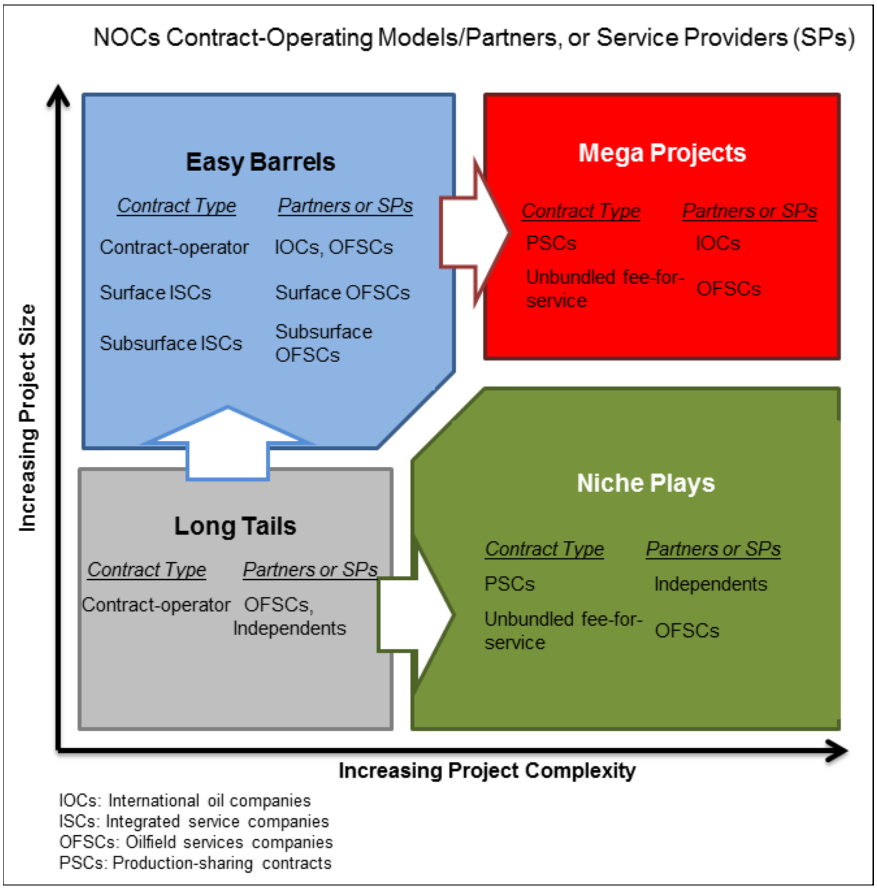
Table 1. Comparison between IOCs and NOCs

	IOCs	NOCs
1) Access to capital	✓ Publicly floated companies with access to liquid stock markets, banks and bond buyers	• State-backed • Increased access to equity and debt in global capital markets
2) Standard technology	✓ Leaning toward low R&D expenditures that drive down costs in complex development environments	• Rapid growth of R&D technology and innovation. • Increase of R&D budgets.
3) Breadth of capabilities and partnerships	✓ International focus. ✓ Partnerships with governments, NOCs, OFSCs and other IOCs.	• Primarily domestic focus of operations (for NOCs with domestic resources). • Expanding businesses globally. • Partnerships with IOCs, Independents and OFSCs.
4) Effective local engagement	✓ Developing models for local engagement by necessity. ✓ More diverse international workforce.	• Operating mostly in their domestic market, and globally to access resources. • Attracting international workforce.

Modified by author from Bain & Company, 2009

Figure 1 illustrates the NOCs' contract types and their partners or service providers with respect to project complexity and size. The mega-projects are characterized by high complexity and very large size. NOCs partner with IOCs to conduct these production-sharing contracts (PSCs). These mega-projects can also be conducted using unbundled fee-for-service contracts in partnership with OFSCs. Examples of this type include Saudi Aramco's agreement with Chevron to develop heavy oil fields, Total's joint venture with Saudi Aramco to build Al-Jubail refinery to process heavy oil, and Rosneft's deal with ExxonMobil in the Arctic.

Figure 1. A matrix of NOCs' operating models showing their different contract types and partners or service providers with respect to project complexity and project size.



Source: Modified by author from Bain and Company.

Moreover, the shift of the INOCs business model toward aggressive international resources acquisition poses challenges for IOCs and independents by questioning the sustainability of their resource-ownership business model. Among these challenges are the declines of production in existing oil fields, the difficulty of replacing oil and gas reserves in limited or restricted access areas, the rapid depletion of conventional or easy-to-access oil reserves, increasing production costs of unconventional resources, and the decline in the operating profit margins. As a result, investors are questioning the IOCs' ability to maintain their ownership-business model as their market and net asset values decline. In addition, the competitive advantage of IOCs is increasingly threatened by NOCs' development of internal technological capabilities and transformation into international-national oil companies (INOCs). NOCs are becoming a new competitor with some advantages. In the future there are likely to be three types of major oil companies: IOCs, NOCs, and INOCs, with the INOCs being defined as primarily those NOCs whose parent countries are oil-resource-poor. But, NOCs would also include those whose parent countries are rich in oil resources, even if they do choose to engage in international investments. Table 2 presents the objectives and characteristics of each type.

The major challenge for NOCs when dealing with OFSCs is managing the risk associated with integrated service contracts (ISCs). OFSCs are developing more end-to-end solutions and improving their technology competencies to support better unconventional and frontier locations. For example, Baker Hughes opened a research center with Saudi Aramco in Dhahran, Saudi Arabia. This R&D center focuses on understanding and developing unconventional oil and gas reserves, especially shale gas and tight gas. Similar to CNOOC and Sinopec to gain new technical capabilities, Saudi Aramco acquired Frac Tech International in late 2011. The greatest challenges for OFSCs are setting the optimal mix of ISCs in their portfolios of operations, and investing in technology and building capabilities to address a large and diverse customer base from IOCs and independents.

Table 2. Types of Emerging Major Oil Companies

	IOCs	INOCs	NOCs
	Seeking reserves and production growth in competition with other IOCs and now INOCs.	Primarily NOCs whose parent countries are oil-resource-poor. More direct competition with IOCs in multiple geographies.	Continue development of enormous domestic reserve base; parent countries are rich in oil resources.
1) Access to capital	✓ Free access to market capital.	▪ State-backed ▪ Increasingly free access to capital markets.	• State-backed.
2) Standard technology	✓ Long established, in-house R&D – looking for leadership position.	▪ Improving in-house R&D capabilities. ▪ Increased R&D investments.	• Partnerships with tech-savvy IOCs/ INOCs/OFSCs.
3) Breadth of capabilities and partnerships	✓ Long history of partnerships in multiple environments. ✓ Coming to terms with new partners.	▪ Improved partnering capabilities. ▪ Strategic differentiation on key capabilities and partnerships.	• Alliances with best-in-class IOCs and OFSCs as required.
4) Effective local engagement	✓ Long history of societal engagement at multiple levels.	▪ Developing skills in local engagement in diverse locations.	• Limited need for overseas local engagement.

Modified by author from Bain & Company, 2009

Efficiency of NOCs

Efficiency can be defined as producing crude oil and products at the lowest possible cost (including labor and materials) relative to the accessibility of the resource, within safe and environmentally sound guidelines. It is not easy to develop broad conclusions about the effectiveness of NOCs in this regard. Wolf (2009) argues that NOCs in OPEC and outside OPEC should be discussed separately. NOCs of OPEC seem to be more efficient compared with private companies due to the quality of their resources. NOCs of non-OPEC states are less efficient, in terms of labor and capital efficiency. Saudi Aramco is regarded as an efficient NOC not because of its resources but because it has had a long time to develop a leadership model, build a capable and lean staff, and create sound business relationships, as compared to, say, PDVSA or Pemex. Wolf also discussed the fundamental differences in goals, policies and data of NOCs and IOCs that often complicate any meaningful comparisons. Despite this important qualification, some studies have tried to develop general impressions of the rise of NOCs.

It is often challenging to distinguish between government policy and government ownership of a petroleum-producing organization and infrastructure. For example, governments might impose price controls irrespective of whether the resource is privately or publically owned. Therefore, some inefficiencies that might be ascribed to NOCs could be attributed to government policies rather than solely government ownership of the NOC. Many of the NOCs found to be inefficient are based in less-developed countries and are under pressure to maximize the flow of funds to the national treasuries or provide energy security to the country. In addition, some NOCs may be viewed as inefficient because of over-staffing, insider sales, and other forms of bad business practices.

Many NOCs appear to produce less petroleum output per unit of labor or other costs than do private, investor-owned corporations. These organizations may restrict current production for several possible reasons (Hartley and Medlock 2008):

- They withhold more output because they use higher discount rates than competitive firms.
- They do not maximize economic profits alone but instead have other political and social objectives.
- They operate less efficiently, incurring higher costs in producing expensive oil.

Unlike private companies, publically-held companies frequently do not disclose sufficient information about their operations that would allow a better understanding of their activities. Constrained by this lack of appropriate data, Eller et al. (2010) compared the ability of government and private companies to generate hydrocarbon revenues, with employees, oil reserves and gas reserves as inputs. They applied both statistical and linear programming approaches to identify each organization's relative efficiency. They concluded that generally NOCs are technically inefficient because they use more employees and reserves per dollar of revenue generated by the organization. In situations where

NOCs may be required by government policy to sell more supplies to subsidized domestic markets, it is unclear whether these lower revenues reveal much about the inefficiency of the NOCs themselves.

Unlike IOCs, NOCs are not necessarily disciplined by the marketplace and, therefore, have a tendency to make economically-inefficient decisions or to tolerate underproductive labor and staff bloating. NOCs do, indeed, have many advantages relative to private corporations, most notably the political "muscle" of their parent government. Also, they usually at least have greater access to capital and the potential to take greater risks without fear of "betting the company."

For NOCs to truly be successful, they should function with the discipline of a well-managed private firm and, wherever possible, segregate their national responsibilities to avoid the potential inefficiencies noted above. If they have larger social objectives, these should be clarified and costed out, so that fraud and abuse are avoided while social objectives are pursued in a cost-effective manner.

Challenges and Opportunities

There are several key challenges and opportunities that can be identified for NOCs to secure a competitive advantage. These challenges include:

- Risk management, reporting and governance.
- Talent development and retention.
- Partnership with IOCs.
- Financial management in a multinational environment.
- Citizenship and social responsibility.
- Climate change and the environment.

Risk Management, Reporting, and Governance

With the turmoil and major risk-related events that took place in the last few years, the current environment for doing business requires NOCs to go beyond their traditional roles of exploring, producing and refining crude oil. For INOCs in oil and gas importing countries such as China, the new challenge requires the development of a global investment strategy designed to secure the hydrocarbon sources on a global basis. For NOCs in significant oil and gas exporting countries, the medium- and long-term security of demand is a top priority of concern on their agenda. NOCs in both importing and exporting countries have recently been involved in negotiations with their respective governments to address many issues, including:

- The extent of security of commodity supply and demand.
- Globalization challenges and international collaboration.
- Physical security of assets and infrastructure in the supply chain.
- Operating in remote or hostile energy domains.

This new marketplace environment has allowed NOCs to take on greater strategic, political, and legal risks than in the past. But it has been suggested that NOC executives do not feel they have a good understanding of business risk in today's environment, which brings up a new challenge for NOCs to direct their interest toward developing a more comprehensive risk management framework.

As more NOCs begin to access capital markets, they also must consider adopting international accounting standards. Furthermore, new reporting systems are needed as markets are shifting business from already established centers to new financial centers. Where New York, London and Frankfurt are well established, Dubai, Hong Kong, Singapore and Shanghai are on the rise, and Riyadh will soon join them.

Corporate governance has been a thorny issue for many NOCs. Environment, health, safety, labor, and trade are essential concerns to the people of the countries where NOCs operate. NOCs should consider these issues in their investment decisions. NOCs, perhaps so more than IOCs, have explicit and implicit social responsibilities and must expect to be held responsible for their decisions in both local and international operations. NOCs also need to be cautious about the way their actions impact public sentiment. As NOCs have access to more capital markets, the corporate governance requires NOCs to be more accountable and transparent to all shareholders, not just to their home countries or ministries.

Talent Development and Retention

The need to retain talent is becoming a burning issue for many companies, especially in the upstream sector. It was claimed (Economist, Oct 7 2006) that talent has become the most sought-after resource after oil itself but, over recent decades, the U.S. oil industry alone has laid off over 1 million jobs through M&A.

With the rise of INOCs, there is more stimulated competition between INOCs and IOCs for the limited talented pool. Simultaneously, this might encourage collaboration or partnership between companies trying to tap into the same talent resources. In 2002, the Algerian NOC collaborated with other companies to access their engineering expertise necessary to improve its operations for exporting liquefied natural gas (LNG) to Europe. Recently, NOCs in Russia, India, Libya and China have all signed collaborative agreements with several IOCs. One of the important success factors requires that NOCs may need to adapt their internal cultures to accommodate the different nationalities and generations of the workforce. The point is that expertise comes primarily from the West and NOCs tend to be at a disadvantage given where they are located and operate.

Partnership with IOCs

Some NOCs have a keen interest in expanding and globalizing their business, so partnering with IOCs is a strategic endeavor to access stronger project, management experience, and key global markets. Also, IOCs can bring new technologies, critical expertise and international experience that may not be as readily available within some NOCs. As a result, IOC-NOC relationships can lead to initiating cross-investments and building institutional knowledge in key areas of key technical proficiencies. The NOC-IOC partnerships can leverage the upstream sector to promote domestic economic development. NOCs traditionally favor long-term relationships, but their focus is shifting toward project-based, short-term agreements. For example, Saudi Aramco and Total established SATORP to develop a greenfield refining and petrochemical project in Saudi Arabia. In addition, Saudi Aramco and Dow formed SADARA to develop the Saudi Aramco-Dow Integrated Petrochemical Complex in Jubail, Saudi Arabia. China National Petroleum Corporation (CNPC) made a deal in Kazakhstan to make investments in power stations, railway lines, and chemical plants.

Another emerging trend is that NOCs in hydrocarbon-rich countries such as Saudi Arabia, Venezuela, and Russia seem to exert more bargaining power over IOCs. I.e., they are coming to have fewer opportunities than in the past in countries with large reserves. This is because NOCs have improved their expertise and have become qualified national operators, making use of OFSCs' specialized services with better deals, acquiring smaller firms to access technology and skills, and building talent and expertise through global partnerships. NOCs from large emerging economy countries with scarce hydrocarbon resources, like China and India, are seen to be harder negotiators as well in their relationships with IOCs.

Financial Management in a Multinational Environment

Over the last decade, the increase and volatility of oil prices have challenged the financial strategies of NOCs in different ways. For OPEC NOCs, more cash flow led to the acceleration of their capital spending programs. Also, this made them concentrate on developing strategies that could help secure a competitive advantage in investments, both upstream and downstream, and in domestic and global markets. In contrast, importing NOCs have raised their financial resources through a diversity of public market channels, from floating bond issues to selling equity. For example, Petroleos de Venezuela S.A. (PDVSA) issued bonds for many years through U.S. debt capital markets. In addition, in 2007 PetroChina Company Limited won approval for an initial public offering (IPO) of shares on the local market that could rise over $7 billion.

Although oil prices may not have high volatility in absolute terms, they have a significant impact on cash flow and outlays. This absolute impact of price volatility can make cash flow management and forecasting more difficult. Therefore, NOCs are required to confront this volatility by devising rigorous strategies for cash and risk management. As NOCs globalize, international tax planning becomes a key aspect of financial planning. NOCs will inevitably take advantage of international tax planning opportunities, double tax treaties, and differing taxation rates in countries in which they operate.

Citizenship and Social Responsibility

Like the IOCs, NOCs are expected to maintain high standards of corporate social responsibility and demonstrate care for the environment, safety and health of labor, and communities throughout the world. Among others, Saudi Aramco, PetroChina Company Limited, Kuwait Petroleum Corporation, and Oil and Natural Gas Corporation of India have announced their commitments and their obligations to corporate citizenship involving environment, health, safety and community practices. It was pointed out that IOCs and OFSCs should have to contribute more to the socioeconomic development, in partnership with the NOCs, of the countries in which they operate (Al-Falih, 2011). With the NOCs, they may be required to provide jobs, develop national talents, create national supply chains, invest in infrastructure, provide financing, and support the development of new domestic industries.

For many countries, NOC-NOC partnerships have become increasingly attractive as exporting NOCs seek long-term demand security. Within OECD countries, the oil and gas markets are largely open and liberalized with IOCs typically controlling the supply and distribution infrastructure. NOCs seeking to secure access to demand in such markets need to establish and maintain good relationships with the host countries.

Climate Change and the Environment

Climate change and the environment have recently grown in concern in many countries. NOCs must showcase their good stewardship towards the environment both in domestic and international operations, and now they must consider climate change as well as they align their environmental practices with the demands of the consumer markets. Saudi Arabia, the world's largest oil exporter, has showcased many initiatives that support actions on global warming through conducting research projects on reducing CO_2 emissions. Saudi Aramco, the largest NOC in the world, has established a carbon management program and launched a pilot project for demonstrating carbon capture and storage (CCS) technology that could potentially be used for enhancing oil recovery (EOR). Further, King Abdullah Petroleum Studies and Research Center (KAPSARC) has studied the development of a framework for a CCS program in Saudi Arabia and its implementation strategies. A comprehensive survey was also conducted in an effort to shape climate change policy in Saudi Arabia. As Abdullah Jum'ah, the former president and CEO of Saudi Aramco, said "*I believe the petroleum industry should actively engage in policy debate on climate change as well as play an active role in developing and implementing carbon management technologies to meet future challenges. National oil companies - like Saudi Aramco- can make meaningful contributions to those efforts*." (Hammond, 2006)

Strategies and Emerging Trends

The strategies and policies of NOCs will have a substantial long-term impact on the pace of resource development in the coming years. Asian and Russian NOCs are increasingly competing for strategic resources in the Middle East and Eurasia, in some cases replacing Western oil companies in important resource development activities and negotiations. Firms such as India's Oil and Natural Gas Corporation Ltd. (ONGC), Indian Oil Corporation Ltd. (IOC), China's Sinopec, China National Petroleum Corporation (CNPC), and Malaysia's Petronas have expanded in Africa and Iran, and are now pursuing investments throughout the Middle East. Russia's Lukoil is becoming a significant international player in key regions such as the Middle East and Caspian Basin. Many of these emerging NOCs are financed or have operations subsidized by their home governments, with strategic and geopolitical goals factored into investment decisions rather than being purely commercial considerations. Strategic investment and trade alliances for emerging NOCs are also being sought on the basis of geopolitics rather than economic considerations.

The interplay between emerging NOCs, major oil-producing countries and Western consumer countries will have a large impact on future energy security and the stability of oil and gas markets, raising many questions. This is an area of research that needs to be explored further. Increasingly, NOCs are in the process of reevaluating and changing business strategies, with substantial consequences for global oil and gas markets.

Within the GCC region, there are a number of companies that have capabilities to expand beyond serving their domestic market. This process is, in part, being hindered by the inadequacy of corporate structures and the lack of information in the GCC region. Internationally, it is being hindered by the rise of economic nationalism and the debate around economic sovereignty, security and ownership of assets, and the perception that NOCs should not seek to acquire international oil companies and assets.

Undoubtedly, political considerations influence and impact the international investment policy of NOCs. The Kuwait Petroleum Corporation is the only GCC region NOC that has integrated a scalable downstream operation in the form of the Q8 brand name in Europe; Venezuela's PDVSA acquired CITGO in the United States; however, the failed bid on the part of China's CNOOC to acquire UNOCAL of the United States in 2005 is a case in point. If an INOC is perceived to be more than just a corporate entity, then its aggressive growth will be questioned.

Within the Gulf Cooperation Council (GCC) region, some regional NOCs have displayed strategic positioning in making international acquisitions. In October 2008, Abu Dhabi's International Petroleum Investment Company (IPIC) increased its stake in Austria's OMV, from 17.6% to 19.2%. IPIC has also invested in Spain's Compania Espanola de Petroleos. Saudi Aramco has experience in investing in refineries and distribution networks abroad as a minority Joint Venture partner.

In light of these dynamics and emerging trends of NOCs, industry players (IOCs, independents and OFSCs) must reexamine two corporate strategic questions: where to play and how to compete successfully with NOCs. The strategic options for IOCs and independents include following a path independent of the NOCs, investing in becoming the partner of choice for NOCs to retain production-sharing rights, and implementing the contract-operator service model. This model involves IOCs collaborating with integrated service companies in the easy oil fields as a way to gain access to the NOCs' larger and more complex projects. OFSCs will have to constantly improve the efficacy and delivery of unbundled services, as this represents the most likely way to procure oilfield services in the immediate future. The strategic options that OFSCs are applying to succeed are: advancing and applying cutting-edge technology, providing low-end offerings competitive with other low-cost service providers, and embracing the contract-operator business model.

In summary, a number of key trends are emerging to guide NOCs' activities at the international level:

- With more access to capital and the development of in-house expertise, there has been a movement from being upstream producers to fully integrated energy companies.
- High oil prices, improved NOC management techniques, and access to capital markets mean that NOCs now have the financial resources to bid for, and complete, major international acquisitions.
- While major global oil companies may be apprehensive about investing in volatile areas of the world or where international sanctions have been imposed, NOCs' decision making merely has to be

compatible with national policy and is unlikely to be hindered by corporate governance requirements and stakeholder action.

- NOCs are better able to mitigate overseas political risks through government-to-government relationships and negotiation strategies.
- NOCs can better tolerate political risk because domestic operations are likely to be unaffected.
- Consortia exclusively led by NOCs are an emerging trend that will likely continue.

In short, there is indeed a rise in the NOCs, which are increasingly looking like international corporations with the full panoply of resources and with the special asset of carrying the imprimatur of their parent nation.

Conclusions

This paper reviewed and discussed the evolution of NOCs, including new roles, opportunities, and emerging challenges faced in the upstream oil and gas industry. The business models and characteristics for the different oil and gas companies were also discussed in the context of NOCs. It also discussed the rise in NOCs' international activities and the consequences for future supply, security, and pricing of oil.

NOCs will continue to aggressively track new opportunities for growth: in terms of reserves and revenue stemming from growing access to capital markets, increasing profits, greater participation in technology advancements, and increasingly effective project management and other technical capabilities. NOCs are now addressing new challenges that require a more comprehensive approach to risk than in the past. The successful rise of NOCs depends on their responses to new challenges that include more effective corporate governance and transparency, financial risk management, talent development and retention, and greater effort to address externalities including climate change.

NOCs are reshaping the playing field by globalizing their business portfolios and crossing national borders, implementing vertical integration in the supply chain, and attracting capital from global markets. The strategic partnerships between NOCs and super majors grant NOCs the lion's share of benefits, as NOCs diversify their foreign assets, participate in unconventional reserve development, access leading-edge technology, and attain skills and expertise.

To sum up, NOCs are on the rise because they have a number of advantages relative to IOCs. At the same time, these NOCs can still do better if they can learn a variety of practices that the IOCs have perfected, namely in dealing with different international financing and taxing authorities, cooperating with one another to utilize their most advantageous skills, finding ways to mitigate risks, and acquiring and retaining the best intellectual capital in the most cost-effective ways.

This paper does, however, glide over some of the advantages and problems that NOCs encounter, including:

- Some NOCs might be characterized as using the political muscle of their government to yield concessions that cannot be gained by IOCs.
- NOCs can often protect their international assets through the political, and sometimes military, influence that their parent government can provide.
- NOCs, as arms of their parent governments, may be constrained by the concerns of other nations.
- NOCs have the potential to be hampered by inefficiencies and corruption, which the IOCs can avoid by employing best business practices and being exposed to a competitive marketplace.

This paper also suggests that unconventional energy is a less desirable area to be in relative to traditional oil fields. This may be the case among the GCC nations, but the reality is that oil's future is likely to include both unconventional and difficult-to-access (e.g., deep water, Arctic, etc.) sources. The IOCs, in developing expertise in these areas, as well as acquiring or partnering with firms having this expertise, are diversifying in a wise manner — and they're buying into renewable technologies as well to cover all bets.

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THE STRUCTURE OF CORPORATE OWNERSHIP AND FIRM PERFORMANCE: SRI LANKAN EVIDENCE

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Abstract

This paper examines the impact of ownership structure and concentration on firm performance in Sri Lanka, an emerging market in Asia. The study estimates a series of regressions using pooled data for a sample of Sri Lankan-listed firms to investigate the impact of ownership concentration and structure on firm performance based on agency theory framework, using both accounting and market-based performance indicators. The results of the study provide evidence for a strong positive relationship between ownership concentration and accounting performance measures. This suggests that a greater concentration of ownership leads to better performance. However, we found no significant impact using market-based performance measures, which suggests the existence of numerous market inefficiencies and anomalies. Furthermore, the findings of the study show that ownership structure does not have a significant distinguishable effect on performance.

Keywords: Corporate Governance, Ownership Concentration, Performance, Emerging Markets, Sri Lanka

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1. Introduction

The effect of ownership concentration and structure on firm performance is considered an important issue in the search for an appropriate governance model for an economy. Much of the literature on good corporate governance of modern corporate entities assumes that corporate ownership is widely dispersed, where a clear distinction is evident between ownership and management. However, the literature shows a high level of ownership concentration in many countries — especially outside the Anglo-Saxon countries (La Porta et al., 1999; Kapopoulos and Lazaretou, 2007; Shleifer and Vishny, 1997). Many studies examine the impact of ownership concentration on performance, concluding that higher ownership concentration may improve performance by decreasing monitoring costs. Alternatively, performance can decline if large shareholders use their control rights to achieve private benefits (see for example, Shleifer and Vishny, 1986; Thomsen et al., 2006; Zeitun and Gary, 2007; Morck et al., 1988; Leech and Leahy, 1991; and Demsetz and Lehn, 1985). However, most studies on ownership concentration and structure were conducted in developed economies, and their results generalized without paying much attention to contextual idiosyncrasies. The contextual settings of developed countries differ vastly from those of emerging markets (Nam and Nam, 2004). For example, governance survey in Asia by Classens and Fan (2002) revealed that most of the Asian markets have governance systems with weak institutions and poor property rights and argued that conventional corporate governance mechanisms have limited effectiveness in these economies. It is widely presume that the theoretical arguments put up on empirical findings and evidence collected from developed countries may have limited applicability to emerging markets. As Zeitun and Gary (2007) point out, the social, economic and cultural factors of a country affect corporate ownership structure, which in turn impacts on firm performance. Very little is known about the performance implications of ownership structure in emerging markets, and there is a dearth of studies in this area. This issue, combined with the divergent results produced by similar previous studies conducted in developed economies, creates a vacuum in the academic literature on corporate governance practices in emerging markets. This study helps to fill this gap by examining the impact of ownership concentration and structure on firm performance in the context of an emerging economy, namely Sri Lanka.

Sri Lanka has undergone much political and economic turmoil in recent decades, and this has produced various macroeconomic anomalies. In comparison to many other emerging markets in Asia, Sri Lanka provides a unique business environment because of its historical inheritance, the 30-year civil war and other socioeconomic influences. As Nanayakkara (1999, p.9) points out, "in many dimensions, Sri Lanka's performance has been paradoxical: high quality of life with low level of productivity; high level of literacy and education with low level of employment and high level of political instability with a stable democratic system of governance". These kinds of inconsistencies at the macroeconomic level create a challenging environment for Sri Lankan corporate governance, which was inherited from British colonial rulers who dominated the country for over four centuries. Due to this historical background, and coupled with other unique economic and political features, the governance structure of Sri Lankan organizations is greatly influenced by the neo-liberal reinforcement of good governance practices (Alawattage and Wickramasinghe, 2004).

Sri Lankan corporate entities have strong historical ties with the systems inherited from British colonial rule. The country adopted liberalized economic policies from 1977, and international funding agencies (such as the World Bank, the IMF and the Asian Development Bank) have also influenced corporate functioning. In the post-colonial era, British structures influenced Sri Lankan accounting and auditing systems, as have, more recently, international standards and practices (Asian Development Bank, 2002). Given these contexts, research is needed on how the various corporate governance practices of Sri Lankan firms operate within these paradoxical conditions, and how they manage to achieve higher performance and investor confidence in order to maximize shareholder wealth.

As in many other emerging markets in Asia, the ownership of Sri Lankan companies is highly concentrated, with a presence of controlling shareholders in most enterprises (Samarakoon, 1999). As per the Colombo Stock Exchange (CSE) listing rules, a public listed company must satisfy a specified public float in its issued share capital at the time of its initial listing and thereafter. In order to be quoted on the CSE, a company must have a minimum public holding of 25 per cent of the total number of shares, and these must be in the hands of a minimum number of 1,000 public shareholders (CSE, 2009). However, this requirement has not been properly monitored or enforced, and the minimum public shareholding of some companies falls short of the required float. Together with the above-mentioned historical, economic and political influences, this has produced a concentrated ownership in most Sri Lankan companies. The study by Senaratne and Gunaratne (2007), which examines the ownership structure of listed companies in Sri Lanka, reveals that the ownership of Sri Lankan companies is characterized by certain features, such as: the controlling shareholder is usually another corporate entity; family ownership as the ultimate owners is widely prevalent; a pyramid ownership structure, cross-holdings and participation in management by controlling shareholders are used extensively; and a large community of arm's-length institutional shareholders is absent. Therefore, corporate control in Sri Lanka often lies in the hands of a few individuals, families or corporate groups who hold the majority of ownership. The existing governance structure of Sri Lankan companies, characterized by their domination by controlling shareholders, shows some similarity to the insider systems of corporate governance model, which is normally characterized by highly concentrated holdings, concentrated voting power, cross-corporate holding and inter-firm relationships. However, whether this type of ownership structure affects firm performance has not been examined in any prior research on Sri Lanka. Therefore, the main objectives of this study are to examine: (1) the impact of *ownership concentration* and (2) the impact of *ownership structure* on the performance of Sri Lankan-listed firms.

The reminder of this paper is organized as follows. Section 2 provides a brief review of the existing literature on the effects of ownership structure and concentration on firm performance. Section 3 explains the data and methodology. The analysis and empirical findings are presented in Section 4, while Section 5 concludes the discussion.

2. Literature Review

Governance issues arise when the ownership of a legal entity is separated from its management (Tricker, 2000). This intensifies the need to search for good governance practices, as identified by Berle and Means (1932). Central to this analysis is agency theory, which explains the conflict of interest between inside owners (directors of the firm who own shares in the firm) and outside owners (shareholders other than directors in the firm). Jensen and Meckling (1976) argue that relative to the amount of ownership held by inside owners, they have incentives to pursue their own benefits, which in turn are aligned to enhance firm value. According to this hypothesis, both a firm's value and its performance increase with the level of insider ownership.

Market-centric economies are largely characterized by the existence of a widely held ownership structure, highly liquid stock markets (due to good investor protection) and control of companies by professional managers on behalf of scattered shareholders (Bhasa, 2004). In these economies, corporate management has more power to make decisions, and these decisions may frequently be in management's own interest, which may then generate an agency cost. Agency theory argues that ownership concentration may improve firm performance by decreasing agency costs (Shleifer and Vishny, 1986). Jensen and Meckling (1976) claim that agency costs consist of three different components: monitoring costs, bonding costs and residual loss. Monitoring costs are the control costs incurred by the principal to mitigate the devious behaviour of the agent. Bonding costs are incurred to ensure that the manager makes decisions beneficial to the principal. Residual loss is a potential cost that occurs when both monitoring costs and bonding costs fail to control the divergent behaviour of the manager.

Jensen and Meckling (1976) illustrate theoretically how the allocation of shares among insiders and outsiders can influence the agency costs and firm value. Since these authors' work, the relationship between ownership and firm performance has attracted special attention. Agency theory and the empirical literature thereof usually consider insider ownership as the main corporate mechanism that increases firm value. However, empirical evidence regarding the relationship between ownership concentration and financial performance (or firm value) has produced mixed results (for example, Agrawal and Knoeber, 1996; Demsetz and Villalonga, 2001; Thomsen et al., 2006). Despite the existence of a wealth of research, the question of whether concentrated ownership contributes to reduced agency costs (and thereby improves firm value and financial performance) remains unanswered.

The agency theory hypothesis (that ownership concentration may improve firm performance by decreasing agency costs) was first challenged by Demsetz (1983), who argues that the ownership structure of a corporation should be thought of as an endogenous outcome of decisions that reflect the influence of shareholders. Demsetz asserts that no systematic relationship should exist between variations in ownership structure and variations in firm performance. Demsetz and Lehn (1985) provide evidence of the endogeneity of a firm's ownership structure, using a measure of the profit rate on a fraction of shares owned by the five-largest shareholdings, and found no evidence of any relationship between profit rate and ownership concentration. Conversely, Shleifer and Vishny (1986) show the importance of the role played by large shareholders, and how the price of a firm's shares increases as the proportion of shares held by large shareholders rises. They argue theoretically for a positive relationship between ownership concentration and firm value.

Morck et al. (1988) ignored the endogeneity issue altogether and re-examined the relationship between corporate ownership structure and performance, measured in terms of Tobin's Q, and propose a non-linear relationship between insider ownership and firm performance. They found a positive relationship between corporate ownership structure and Tobin's Q for less than five per cent board ownership range, a negative relationship in the 5–25 per cent range and a positive relationship for ownership exceeding 25 per cent. However, their results are not supported by accounting-based performance measures. Wu and Cui (2002) found a positive relationship between ownership concentration and accounting profits, indicated by return on assets (ROA) and return on equity (ROE), but the relationship is negative with respect to the market value measured by the price-earnings ratio (P/E) and market-to-book-value ratio (MBR).

Corporate governance mechanisms vary around the world and can produce different ownership effects on firm performance. The academic literature identifies the existence of four different models of governance: the market-centric model (outsider model), the relationship-based model (insider model), the transition model and the emerging market model. These models are vastly different in terms of how those associated are accountable in the process of the separation of ownership and control within the organization (Bhasa, 2004). In countries such as the US and the UK, where market-centric mechanisms operate, firms rely substantially on the legal protection of investors and the dispersed ownership structure. Europe and Japan, where relationship mechanisms operate, rely less on legal protections, but more on large investors and banks. The transition model is mainly used by central and eastern European countries and newly independent states from the former Soviet Union. The emerging market model is characterized by the existence of a lively capital market, formal and functional legal systems, and both family-held and widely-dispersed firms. The emerging market model has arisen as a result of an attempt to impose and replicate the relationship-based and market-centric governance models originating in the developed economies on emerging markets (Vinten, 2002; Sarre, 2003). While market-centric and relationship-based governance models are widely discussed in the governance literature, the emerging governance model has not been examined extensively — despite its applicability to many developing countries in the world (OECD, 2009; Kirkpatrick, 2009).

The literature extensively examines corporate governance issues under various theoretical perspectives, such as the agency, stewardship, stakeholder and political models. These theoretical perspectives provide different viewpoints from which to investigate firms and their governance (Turnbull, 1997). However, the dominant focus in the mainstream literature is from an agency perspective of the firm, with a view to securing owners' interests by reducing agency costs. Most of these theories are developed and examined in the developed economies, assuming contextual conditions of these economies provide universal reference. Tricker (cited in Turnbull, 1997, p. 187) states that "stewardship theory, stakeholder theory and agency theory are all essentially ethnocentric. Although the underlying ideological paradigms are seldom articulated, the essential ideas are derived from Western thought, with its perceptions and expectations of the respective roles of individual, enterprise and the state and of the relationships between them". An increasing body of literature refers to the potential differences in the economic characteristics of developing countries. However, the interaction of these economic characteristics with governance and corporate structures, and the performance implications of these factors have not been examined thoroughly. Therefore, these contextual differences across countries create another dimension to the ownership structure and performance issue. In an attempt to reconcile this divergent evidence, Udayasankar and Das (2007) notionally explain the performance implication of corporate governance in the context of the exogenous environment, supported with multiple theories of corporate governance, such as agency, stakeholder, resource-dependence, and institutional theories, and construct an argument that the regulation and competitive forces in the environment interact with the governance practices of firms, resulting in idiosyncratic effects on performance.

Because of the contextual differences across countries, different relationships between ownership structure and firm performance might be expected. For example, in emerging economies, where firm ownership is highly concentrated with family ownership, a significant positive effect of ownership concentration on firm performance is proposed. This argument is confirmed by the study of Zeitun and Gary (2007), which examined the relationship of ownership concentration and firm performance both in term of accounting measures and market measures using a sample of public listed companies on the Jordan stock exchange. They found a significant positive relationship between ownership concentration and accounting performance measures. Abor and Biekpe (2007) investigated the effects of corporate governance and ownership structure on the performance of SMEs in Ghana and found that board size, board composition, CEO duality, inside ownership and family ownership have significant positive impacts on profitability. Despite these efforts, the various performance implications of ownership concentration and structure are yet to be explored with a particular focus on emerging economies. This study analyses ownership concentration and structure, and their performance implications in the Sri Lankan context, thereby starting to resolve this knowledge gap.

3. Data and Estimation Method

3.1 Data

The sample used in the study consisted of 157 non-financial Sri Lankan companies listed on the CSE over the period 2000–2008. As per the CSE website, 232 companies were listed on CSE in 2010 and the number of companies varied from 232 to 240 over this period. Accordingly, this sample represents approximately 68 per cent of the listed companies. The data for the study were obtained from three main sources: Bureau Van Dijk's OSIRIS database (OSIRIS), CSE's Data Library which provides share price information of Sri Lankan stock market and the annual reports of public listed companies in Sri Lanka. The major items of interest to this study were balance sheets, income statements, ownership structure, shareholdings of main shareholders and the market prices of shares. The balance sheet and income statement items were directly extracted from the OSIRIS database. However, information on ownership structure and the share ownership of main shareholders was not available in the OSIRIS database, and hence they were extracted directly from the annual reports of relevant companies. The market share price information of sample firms was obtained from the *Data Library* published by the CSE.

Table 1 presents the sample profile of companies which consists of 846 firm-years, covering the period between 2000 and 2008. These companies belonged to ten different industrial sectors, of which the manufacturing sector represented the highest number of companies (26 per cent) in the sample. As per this table, the number of companies in each industry sector ranged 3–26 per cent. The sample includes all industrial sectors of the CSE, excluding the bank, finance and insurance sector, which consisted of approximately 30 companies over the sample period. This sector was excluded from the initial sample selection process mainly due to non-comparability of applicable regulations, especially in respect of share ownership, profitability measures and liquidity assessment, compared to other sectors.

Table 1. Sample Profile

Industry	No. of Firms	%	Firm-Years (2000–2008)	%
Beverage and food	14	8.9	95	11.2
Diversified	7	4.5	48	5.7
Health	6	3.8	21	2.5
Hotel	25	15.9	123	14.5
Investment & property	11	7.0	65	7.7
Manufacturing	40	25.5	220	26.0
Motors	6	3.8	42	5.0
Plantations	22	14.0	108	12.8
Service and trading	17	10.8	79	9.3
Other	9	5.7	45	5.3
Total	**157**	**100.0**	**846**	**100.0**

The data set contains detailed information on performance, measured in terms of accounting and market return, ownership concentration (OC), ownership structure (OS) and other financial information capable of measuring the size, age and leverage of the companies.

3.2 Measurement and Selection of Variables

As this study aims to explore the diverse performance implications from ownership variables, both accounting and market performance measures are alternately employed in the analysis model. Prior studies which examine the performance implications of ownership have argued that the accounting and market performance measures are differ at least in two important respects and employed both accounting profit rate and Tobin's Q (TQ) in some of these studies (Demsetz and Lehn, 1985; Zeitun and Gary, 2007; Morck et al., 1988; Agrawal and Knoeber, 1996; Demsetz and Villalonga, 2001; Thomsen et al., 2006). In consistence with the arguments propagated by these studies, we employed both performance variables which include return on assets (ROA) and return on equity (ROE) as the accounting performance measures while TQ and market-to-book-value ratio (MBR) as the market performance measures in order to find out the impact of ownership on firm performance in a different contextual setting. These performance variables were measured using pooled data as given below.

ROA: Net profit before tax to total assets; measured operational efficiency of the firms

ROE: Net profit after tax to total equity; measured profitability of firms from equity shareholders' point of view.

Proxy TQ: The market value of a firm's equity plus the book value of its debt to the book value of total assets.

MBR: Market value of a firm's equity to its book value

Accounting and market performance measures are diverse in many respects out of which two important aspects appeal discussion. The first relates to the time horizon: accounting profit is based on the historical performance of the firm, and is therefore a backward-looking measure; while TQ ratio reflects the investors' expectation, and is therefore a forward-looking measure. The second difference arises due to measurement problems: accounting profit is largely distorted by accounting principles, concepts and standards. In contrast, TQ is based on market values, and therefore is affected by investors' expectations about future events, which are subject to manipulations, signalling, group behaviour, and mistakes (Kapopoulos and Lazaretou, 2007). TQ also suffers from accounting measurement problems, due to the use of proxy book value in place of replacement value of tangible assets. Book values generally have serious problems caused by inflation and arbitrary depreciation choices. Furthermore, TQ does not reveal the investment made in intangibles; and neither does it reflect the value placed by investors in intangibles. Due to these reasons, validity of TQ as a performance measure is debatable, especially in an emerging market where market anomalies and inefficiencies play a dominant role in deciding the market price for securities.

The accounting performance variables are subject to various limitations which are typically resulted from the fundamental limitations of financial statements. Though the financial statements are prepared based on generally accepted accounting standards, accounting process is dominant by subjective interpretation of standards and the application of firm-specific accounting rules and policies. This makes it difficult to compare the firm performance measured in accounting terms in a realistic manner. Despite this inherent limitation, the applicable legal requirements and the financial statement preparation process of Sri Lankan listed firms are in par with the international standards in many respects. The Sri Lankan firms are required to prepare financial statements based on Sri Lanka Accounting Standards which are fully compliant with the International Financial Reporting Standards

(IFRS). The financial statements of Sri Lankan companies are required to be audited by a qualified auditor as per the Companies Act No.07 of 2007. Furthermore, they are required to comply with the listing rules of CSE and are subject to constant monitoring by the Securities and Exchange Commission and the Sri Lanka Accounting and Auditing Standards Monitoring Board. The published financial statements can therefore, serve as the prime data source for obtaining information in measuring performance of companies (De Zoysa and Rudkin, 2010).

Ownership concentration (OC) is measured using four variables: (1) the percentage of shares held by first three-largest shareholders (SH_3); (2) the percentage of shares held by first five-largest shareholders (SH_5); (3) the percentage of shares held by first ten-largest shareholders (SH_{10}); and (4) the Herfindahl Index (HERF). The HERF index, which is the sum of squared percentage of shares controlled by each of the top-five shareholders, can be considered a special concentration variable, because it lends more weight to larger shareholders in the index. Similarly, the ownership structure (OS) is measured using two fraction ratios: (1) the fraction owned by individuals (F-Ind), and (2) the fraction of shares owned by other companies (F-Com).

The main argument in relation to the influence of OC on firm performance is that the high concentration improves performance through the reduction of agency costs. For example, Berle and Means (1932) argue that disperse ownership adversely affects firm performance. In consistence with this assertion, Shleifer and Vishny (1986) argue that ownership concentration may improve performance by reducing the problem of small investors and decreasing monitoring costs. On the basis of these claims, this study investigates the impact of ownership concentration on firm performance using concentration variables in order to achieve the first objective of the study.

The studies that examine the performance implication of ownership structure claim that higher individual ownership leads to higher firm performance whereas higher corporate ownership leads to poorer firm performance. This is achieved through individual owners' monitoring capabilities and incentive to pursue personal interest. When individuals own majority of shares of a firm, they are more likely to be involved in monitoring of operational activities. Also, they may become insider owners who always pursue their own interest leading to better overall performance. Both situations have a positive influence on the better performance of the firms. Jensen and Meckling (1976) argue that relative to the amount of ownership, insider owners have incentives to pursue activities to serve their own interests, and conclude that both a firm's value and its performance increase with the level of insider ownership. Conversely, if corporate entities own shares, their ultimate owners are less likely to be capable of monitoring firm performance, due to their indirect ownership.

If the ownership structure is endogenous as argued by Demsetz and Lehn (1985) and some of the subsequent studies, ownership is more likely to be affected and possibly determined, among other factors, by firm performance. The managerial ownership is found to be affected by performance due to various factors such as performance based compensation, insider information. For example, panel data evidence provided by Himmelberg, Hubbard and Palia (1999) revealed that managerial (insider) ownership is endogenous to performance. Management compensation in the form of stock options is found to be one of the main reasons for a reverse causation in which firm performance affects ownership structure. The finding that ownership structure is endogenous implies that the endogeneity must be taken into account when determining the relationship between ownership and performance. Failing to do so is bound to yield biased regression estimates. However, the managerial ownership by itself is not sufficient to fully capture a firm's ownership structure. Furthermore, in corporate governance systems where ownership structure is much more stable, ownership is likely to be exogenous to performance (Gugler and Weigand, 2003).

As revealed by Samarakoon, (1999) and by Senaratne and Gunaratne (2007), the ownership structure of Sri Lankan listed firms is very much steady and characterized by certain features, such as highly concentrated ownership with a presence of controlling shareholder, holding controlling ownership usually by another corporate entity, holding ultimate ownership by family owners. Thus most of the Sri Lankan firms have stable ownership structure and therefore ownership is more likely to be exogenous to performance. Furthermore, direct managerial ownership in Sri Lankan companies is relatively small, because ownership is usually dominated by another corporate entity. These entities usually have family ownership as the ultimate owners, and therefore, direct managerial ownership does not play an influential role in Sri Lankan context. Thus, we do not examine the endogeneity issue in this study and have follow-on studies that do not treat managerial and outsiders' ownership as endogenous. However, individual owners have more powers in participating in the operational activities of a firm, especially in the Sri Lankan market, where controlling shareholders' influence in management is considerably high. Thus, the ownership fraction is expected to be significant in the regression estimates. On the basis of this argument, we investigated the impact of ownership structure on firm performance using fraction variables (F-Ind and F-Com) in order to achieve the second objective of the study.

In this study, we design a regression model incorporating OC and OS as the main independent variables to carry out an empirical analysis. The analysis controls for other firm characteristics that may affect performance. These control variables represent size, operational experience and leverage of the sample firms. The size represented by total sales is expected to be positively related to corporate performance, while the operational experience of the firm represented by the age of the firm is expected to be positively related to the performance, because experience reduces operational costs via economies of scale and the process efficiencies. The leverage represented by the ratio of total debt to total assets is expected to relate negatively to firm performance, because debt exposes firms to a higher risk through refinancing and the cost of capital commitments.

3.3 The Model

Based on the assumed causal relationship between ownership and firm performance, we developed the following regression model using four different measures of performance: return on assets (ROA), return on equity (ROE), Tobin Q (TQ) and market-to-book-value ratio (MBR). The explanatory variables used in this model are the ownership concentration (OC) and ownership structure (OS) measured using two fraction (F) ratios. The control variables of the model are: firm size measured in terms of the natural logarithm of total sales (LN-TSal), operational experience measured in terms of the natural logarithm of firm age (LN-Age) and leverage measured in terms of total-debt-to-total-assets ratio (TD-TA). The regression equation is estimated using the following specifications:

$$Y = \beta 0 + \beta 1\ (OC) + \beta 2\ (LN\text{-}TSal) + \beta 3\ (LN\text{-}Age) + \beta 4\ (TD/TA) + \beta 5\ (F) + e \qquad (1)$$

Where Y is alternately ROA, ROE, TQ, and MBR for firm, as a measure of performance. The concentration variables (OC) are represented alternately one of the concentration measures, and the ownership structure (OS) is represented alternately by two F ratios: F-Com and F-Ind ratios. Size, operational experience, and leverage are represented by LN-TSal, LN-Age and TD/TA ratio respectively, while e is the error term.

4. Analysis, Results and Discussion

4.1 Descriptive Statistics

The ownership and performance variables are initially examined with exploratory data analysis and descriptive statistics and the results are shown in Table 2. The descriptive statistics shows that the first three OC ratios (SH_3, SH_5 and SH_{10}) indicate a very high ownership concentration in the sample of Sri Lankan firms. Specifically, the mean values of each of the three OC ratios in the sample were above 70 per cent, with an overall mean value of 77 per cent. The data also indicates that a substantial variation across firms in ownership concentration exists. The average range of the three OC ratios is 66 per cent, with an average standard deviation (SD) of 14 per cent. The data in Table 2 reveals that the first ten-largest shareholders (approximately 80 per cent of the sample firms) held over 75 per cent of shares. This indicates that the majority of firms are not in compliance with the CSE listing rule requirement which stipulates that a minimum float of 25 per cent shares should be held by at least 1,000 shareholders. The forth OC ratio, the HERF index, further confirms the existence of a high concentration of ownership in Sri Lankan firms. As per the data in Table 2, the mean value of HERF index amounted to 3,210. According to the merger guidelines issued by the US Department of Justice (2010), an HERF index in excess of 1,800 points is considered as a high concentration. This also indicates the presence of a controlling shareholder for most of the Sri Lankan firms. The ownership structure of firms indicates a higher corporate ownership compared to individual ownership. As per table 2, the average value of the fraction of shares owned by other corporate entities (F-Com) is 72 per cent, compared to 28 per cent owned by individuals (F-Ind).

As shown in Table 2, all four OC ratios indicate a very high concentration but dispersion of these variables divers considerably. The final regression model includes only two OC ratios alternately to avoid the repetition of analysis. These two variables are chosen based on the dispersion and importance given to largest shareholder in estimating the proxy variable considering the role played by controlling shareholder in achieving better performance. The SH_3 is selected as the first OC ratio as it records the highest dispersion, with a standard deviation of 17 per cent. The HERF index is chosen as the other OC variable as it gives more weight to larger shareholders (or a controlling shareholder) in its estimation.

Table 2. Descriptive Statistics of Variables; 2000–2008

Variables	Mean	Std. Dev.	Min.	Max.	Skewness	Kurtosis	Shapiro-Wilk	Prob.
ROA	5.493	10.243	−113.219	87.833	−0.817	28.430	.820	.000
ROE	8.097	24.458	−327.308	153.777	−3.380	48.640	.710	.000
Tobin Q	1.099	0.587	0.239	4.941	2.802	10.768	.741	.000
MBR	1.268	2.402	−9.331	55.010	14.757	309.140	.317	.000
SH_3	70.362	16.999	25.273	98.441	−0.452	−0.482	.960	.000
SH_5	77.510	13.945	30.275	98.876	−0.864	0.671	.939	.000
SH_{10}	84.065	10.906	41.489	99.763	−1.187	1.975	.917	.000
HERF	3,209.857	2,097.330	270.973	8,952.334	0.894	0.071	.920	.000
F-Ind	28.654	22.967	1.496	100.000	1.258	0.880	.863	.000
F-Com	71.346	22.967	0.000	98.504	−1.258	0.880	.863	.000
TD-TA	0.512	0.355	0.000	3.922	3.469	27.266	.770	.000
LN-TA	14.100	1.506	8.701	18.382	−0.218	0.487	.993	.000
LN-Age	3.316	0.799	0.000	5.100	−0.067	0.469	.977	.000
LN-TSal	13.574	1.935	4.248	17.685	−0.552	0.621	.981	.000

Sample (N) = 846.

4.2 Correlations and Regression results

Correlations: The results of the correlation analysis shown in Table 3 indicate the extent of correlation between the explanatory variables used in this study. Accordingly, we found the size of the firm to be negatively correlated with the OC ratios, implying that larger firms tend to have more dispersed ownership. We observed a similar relationship between the age of the firms and OC ratios, because older firms tend to have less concentration, as they are normally subjected to expansion through public share issues. As expected, we found the two OS ratios, SH_3 and HERF, to be highly correlated with each other. However, because they are used in the regression model alternately, the high correlation between these two variables has no impact on the model. The result also shows that the F-Com ratio is positively correlated with the OC ratios. This implies that most of the Sri Lankan firms in the sample had parent companies as their principle shareholder, with larger share ownership. In addition, the negative relationship between F-Ind ratio and OC ratios shows that the individually owned companies were less concentrated.

Table 3. Correlation Matrix of Explanatory Variables, 2000–2008

	SH_3	HERF	F-Ind	F-Com	TD-TA	LN-Age	LN-TSal	VIF
SH_3	1							1.488
HERF	.825**	1						1.465
F-Ind	−.570**	−.556**	1					1.499
F-Com	.570**	.556**	−1.000**	1				1.499
TD-TA	−.034	−.040	.013	−.013	1			1.075
LN-Age	−.068*	−.023	.111**	−.111**	.046	1		1.026
LN-TSal	−.042	−.067	−.020	.020	.262**	.109**	1	1.090

Note: ** significant at 5% level, * significant at 10% level.

Regression results: Table 4 shows the results of the pooled regression models for 846 sample observations for the period between 2000 and 2008 for each of the performance measures, using the SH_3 ratio as the measure of OC. Table 5 presents the results of the pooled regression models for the same sample observations where the HERF index is used as the measure of OC. The F ratios are used interchangeably with each of the models where Model A runs with the F-Ind ratio, while Model B runs with the F-Com ratio. As Table 3 illustrates, the correlation coefficient of some variables are more than 50 per cent. This suggests the existence of multicollinearity among the variables in the regression models. Thus, we carried out a diagnostic test with the calculation of variance inflation factors (VIF), which quantifies the severity of multicollinearity in a regression analysis, for each of the regression models to assess the multicollinearity among the variables. The summary scores of the VIF shown in Table 3 indicate fewer than 2 scores for all variables in the model. In general, VIF scores under 10 (or scores under 2.5 even in a weaker model) can be considered as a good indicator for non-multicollinearity (Gujarati, 2003).

The regression results in Table 4 indicate that a significant positive relationship exists between the OC ratio and accounting performance measures. As per this Table, the SH_3 variable is found to have a positive and significant impact on both ROA and ROE at the one per cent significance level for various equations. Similarly, the results in Table 5 indicate that the HERF index also has a positive and significant impact on both ROA and ROE at the one and five per cent levels respectively. This empirical evidence suggests that the concentrated ownership plays a dominant role in Sri Lankan firms in improving performance through reducing agency costs by effective monitoring or direct involvement in management, as suggested by Jensen and Meckling (1976).

However, the analysis we carried out to examine the impact of ownership concentration on market-based performance measures found no significant positive relationship between variables. More specifically, we found the OC variable of SH_3 to have no significant impact on both TQ and MBR. We also found the estimated coefficients of SH_3 for all the models to be close to zero. Furthermore, the other OC variable of the HERF index has positive impact on both TQ and MBR at the five and 10 per cent significant levels; and the coefficient of all models are close to zero, indicating a negligible impact. This strongly suggests that market anomalies exist in Sri Lankan markets where economic and company fundamentals do not reflect on share prices, restricting the ability of a market price to give a true picture of a company's performance.

Table 4. Estimation Results for Pooled Data Models using OC-SH_3 and Structure (F) Variables

	ROA		ROE		TQ		MBR	
	A	B	A	B	A	B	A	B
(Constant)	−23.367	−19.690	−44.474	−45.769	1.461	1.244	1.132	1.625
	(−7.028)***	(−6.556)***	(−5.360)***	(−6.107)***	(7.641)***	(7.203)***	(1.345)	(2.137)**
OC-SH_3	0.080	.080	.151	.151	.001	.001	.003	.003
	(3.399)***	(3.399)***	(2.588)***	(2.588)***	(.841)	(.841)	(.544)	(.544)
TD_TA	−7.234	−7.234	−3.103	−3.103	.604	.604	.311	.311
	(−7.581)***	(−7.581)***	(−1.303)	(−1.303)	(11.017)***	(11.017)***	(1.287)	(1.287)
LN-Age	0.448	.448	.805	.805	−.007	−.007	.056	.056
	(1.080)	(1.080)	(.779)	(.779)	(−.289)	(−.289)	(.530)	(.530)
LN-TSal	1.799	1.799	3.036	3.036	−.049	−.049	−.042	−.042
	(10.204)***	(10.204)***	(6.901)***	(6.901)***	(−4.843)***	(−4.843)***	(−.951)	(−.951)
F-Ind	0.037		−.013		−.002		.005	
	(2.111)**		(−.298)		(−2.167)**		(1.118)	
F-Com		−.037		.013		.002		−.005
		(−2.111)**		(.298)		(2.167)**		(−1.118)
No. of	846	846	846	846	846	846	846	846
R^2	.145	.145	.067	.067	.139	.139	.005	.005
Adjusted R^2	.140	.140	.061	.061	.134	.134	−.001	−.001
F-stat	28.559	28.559	11.977	11.977	27.105	27.105	.760	.760
P-value	0.000	0.000	0.000	0.000	0.000	0.000	0.579	0.579

Note: *** significant at 1% level, ** significant at 5% level, * significant at 10% level. Numbers in parentheses are t-values.

The significant impact of the OC variables on ROA and ROE support Shleifer and Vishny's (1986) hypothesis that concentrated ownership might reduce the agency cost, and hence increase firm performance. These results are also consistent with the claims made by Zeitun and Gary (2007): that ROA and ROE are the most important factors used by investors — not the market measure of performance. This finding is also consistent with the results found by Wu and Cui (2002): that a positive relationship exists between ownership concentration and accounting profits, measured in terms of ROA. The insignificant results of concentration variables on both TQ and MBR could be due to the inefficiency of the Sri Lankan equity market, where company fundamentals are not impounded into share price efficiently. The use of a proxy TQ might have aggravated the problem because accounting measurement problems are also imbedded into TQ in addition to market inefficiencies. Both TQ and MBR are subjected to inherent market anomalies, such as insider trading and price fixing, which are common in small markets. Furthermore, other factors not considered in the model could affect the market performance.

Table 5. Estimation Results for Pooled Data Models using OC-HERF and Structure (F) Variables

	ROA		ROE		TQ		MBR	
	A	**B**	**A**	**B**	**A**	**B**	**A**	**B**
(Constant)	−19.125	−16.166	−37.642	−39.148	1.415	1.287	.914	1.743
	(−6.831)***	(−5.759)***	(−5.401)***	(−5.603)***	(8.838)***	(8.023)***	(1.296)	(2.465)**
OC-HERF	.001	.001	.001	.001	.000	.000	.000	.000
	(2.728)***	(2.728)***	(2.560)**	(2.560)**	(2.478)**	(2.478)**	(1.932)*	(1.932)*
TD_TA	−7.241	−7.241	−3.097	−3.097	.606	.606	.317	.317
	(−7.570)***	(−7.570)***	(−1.301)	(−1.301)	(11.080)***	(11.080)***	(1.313)	(1.313)
LN-Age	.385	.385	.658	.658	−.010	−.010	.044	.044
	(.926)	(.926)	(.635)	(.635)	(−.430)	(−.430)	(.420)	(.420)
LN-TSal	1.808	1.808	3.073	3.073	−.047	−.047	−.036	−.036
	(10.205)***	(10.205)***	(6.966)***	(6.966)***	(−4.668)***	(−4.668)***	(−.804)	(−.804)
F-Ind	.030		−.015		−.001		.008	
	(1.707)*		(−.349)		(−1.285)		(1.898)*	
F-Com		−.030		.015		.001		−.008
		(−1.707)*		(.349)		(1.285)		(−1.898)*
No. of observations	846	846	846	846	846	846	846	846
R^2	.141	.141	.066	.066	.144	.144	.009	.009
Adjusted R^2	.136	.136	.061	.061	.139	.139	.003	.003
F-stat	27.609	27.609	11.946	11.946	28.366	28.366	1.449	1.449
P-value	0.000	0.000	0.000	0.000	0.000	0.000	0.204	0.204

Note: *** significant at 1% level, ** significant at 5% level, * significant at 10% level. Numbers in parentheses are t-values.

An additional issue worth addressing in this study is whether ownership structure impacts on performance, based on the argument that larger individual ownership is positively related to firm performance, while larger corporate ownership is negatively related to firm performance. If ownership structure is irrelevant to firm performance, we would expect the ownership fraction to be insignificant in the regression estimates. The results in Table 4 and 5 indicate strong evidence of a positive significant relationship between individual ownership (F-Ind) and ROA, and a significant negative relationship with corporate ownership (F-Com) and ROA. Both are significant at five per cent level. This result is consistent with our argument that individual owners (compared to corporate owners) are actively engaged in operational activities or are highly influential in monitoring the functions of firms. Consequently, agency costs are expected to be reduced, resulting higher performance; and the counterargument is true for corporate ownership.

This study however reveals some conflicting results in relation to ROE and market performance measures. As shown in Table 4, the sign of the coefficients of F-Ind are negative with regard to ROE and TQ, while they are positive and non-significant for MBR. This indicates that either a negative relationship exists between F-Ind and performance, or that individual ownership is irrelevant to firm performance. Conversely, corporate ownership (F-Com) shows positive coefficients with ROE and TQ. However, as shown in Table 4, only the TQ coefficient is significant at the five per cent level. This implies that, although the controlling shareholder is often another corporate entity, its ultimate ownership lies with a family. Therefore, a larger fraction of corporate ownership does not indicate that a firm has a greater ownership concentration of external investors. The existence of family ownership as a controlling shareholder, either through direct ownership or through another corporate entity, is a common feature of Sri Lankan companies. Therefore, share ownership fractions do not necessarily have any significant distinguishable performance implications.

In summary, the empirical evidence suggests that ownership concentrated in individuals has a positive effect on performance measured by ROA, and a negative effect on performance if ownership is concentrated on corporate entities. However, we did not find consistent empirical results in respect of other performance measures, such as ROE, TQ and MBR. Despite the conflicting outcome, these empirical results support the theory that a relationship exists between ownership structure and firm performance (Jensen and Meckling, 1976).

In all regression models, both firm size measured in total sale and firm age have a positive impact on firm performance, measured by ROA and ROE. While firm size is significant at the one per cent level, age is not significant. Furthermore, leverage measured in TD/TA has a negative impact on both ROA and ROE. However, while the impact on ROA is significant at the one per cent level, ROE is non-significant. In general, the sign of the coefficients for control variables on ROA and ROE are inconsistent with previous findings and the economic arguments. However, both size and age have a significant negative impact on TQ; whereas the impact on MBR is not significant and leverage has a positive impact on TQ and MBR. These results are robust, and provide further evidence for the existence of market anomalies, which are inherent to most of the small, emerging markets such as Sri Lanka.

5. Conclusions

The academic literature mostly discusses corporate governance issues within the context of developed economies. Although corporate governance is identified as one of the structural weaknesses of emerging markets, less attention has been paid to various corporate governance issues in these markets. One governance issue that has attracted a high attention in developed markets, but which has not been examined adequately in emerging markets, is whether ownership concentration and of firm structure can affect corporate performance. The studies conducted on this aspect in developed markets offer divergent results. Although some theories suggest that ownership structure affects firm performance, numerous empirical investigations suggest that performance implications of ownership structure are largely contextual. Because no prior studies exist on this issue in Sri Lanka — an emerging economy with unique social, cultural and economic settings—the major objective of this study was to examine the impact of ownership concentration and structure on the performance of public listed firms in Sri Lanka. For this purpose, we carried out an analysis based on a regression model using pooled data for a sample of 157 Sri Lankan public listed firms for a nine-year period between 2000 and 2008. This study provides useful information on the relationship between various ownership concentration and structure measures and their influence on both accounting and market performance.

Empirical findings indicate that a significant relationship exists between ownership concentration, measured by SH_3 and the accounting performance measures ROA and ROE. The HERF index also has a positive and significant impact on both ROA and ROE. This result suggests that a greater concentration of shares leads to either effective monitoring of management behaviour or larger internal ownership, which results in better performance. However, ownership concentration did not show any significant effect on market-based performance measures, which points to the existence of market anomalies and inefficiencies which are common to most emerging markets such as Sri Lanka.

An examination of the impact of ownership structure on performance provides evidence that share ownership fractions have a significant effect on ROA. However, all other performance measures show conflicting results in respect of the sign of the coefficients or significance thereof. These results provide evidence for a pattern of share ownership in Sri Lankan firms, for most of which, the ultimate controlling share ownership lies in the hands of families or business conglomerates acquired through individuals or other corporate entities. Therefore, the fraction ratios, measured as the percentage of shares owned by individuals, and the percentage of shares owned by other corporate entities do not have any significant distinguishable effects on performance.

One of the main limitations of this study is the use of pooled data regression analysis, which assumes that the intercept and slope coefficients are constant across time and sectors. However, this assumption may be inappropriate after taking into account the number of sectors, and their vast diversity, as examined in the present study. Future studies could address this limitation by applying either a fixed-effect or random-effect model into the panel regression analysis, to capture the diversity of different sectors over the period into the analysis.

The scope of this study is limited to an examination of the ownership concentration and structure measured in terms of direct shareholdings without analysing ultimate ownership. However, given the nature of ownership structure in Sri Lankan companies, some other companies and individuals may hold ultimate ownership of the companies through indirect shareholding and significantly affect the performance of the sample companies. Therefore, we suggest that future studies extend the definition of ownership beyond direct shareholdings to examine the impact of ultimate ownership on firm performance.

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THE IMPORTANCE OF BRANDING FOR SOUTH AFRICAN SMES: AN EXPLORATORY STUDY

Michael C. Cant*, Johannes A. Wiid**, Yu-Ting Hung***

Abstract

One of the most challenging micro-environmental variables that small and medium enterprises SMEs are faced with is marketing, and more particularly branding. The research study investigates the importance of branding to South African SMEs and determines whether SMEs comprehend the significance of branding in the business' success. The objective of this paper is to determine how brand orientated SMEs are, their perceived brand distinctiveness and the barriers they are faced with. A questionnaire was conducted and judgement sampling was used to gather the responses of 43 SMEs. The research identified that SMEs are aware of the importance of branding; however some SMEs do not have to necessary resources available for it. The challenge now is to improve the skills and capabilities of SMEs to ensure effective branding, which ultimately influences their success, as they play a vital role in the South African economy.

Keywords: Business Problems, Business Elements, Marketing, Branding, South Africa, SMEs

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Introduction

Due to modern technological developments, small, medium and large organisations are now competing in an environment that is global in nature and scope, rich in information and knowledge based (Abimbola & Vallaster, 2007:341). This presents various opportunities and threats for SMEs, namely that they not only compete with other SMEs, but also well established, large businesses. Pencak (2012) states that branding is a key concept in the marketing field, and that it is important to every business, regardless of the size. A strong and well defined brand drive sales, builds customer loyalty, creates brand value and is seen as a catalyst for business growth (Pencak, 2012). Strong brands convey familiarity and trust, reduces risk and serves as the basis for, and engagement between, individuals and companies (Abimbola & Vallaster, 2007:342).

The role and value of SMEs cannot be negated and they play a crucial role in most third world countries, such as South Africa, by creating employment and contributing to a more equitable income distribution (Fatoki & Garwe, 2010:729). Kongolo (2010:2288) estimated that South African SMEs account for 91% of formal entities that contribute between 51-57% to the GDP and 60% of employment. However, it is estimated that only about 40% of SMEs survive to the second year of trading due to various reasons (Roberts, 2010). This is not unique to South Africa and one way of trying to stem this tide is by means of a strong brand. Branding is seen as an effective way to facilitate the growth of business which can give an organisation a competitive advantage, attract and keep new customers and generate loyalty from existing customers which can lead to increased profits (Pencak, 2012). Berthon, Ewing and Napoli (2008:28) indicate that the relevance and importance of branding in SME's have been hugely neglected as the focus is generally more on large multinationals.

The focus of this study was on the establishment of the importance of branding of SMEs in South Africa. Previous studies conducted by Abimbola (2001:97) highlighted the relevance of branding for SMEs and identified guidelines that SMEs could follow in order to build a successful brand. In a similar way, Merrilees (2007) investigated how branding could facilitate SME development of new ventures. Berthon *et al.* (2008) assessed the nature and scope of brand management within SMEs and found significant differences between SMEs and large organisations regarding the various brand dimensions that exist. It is also clear from the studies conducted that the focuses have traditionally been on corporate branding and not so much on SME's. It is however clear that branding plays an important role in the success of many businesses but that little research has been conducted, particularly in developing countries such as South Africa, regarding the importance and role of branding among SMEs.

Many, if not most SMEs fail in spite of government initiatives to assist them, and branding is seen as a possible tool that can assist in the growth and success of SMEs. Therefore, the aim of this research is to identify the perceived importance of branding for South African SMEs and to determine whether SMEs comprehend the significance of branding in the business's success.

Research Objectives

The main aim of the research was to establish the perceived importance of branding in South African SMEs, and more specifically:

- To what extent is South African SMEs brand orientated?
- To what degree is South African SMEs distinctive?
- Which brand barriers have an impact on South African SMEs?

Literature Review

A SME is defined by the National Small Business Act of South Africa of 1996, as amended in 2003, as: "…a separate distinct entity including cooperative enterprises and non-governmental organizations managed by one owner or more, including branches or subsidiaries if any is predominately carried out in any sector or sub-sector of the economy mentioned in the schedule of size standards and can be classified as SME by satisfying the criteria mentioned in the schedule of size standards" (Government Gazette of the Republic of South Africa, 2003). Branding makes it possible for organisations to create, nurture and innovate the market offerings in such a way that it is viewed by consumers as presenting value, resulting in brand equity, and ultimately profitable for the firm (Abimbola, 2001:98). Brand orientation, brand distinctiveness and brand barriers are variables which establish the perceived importance of branding; these are discussed below.

Brand orientation

Just as a consumer orientation has been the focus point of an organisation over the years, there is greater emphasis being placed on a brand orientation by organisations. Many marketers regard branding as the starting point in the formulation of a competitive advantage of a company compared to its competitors (Urde, 1994:18). Wong and Merrilees (2008:374) defined brand orientation as "…a mindset that ensures that the brand will be recognised, featured and favoured in the marketing strategy". This increased awareness in branding can be attributed to the accelerated pace of globalisation and technological advancements which has resulted in a tougher competitive market and shortened product lifecycles (Bridson & Evans, 2004:403-404). Established brands are seen to be in a better position for competition, growth and profitability (Urde, 1994:18).

Brand distinctiveness

Brand distinctiveness is "…a combination of measures that indicate the uniqueness and superiority of a brand in a market" (Wong & Merrilees, 2008:374). A brand achieves distinctiveness when its identity is unique and unmistakable which is based on a number of things including the brand name, logo, packaging, colours advertising etc (Hollis, 2003:1). Abimbola (2001:101) emphasises that the strongest link between branding and SMEs are inventiveness, innovation and creative flair. SMEs, due to their very nature, are in a good position to be more creative and innovative in its brand offering due to a high level of flexibility in decision making. This often leads to a higher level of distinctiveness in terms of the brand.

Brand barriers

Given the nature of challenges faced by SME's it is a known fact that SMEs are faced with various variables that hinder its success. Marketing, for one, is regarded as an area that is troublesome and problematic for SMEs (Krake, 2005: 229). The lack of resources such as finances, and expertise are also barriers in establishing a brand (Abimbola, 2001:102). This combination of variables, as well as the set of beliefs and actions of the SMEs, can and will obstruct the development of a brand (Wong & Merrilees, 2008:374).

Bearing this in mind, the research was conducted among the SMEs in South Africa.

Research Methodology

The research followed a quantitative analysis of the research question to establish how brand orientated and distinctive South African SMEs are and the branding barriers that they are faced with. To address the problem adequately, the research methodology was based on the primary data collected from South African SMEs. The sample consisted of 43 SMEs operating in the Tshwane area. To achieve a low level of error, judgement sampling method was used. The questionnaire consisted of a set of questions which were divided into two major sections. The first section is the demographic section which describes the profile of the respondents in terms of position, involvement, and level of education, gender, age and race. The second major section of the questionnaire investigates the perceptions of branding experienced by SMEs. The main constructs of this study are brand orientation, brand distinctiveness and brand barriers; these were measured through Likert-type scales. The basic Likert scale consisted of seven scale points with labels ranging from "strongly disagree" to "strongly agree". The data will be quantified and analysed by examining the frequency of occurrences and the importance of the problem.

Research Findings

The previous section provided a review of branding within SMEs. This section reports on the key findings from the research conducted. Completed questionnaires were received from 43 respondents (n=43) who either own or manage a SME in the Tshwane area.

Survey population profile

The demographic profile of the respondents who participated in the study, are as follows:

Figure 1. The type of business

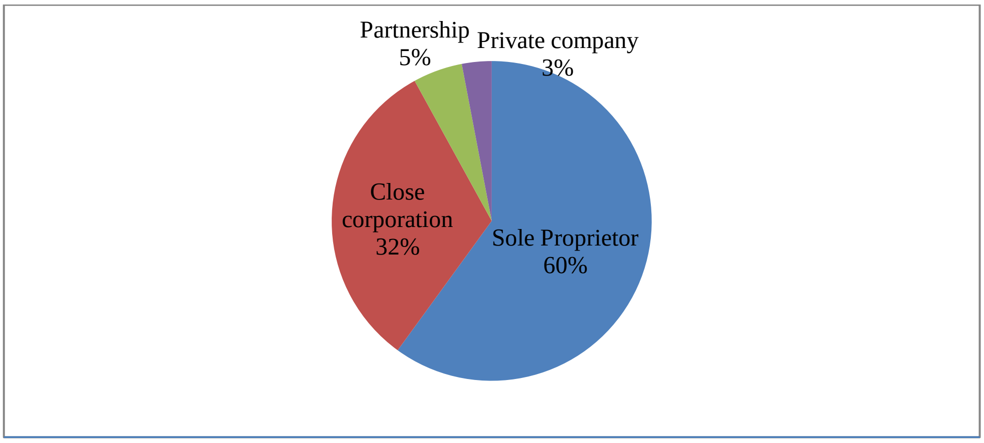
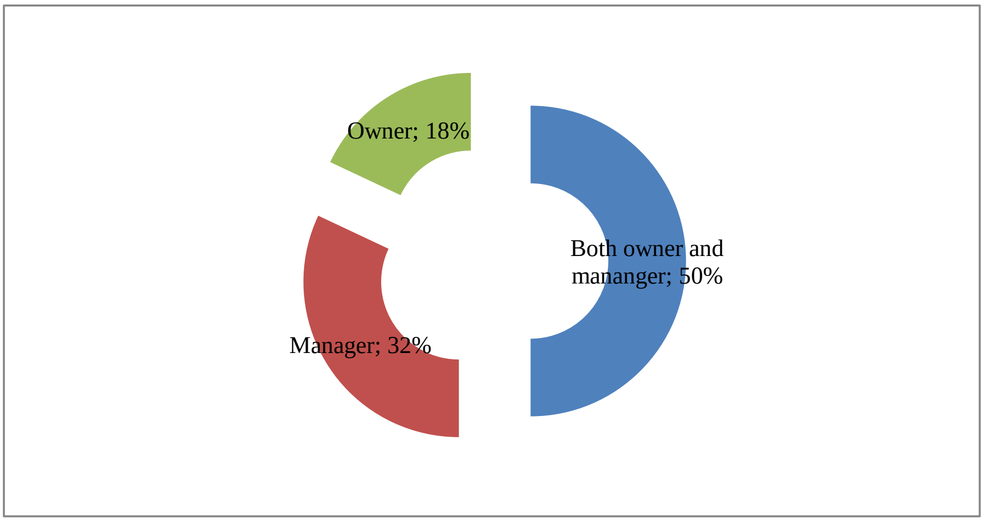


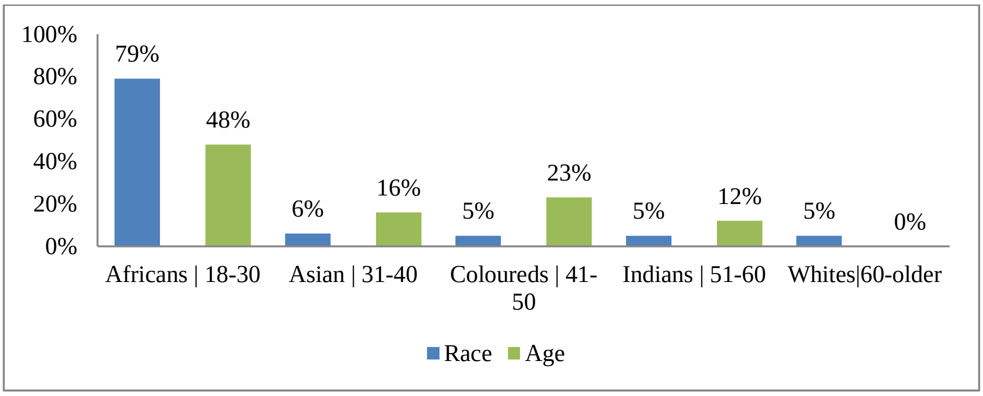
Figure 1 illustrates the sample consisted of 60% sole proprietors, 32% close corporations, 5% partnerships and 3% private companies respectively. Figure 2 below shows the position held by respondents of the study.

Figure 2. The position held by the respondent



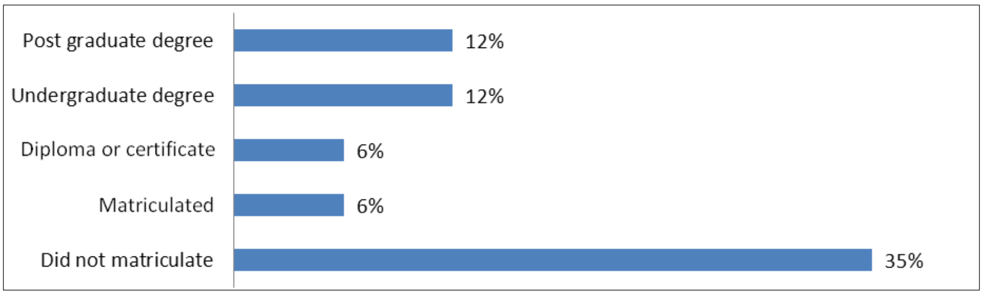
It is clear from the figure that half (50%) of the respondents are both the owner and the manager, whereas 32% are just a manager and 18% are just the owner. Figure 3 below graphically portrays the racial and age profile of respondents in the study.

Figure 3. Race and age of respondents



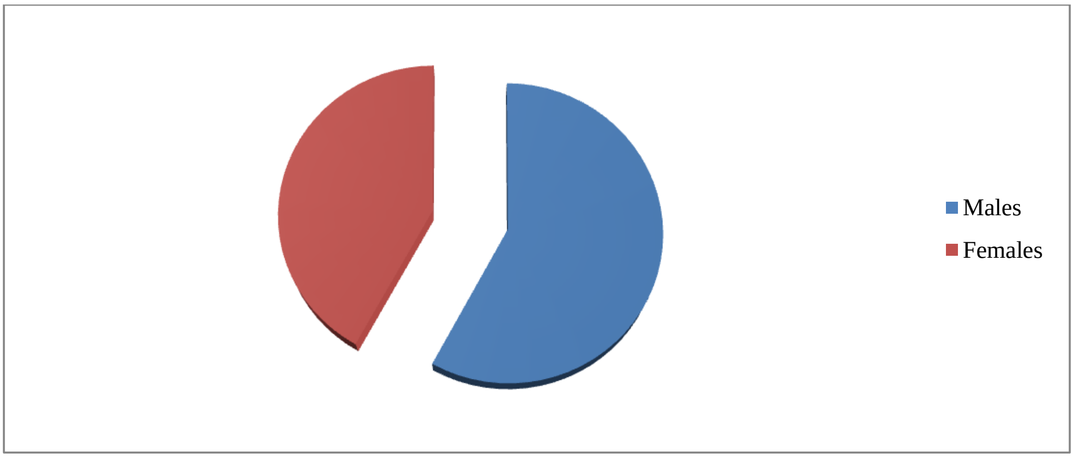
The figure indicated that roughly eight in every ten SMEs (79%) were owned or managed by Africans, 6% by Asians, 5% by Coloureds, Indians and Whites respectively. On the other hand, about half (48%) of respondents are between the ages of 18-30, 16% between the ages of 31-40, 23% between the ages of 41-50 and 12% between the ages of 51-60. The levels of education of the respondents in the study are shown in figure 4 below.

Figure 4. The level of education of respondents



Approximately a third (35%) of respondents did not graduate matric. While the rest have matriculated (6%), a diploma or certificate (6%), undergraduate degree (12%) or post-graduate degree (12%) respectively. Roughly two thirds of the respondents are male (58%) and the rest are female (42%) represented in figure 5 below.

Figure 5. The gender of the respondents



Brand orientation

This question in the survey was in the form of a seven-point Likert scale ranging from "strongly disagree" (1) to "strongly agree" (7) with various statements. Table 1 depicts the mean score and standard deviation of the brand orientation of SMEs.

Table 1. Brand orientation

	Item	Mean	St. Deviation
1	Branding is essential to our strategy	5.419	1.435
2	Branding flows through all our marketing activities	3.442	1.680
3	Branding is essential in running this company	3.372	1.480
4	Long term brand planning is critical to our future success	4.139	1.627
5	The brand is an important asset for us	4.395	1.466
	Overall	4.154	1.538

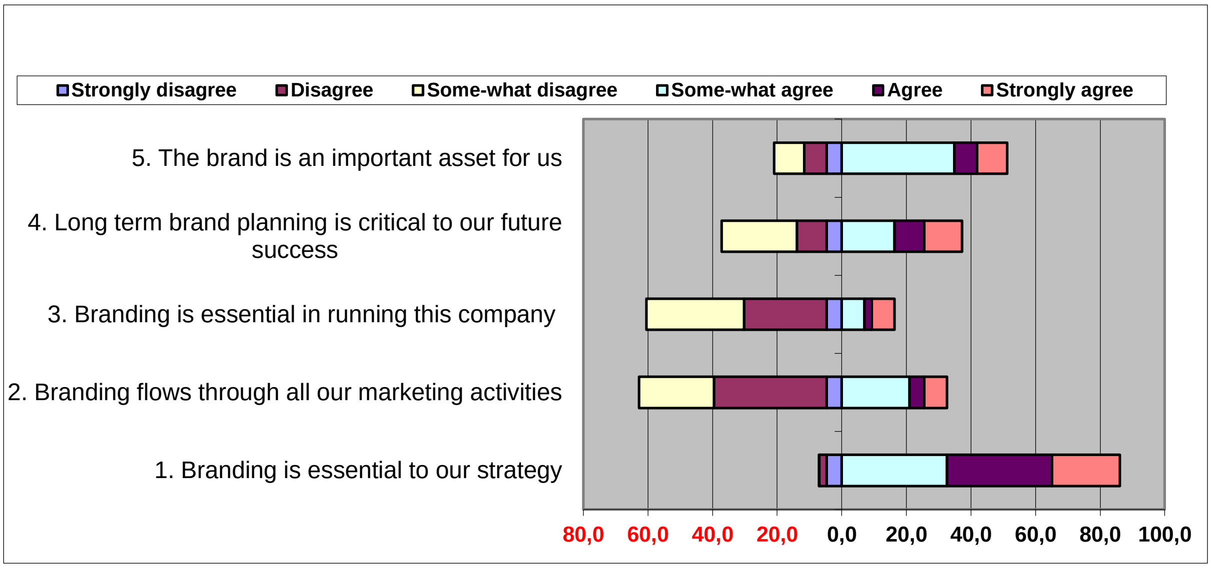
** Measurement was done on a seven-point Likert scale, whereby 1 = Strongly disagree and 7 = Strongly agree.*

From Table 1 it can be seen that the highest degree of agreement was for statement 1 "Branding is essential to our strategy" (Mean=5.419). The lowest agreement was found to have come from statement 3 "Branding is essential in the running of this company" (Mean=3.372). From the statements that were asked, it is clear that SMEs perceive themselves to be brand orientated, with a total mean score of 4.154 and a standard deviation of 1.538.

To establish whether the five Likert items of the theme or construct *Brand orientation* are related an item analysis was performed. An overall Cronbach's alpha value of 0.9749 was recorded for these items. This Alpha value represents acceptable consistency and relationship between the items. An overall theme or construct could therefore be represented by the items.

Figure 6 is thus indicative as to these statements and graphically presents the degree if agreeability and disagreeability.

Figure 6. Brand orientation



The majority (77.4%) of SMEs agreed that branding is essential to their strategy. Less than half of respondents (49.2%) agree that branding flows through all their marketing strategies and that branding is essential in running their company (48.2%).

Brand distinctiveness

Brand distinctiveness was evaluated on a seven-point Likert scale ranging from "strongly disagree" (1) to "strongly agree" (7). These statements attempted to determine the how distinctive the companies are. Table 2 depicts the mean scores and standard deviation of the perception of SMEs and their brand distinctiveness.

Table 2. Brand distinctiveness

	Item	Mean	St. Deviation
1	Our firm has a different approach or position in the market compared with our competitors	4.535	1.437
2	Our overall marketing strategy is very distinctive	4.093	1.360
3	We know our main strengths and that really helps us compete in the market	4.00	1.528
4	Our products/services are differentiated from those of competitors	4.00	1.215
5	We know where we are heading in the future and how to market the business to get there	3.581	1.500
	Overall	**4.042**	**1.408**

** Measurement was done on a seven-point Likert scale, whereby 1 = Strongly disagree and 7 = Strongly agree.*

From Table 2 it can be seen that the highest degree of agreement was statement 1 “Our firm has a different approach or position in the market compared with our competitors” (Mean=4.535). The lowest degree of agreement was found to have come from statement 5 “We know where we are heading in the future and how to market business to get there” (Mean=3.581). From all the statements that were asked, it is clear that businesses perceive their brands to be distinctive and different from that of competitors with a total mean score of 4.042 and a total standard deviation of 1.408.

To establish whether the five Likert items of the theme or construct *Brand distinctiveness* are related an item analysis was performed. An overall Cronbach’s alpha value of 0.9825 was recorded for these items. This Alpha value represents acceptable consistency and relationship between the items. An overall theme or construct could therefore be represented by the items.

Figure 7 illustrates this statement and presents the degree of disagreeability and agreeability.

Figure 7. Brand distinctiveness

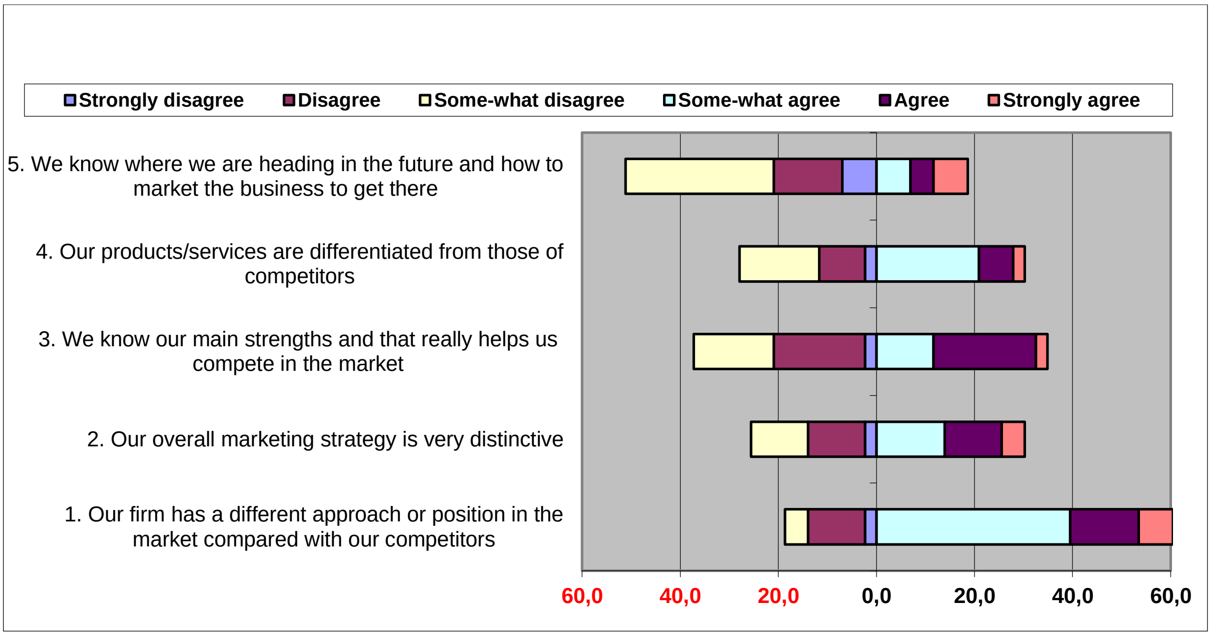


Figure 7 illustrates how distinctive SMEs perceive themselves to be. The majority (64.8%) of respondents agreed that their business has a different approach or position in the market compared with competitors and about half of the respondents felt that they knew where they are heading in the future and how to market business to get there (51.2%).

Brand barriers

Brand barriers were evaluated on a seven-point Likert scale ranging from “strongly disagree” (1) to “strongly agree” (7). These statements attempted to determine the barriers that companies faced with regards to branding. Table 3 depicts the mean scores and standard deviation of the perception of SMEs and their brand distinctiveness.

Table 3. Brand barriers *

	Item	Mean	St. Deviation
1	Branding activities are too costly for us	4.302	1.767
2	We are too busy with the daily operation of the business to worry about our brand	4.744	1.575
3	Branding is not that relevant or necessary for small firms	4.488	1.624
4	Branding is not needed until we grow a lot bigger	4.256	1.677
5	Short term selling is more important than branding	4.162	1.675
	Overall	**4.042**	**1.664**

** Measurement was * Measurement was done on a seven-point Likert scale, whereby 1 = Strongly disagree and 7 = Strongly agree.*

From Table 3 it can be seen that the highest degree of agreement was statement 2 "We are too busy with daily operations to worry about the brand" (Mean=4.744). The least agreement was with statement 5 "Short term selling is more important than branding" (Mean=4.162). From all the statements that were asked, it is clear that businesses are faced with various branding barriers with a total mean score of 4.391 and a total standard deviation of 1.664.

To establish whether the five Likert items of the theme or construct *Brand barriers* are related an item analysis was performed. An overall Cronbach's alpha value of 0.9916 was recorded for the items. This Alpha value represents acceptable consistency and relationship between the items. An overall theme or construct could therefore be represented by the items.

Figure 8 illustrates this statement and represents the degree of disagreeability and agreeability.

Figure 8. Brand barriers

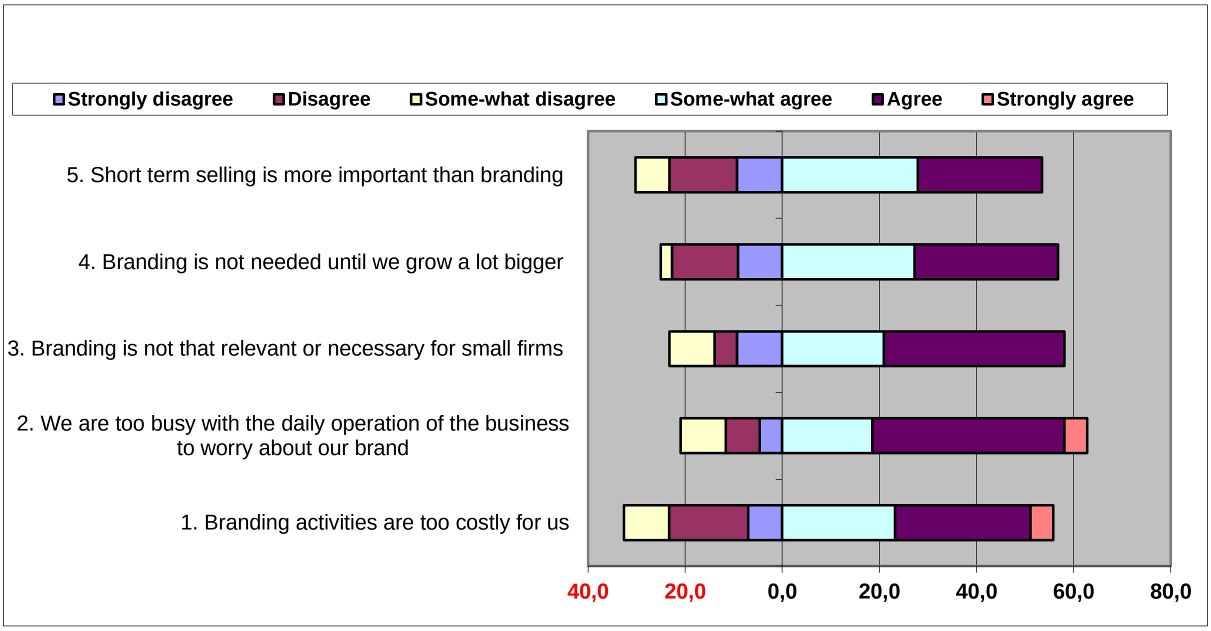


Figure 8 illustrates the barriers that SMEs are faced with. The majority (67.8%) of respondents agreed that they are too busy with the daily operations of the business to worry about the brand and that branding is not that relevant or necessary for small firms (64.1%). It is also evident from figure 8 that branding activities are too costly for businesses (61.5%), branding is not needed until their business grows bigger (60.8%) and that short term selling is more important than branding (59.5%).

A correlation test was conducted between the mean scores of the themes *(brand distinctiveness, brand orientation, brand barriers*). The correlation coefficients are depicted in Table 4.

Table 4. Correlation coefficients*

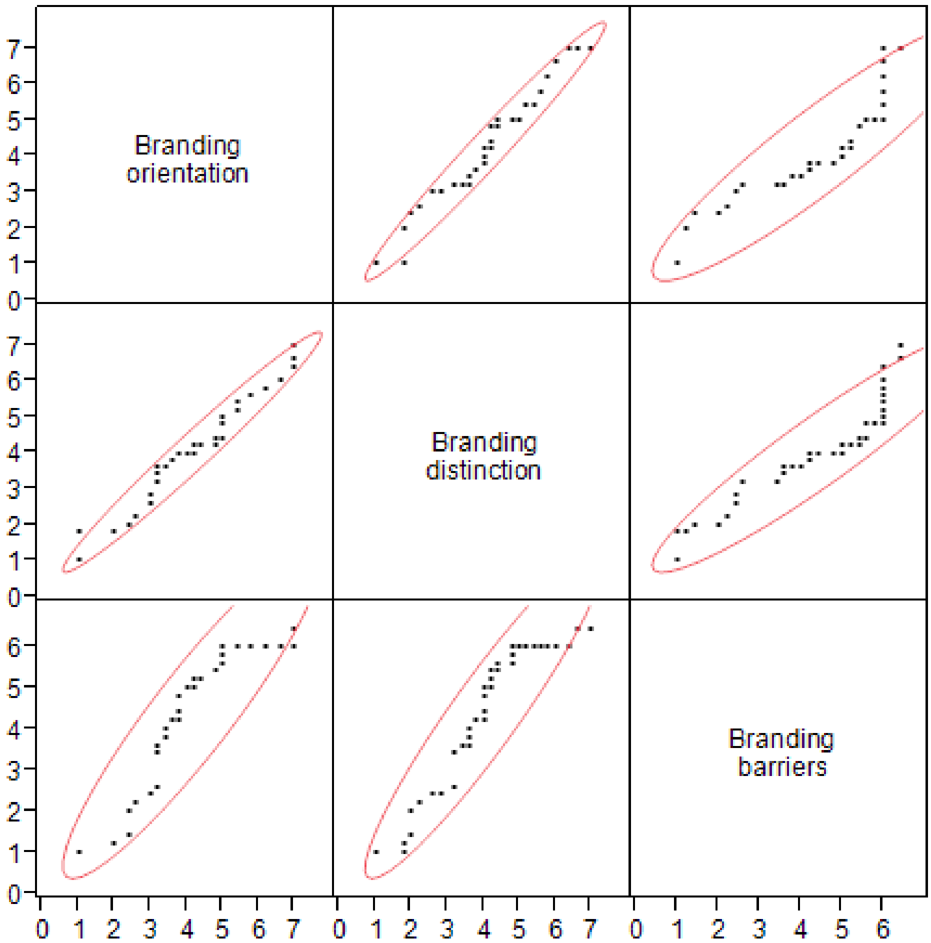
Theme	Branding orientation	Branding distinction	Branding barriers
Branding orientation	1.0000	0.9807	0.9235
Branding distinction	0.9807	1.0000	0.9403
Branding barriers	0.9235	0.9403	1.0000

** A rough guide to interpreting the correlation coefficient: ±1.0 Perfect linear correlation; ±0.8 Strong correlation; ±0.5 Medium correlation; ±0.2 Weak correlation and ±0.0 A total lack of correlation.*

It is clear from Table 4 that the mean score themes are highly positively correlated with the strongest correlation coefficient (0.9807) between brand orientation and brand distinction.

The following correlation matrix displays the strength of the linear relationship between the themes (*brand distinctiveness, brand orientation and brand barriers*).

Figure 9. Theme score correlation matrix



Limitations

The limitations of this study need to be recognised and taken into consideration. Firstly the sampling size that was used was very small (n= 43), therefore variables identified cannot be generalised to be representative of all South African SMEs. Secondly, since the sample size is so small, it is apparent that not all SMEs were approached therefore the results cannot be representative of all SMEs in the Tshwane region.

Conclusions

SMEs in South Africa play an essential role in the development of South Africa's economy and have become the primary source of job creation. These SMEs are faced with a variety of endogenous variables, namely marketing is not only affecting day to day business, but also long term success and survival. The aim of this study was to determine the importance of branding for South African SMEs. The research formulated three objectives to establish South African SMEs' brand orientation, brand distinctiveness and brand barriers. The results reflected in the study indicated that branding is seen as essential in SME strategies; however it does not flow through all their marketing strategies, nor is it essential in running the business. This can attributed to the fact that SMEs are too busy with their daily operations to worry about the brand. Future research can be done on other regions and sectors in South Africa and a comparison can then be done.

It is evident that SMEs understand the importance of branding, but do not fully implement it as it does not flow through all their marketing activities and branding is not seen as essentinal in running the business. Branding is a key aspect in marketing which is receiving more attention due the macro-enviomental changes occuring in socierty. Consumers are more demanding than ever before and expect more from companies and their brands, especially in terms of interactions. Branding is seen an important element which should be utilised by SMEs, however currently it is not being implemented and it is perceieved as not being essential in running the business.

It is revealed that SMEs are aware of the benefits of differentiation that can be achieved through branding. SMEs due to its nature may find it difficult to build a reputable brand name that consumers acknowledge and trust. SMEs focus mainly on the day-to-running of the business, with little time spent on branding issues as it is not perceived to be relevant or necessary for SMEs. This perception may be due to the fact that SMEs have to deal with other majors issues that negatively influence its survival. An example would be that SMEs have too many inventory complications or not enough cash flow, which leads to SMEs agreeing that short term selling is more important than branding.

Branding can assist SMEs to ensure sustained growth and ultimately its survival, however many struggle to integrate it into other daily business operations and build a reputable brand. It is therefore recommended that the training programmes and workshops targeting SMEs should incorporate text on methods that South African SMEs should follow and allow for practical application of concepts and procedures in terms of marketing and branding. Furthermore, associations and representative bodies should be formed which focuses on using other mediums such as social networks to build and grow brands effectively. Lastly, negotiations should be done with local government to increase its roles in supporting SMEs by providing workshops and programmes related to marketing and branding.

It can be concluded that all three the important elements or objectives for establishing SMEs, namely, brand orientation, brand distinctiveness and brand barriers, have a strong correlation and if one element is left out or is changed, it will negatively affect the other elements. It is therefore imperative that SMEs consider all three elements as a whole and approach it with caution.

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ASSET LIQUIDITY AND BANK PROFITABILITY IN SOUTH AFRICA

Godfrey Marozva*

Abstract

This paper empirically analyses the relationship between asset liquidity and bank profitability for South African banks for the period between 1994 and 2011. The study employs Ordinary Least Squares (OLS) and the Autoregressive Distributed Lag (ARDL)-bound testing approach to examine the linkage between return on assets (ROA) and liquidity, and the nexus between return on equity (ROE) and liquidity to capture the short-run and long-run dynamics. The study observes that there is neither a significant relationship between ROE and liquidity nor a relationship between ROE and liquidity. These observations hold for both the short-run and long-run. Banks are recommended to embrace the asset liability framework in their analysis and management of liquidity as the asset only approach is insufficient and misleading.

Keywords: South Africa, Liquidity, Bank Profitability, ARDL-Bounds Testing Approach, OLS.

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1. Introduction

During the last three decades the financial sector has experienced a significant change in its operational environment. Changes in both the internal and external factors have affected financial institutions structure and profitability. Banks are required to hold a considerable position in liquid assets while on the other hand it is required to be profitable for it be sustainable and to remain as a going concern. Despite the increased efficiency in many banks resulting from holding higher positions of liquid assets, profitability has severely suffered. Liquidity and profitability are inversely related, when liquidity increases profitability decreases and vice versa while on the other hand there is a direct relationship between higher risk and higher return, hence the dilemma in liquidity management is finding a balance between liquidity and profitability.

While it is generally agreed that the is a negative relationship between liquidity and bank profitability the is a counter evidence that shows a need to consider the trade off between resilience to liquidity shocks and cost of holding less profitable liquid assets as the later is assumed to impact bank's ability to take advantage of opportunities arising in the market that may result in increase in revenue, capital or ability to extend capital extend credit (Bordeleau and Graham 2010). Banks on the asset side hold low yielding securities such as treasury bills and highly rated short term corporate bonds in order to minimise a scramble for liquidity when credit use increases in time when money is tight (Holmstrom and Tirole 1998). Thus in essence a liquid financial institution has a smaller portion of its assets in long term loans and a greater proportion of its assets in short term securities that can be quickly liquidated into cash that can then be loaned out, however a highly liquid bank may mean lack of profitable projects to invest the money.

Given that liquid asset has a low liquidity premium and therefore a lower return relative to illiquid assets holding them imposes an opportunity cost on a bank. Liquidity management becomes a very important part in financial management decisions, where the liquidity management efficiency could be achieved by firms that manage a trade-off between liquidity and profitability (Bhunia and Khan 2011). The impact of bank asset liquidity on profitability has of late attracted the interest of academic research, financial market analysts, bank management and bank monitors. This paper investigates the effects of holding liquid assets on profitability. The evidence is based on the panel of South African banks from 1994 to the end of 2011. The Autoregressive Distributed Lag (ARDL) –bound test approach and Ordinary Least Squares (OLS) testing are utilised in an attempt to find if the is a long-run or short-run relationship between bank profits and their asset liquidity and results indicated that there is no significant relationship between the variables under consideration.

This study differs from other studies in three main respects. First, the article focuses mainly on the nature of relationship between asset liquidity and South Africa Banks profitability with the analysis including the cointergration relationship. Second, the paper consider all banks in South Africa as a representative sample over a more recent period, thus providing more appropriate and recent empirical evidence. Lastly, our empirical analysis does not only focus on the nature of relationship of variables in question but also looks at the implications of this interconnectedness in the context of Asset liability Management (ALM).

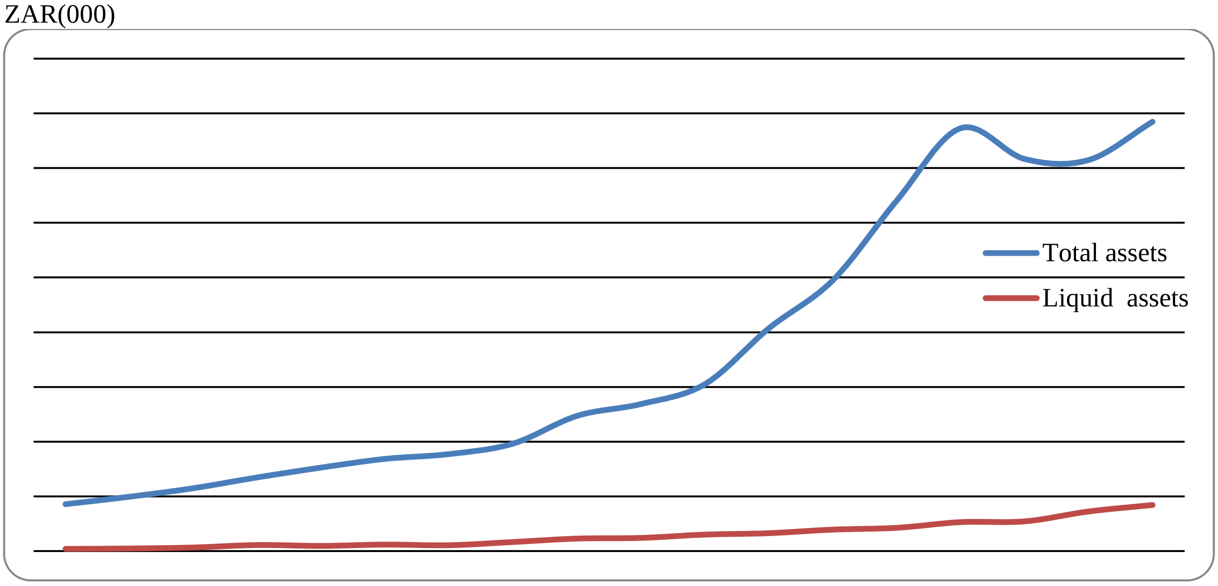
The paper is organised in the following manner. Section 2 discusses facts on South African banks liquidity (Liquidity in this context refers to liquid assets of the bank that are defined as cash, interbank deposits and short term government and corporate securities) and also a brief discussion on the banks' profitability. This is followed by section 3 that constitutes a brief discussion of literature and the empirical framework as applied in this article. Section 4 presents the estimation method and empirical results. Finally, conclusions and recommendations are presented and policy implications are drawn in section 5.

2. Asset liquidity and bank profitability in South Africa

As evidenced in fig 1, there has been an exponential growth in the balance sheet of South African Banks. Total assets increased undeterred until the financial crisis in 2008. The banks witnessed a slump during the crisis and after some corrective measures the trend began to be upward again. Liquid asset had a steady growth over the entire period, and this growth did not correspond with the growth and volatility in total assets. While the total assets sky rocketed, liquid assets maintained its growth rate presumably because the banks were investing in less liquid asset in a bid to maximise profits in times when financial markets were strong and calm.

Figure 1. Total assets and liquid assets

ZAR(000)

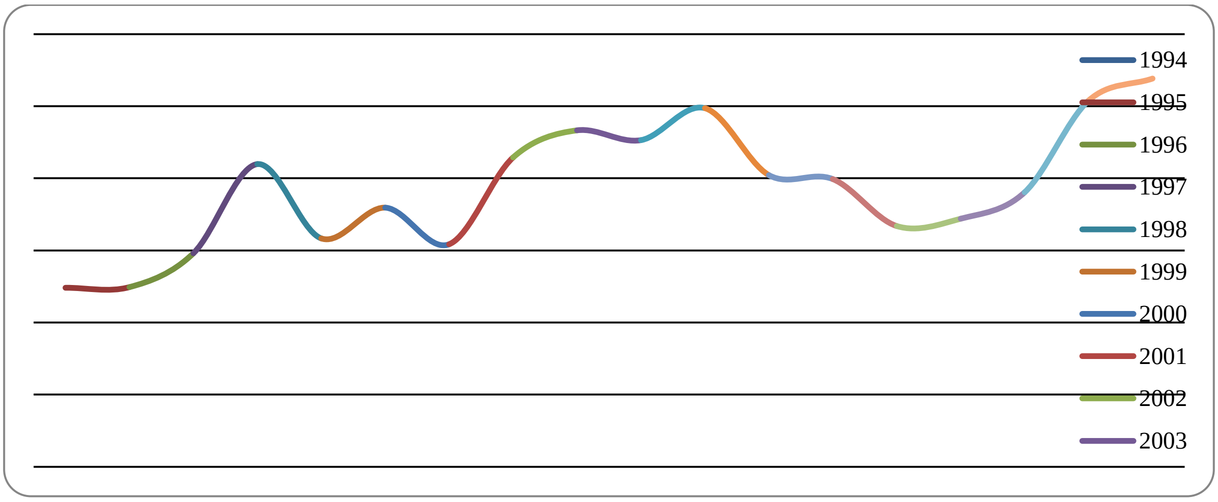


Source: McGregor BFA database

Total assets do not include intangible assets like good will, while liquid assets refer to Money Market Investment Assets (Money Market Investment Assets represents the short-term investment in financial assets by the bank as part of its banking operations) and Liquid Investment Assets (Liquid Investment Assets represents the cash on hand and the balances with other banks as per the notes to the annual financial statements in respect of the banking operations of the Company or Group).

Fig 2 represents the percentage of liquid assets as a percentage of total assets. The graph shows that the ratio has been increasing over time but with a very high degree of volatility.

Figure 2. Liquid assets as a percentage of total assets

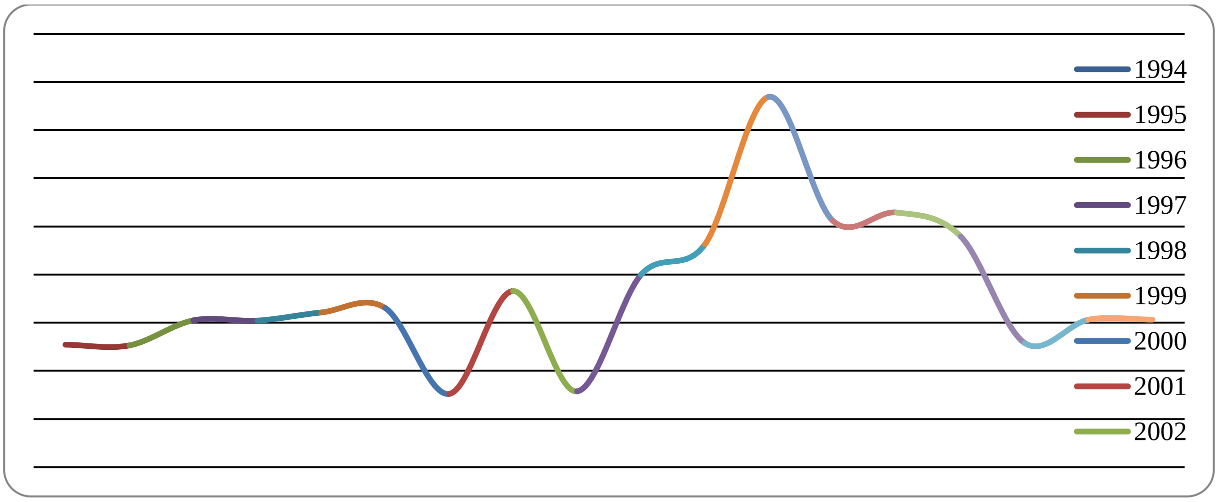


Source: McGregor BFA data base.

Since 2005 until the beginning of financial crisis in 2008, banks have been reducing their holding of liquid assets relative to total assets. In reaction to funding and liquidity pressures during global financial crisis banks in South Africa began to hold considerable liquid assets relative to total assets. It is during the crisis when the strength of a bank had to be measured in terms of how liquid the financial institution was rather than on the basis of the size of the balance sheet or profitability. Previously banks took advantage of mismatches between assets and liabilities; banks massively leveraged on these mismatches and were their key component of extremely profitable business model a phenomenon that changed after the recent financial crisis (Barua et all 2010). During the financial crisis, need for liquidity became fundamentally inherent to the financial sector. In fact, one of the key functions of the banking industry in a modern economic system is to allow the reallocation of financial resources from the liquid sectors to the illiquid ones. The Basel lll framework, released in December 2010 also calls for significant changes in liquidity requirements. The framework introduces more stringent liquidity requirements which are expected to be phased in over a number of years. Regardless of the fact that these changes has to be effected in over time many banks deems it prudent to maintain even higher than recommended liquidity levels in the interim.

The bank profitability variables are better represented by the return on equity (ROE) and return on assets (ROA). ROE shows the return that shareholders will get from their investment in the equity of the bank. ROA indicates ability of a bank to generate profits from utilising its assets, thus it measures the efficiency of management in using bank assets to generate earnings.

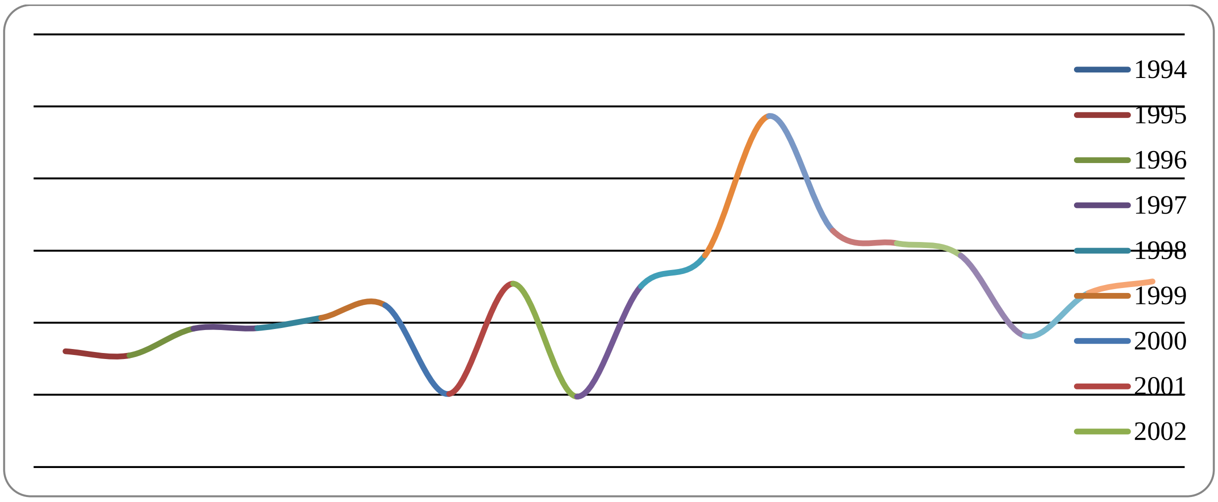
Figure 3. Return on Equity



Source: McGregor BFA data base.

A lot of developments on the global arena and South Africa's local arena in the past two decades resulted in a highly volatile ROE for South African banks. There was a steep increase in ROE from 2002 to 2005 that was followed by a steep fall in 2006 until 2009. The fall in ROE could have been a result of the country having gone through an economic recession coupled with a spillover effect of the global economic crisis in 2008/9 resulted in the people losing confidence in financial institutions. Since the business environment in general wasn't conducive this meant trading was theme on all spheres there by affecting consumer affordability, resulting in consumers being more reluctant to take on more debt, thereby negatively affecting the profitability of the banking sector. The fall in ROE was not disastrous because most of the financial institutions had very strong risk management systems in place as the South African Banks were amongst the first to implement Basel II recommendations. Though stiff regulations on financial institutions is blamed for stifling innovation and reducing growth 2008/9 global financial crisis meant otherwise.

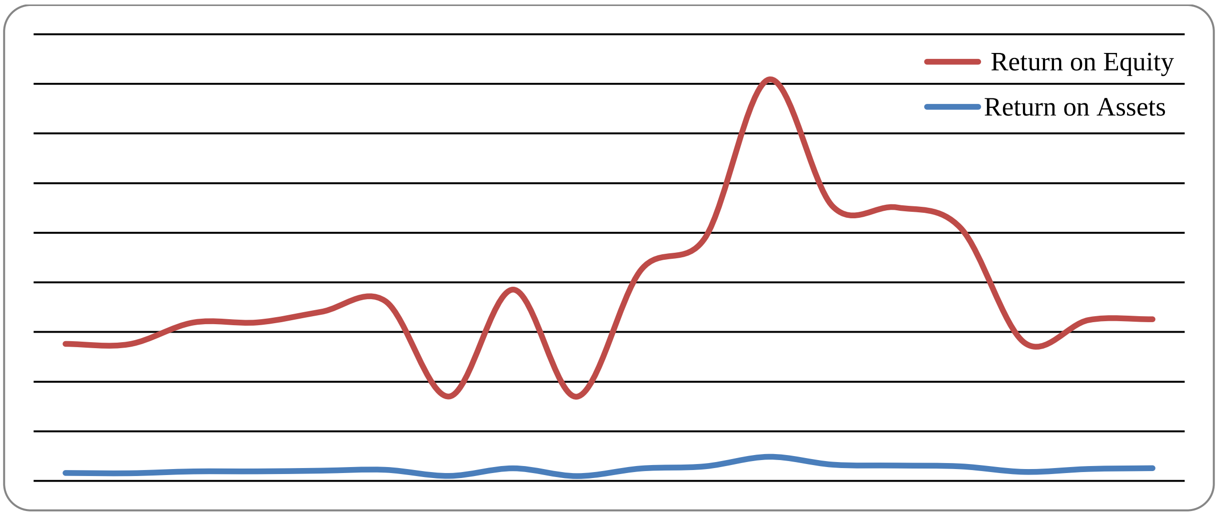
Figure 4. Return on assets



Source: McGregor BFA data base.

The return on assets also has not been stable over the past decade. ROA has the same trend as ROE the only major difference is that ROA is less than ROE due to the mathematics behind their calculations due to the differences of the composition of the denominators, where ROA has a larger denominator than ROE. The steep rise in ROA during the period of 2002 to 2006 was enhanced by the expansion of consumer credit, the South African economy experienced significant growth during this period. By the end of 2006 the economy began to slow down as the effects of global depression kicked in and we saw the reversal of the gains from previous years.

Figure 5. Return on Equity and Return on Assets



Source: McGregor BFA data base.

Fig 5 shows that South African banks some how relied heavily on liabilities to support assets and consequently they have higher ROEs and lower ROAs. This shows that the South African banks' equity base is too small relative to the total balance sheet as signified by total assets and thus can negatively impacts the banks' ability to borrow and can even be very disastrous if there is a run on deposits especially in an environment associated with dwindling confidence and a sudden increase in interest rates.

3. Literature review

Liquidity though not a new phenomenon in finance literature, there is no universally accepted definition of it. Adler (2012) asserts that the lack of agreed-upon definition emanates from the fact that the concept of liquidity arises from different economic perspectives. Liquidity can be defined in the context of how easy a security can be traded and in the context of how easy one can obtain funding to trade a security, the former being called market liquidity and the latter being funding liquidity. The focus of this paper will be on both the funding liquidity and market liquidity since the easier you can trade a security means the easier it is to get funds to trade securities, ideally market liquidity and funding liquidity are complementary. Most papers were written on the sources of liquidity risk and on how markets should be designed and regulated to cope with the effects of illiquidity. This literature review will attempt to summarise the impact of liquidity on bank profitability, hence need to look at liquidity as a cost, and as a risk and their impact on ROA and ROE. That is, investors need to be rewarded for holding illiquid assets and for the sensitivity of the security to liquidity shocks.

There are a very limited number of studies that were specifically carried out to investigate the impact of liquidity on bank profitability. Surprising most of these few studies were done on manufacturing companies. Therefore, most of the studies we draw the following conclusions were mainly focused in finding determinants of bank profitability with liquidity being one of the determinants and their empirical results were mixed. Some writers found a positive relationship; some found a negative relationship while others found both results and a few found no relationship at all. The debate is still rampant.

Bourke (1989) in his study on performance of banks in twelve countries in Europe, North America and Australia found evidence that there is a positive relationship between liquid assets and bank profitability. The results which seem counterintuitive, as we expect that illiquid assets have higher liquidity premium and hence higher return than liquid assets. Kosmidou and Pasiouras (2005) realised that the ratio of liquid assets to customer and short term funding is positively related to ROA and statistically significant. Also, they found a significant positive relationship between liquidity and bank profits. Kosmidou (2008) examine the determinants of performance of Greek banks during the period of EU financial integration (1990-2002) using an unbalanced pooled time series dataset of 23 banks found that less liquid banks have lower ROA. This is consistent with their previous findings like Bourke (1989) who found out that there is a positive relationship between liquidity risk and bank profitability. Recently, Olagunju, David and Samuel (2011) found out that there is a positive significant relationship between liquidity and profitability. They concluded that there is a bidirectional relationship between liquidity and profitability where the profitability in commercial banks is significantly influenced by liquidity and vice-versa.

On the contrary, Molyneux and Thornton (1992) recognized that there is inverse relationship between bank profitability and liquidity and they attributed this to the fact that banks hold liquid assets as an obligation to the requirements imposed by the authorities. However, if we are to view this relationship from the context that banks hold liquid assets as mandated by the central bank or any other authorities, then we may miss our argument as banks also hold liquid assets for other reasons. One to assume that banks only hold liquid assets as a requirement is in its self-perfidious or a deliberate ignorance of the knowledge of how banks functions, as Tobin (1958) way back suggested that liquidity is held for transaction purposes and for investments reasons. Tobin's proposal was a simplification of Keynes' liquidity preference theory. Keynes (1936) argued money is demanded for transaction purpose, speculative purpose and precaution purpose therefore we can firmly say without and prejudice say that liquid assets over and above mandatory requirements they are held for transaction, speculative and precautionary purpose.

Some authors found mixed results of both negative and positive relationship. Shen et al (2009) asserts that in market-based financial system liquidity risk is positively related to net interest margin an indication that banks with high levels of illiquid assets receives higher interests income. Conflicting to their earlier establishment on the relationship with net interest margin, they realised that liquidity risk is negatively related to return on average assets and also inversely related to return on average equity. They pointed out that banks incurred higher funding cost in the market if they have illiquid assets as they had to raise the money in the market to meet the funding gap. They also discovered that there is no relationship between liquidity risk and performance in a bank-based financial system as the banks play a major role in financing, therefore are not affected by liquidity risk. Demirguc-Kunt and Huizinga (1999) had inconclusive results; they found a positive relationship between loans to total assets and the net interest margins. The also established an inverse relationship between the net interest margin and before tax profits. Naceur and Kandil (2009) in their analysis cost of intermediation in the post-capital regulation period which included; higher capital-to-assets ratios, an increase in management efficiency, an improvement of liquidity and a reduction in inflation found out that Banks' liquidity does not determine returns on assets or equity significantly.

Therefore conclusions about the impact of banks' liquidity on their profitability remain ambiguous and further research is required.

4. Data, empirical model specification and estimation techniques.

4.1 Data sources and definition of variables

This study uses annual time series data for the period between 1994 and 2011 all data used in this study were obtained from McGregor data base and the central bank of South Africa (SARB). Liquid assets were computed as a total of Money Market Investment Assets and Liquid Investment Assets. The ROE on the other hand was measured by the ratio of net income to total equity while the ROA measured as a ratio of net income to total assets. Initially the regression model was run to see the short run relationship of the profitability as measured by ROE/ROA and independent variable of Liquidity. Then, in an attempt to establish a long-run cointergration relationship between liquidity and profitability the auto regressive distributed lag (ARDL) - bounds testing approach by Perasan et al. (2001) model was adapted.

4.2 Regression Model

The regression model was run to investigate the short run relationship of the profitability as measured by ROE/ROA and independent variable of Liquidity. We can express the relationship between liquidity and profitability mathematically as follows:

$$\text{ROA} = f(L) \quad (1)$$

$$ROA = \propto + \beta L + \varepsilon \quad (2)$$

$$\text{ROE} = f(L) \quad (3)$$

$$ROA = \propto + \beta L + \varepsilon \quad (4)$$

Equations (1) and (3) shows return on asset and return on equity as functions of liquidity. The regression models are indicated by the equation (2) and equation (3). Profitability in this case is represented by ROA and ROE which are the dependent variables, Liquidity (L) is the explanatory/independent variable and α and β are coefficients. There is a plethora of empirical evidence (Bourke (1989), Kosmidou et al.(2005) Kosmidou (2008), Olaguju et al. (2011), and Molyneux et al. (1992)) that attest to the fact that there is statistically significant relationship between liquid assets and bank profitability. This evidence is conflicting and therefore, it is incumbent upon the researcher to contribute to the body of knowledge by further determining the nature of relationship between the variables in question. The first step was to find whether there is a deterministic or short run relationship between profitability and liquidity. The results of a simple LOS are as follows.

Dependent variable	Function	P-Value	F-Test statistic
ROA	ROA(Liquidity)	0.6830	0.1731
ROE	ROE(Liquidity)	0.5373	0.3975

**** Denotes 1% level of significance, ** Denotes 5% level of significance, and *Denotes 10% level of significance*

The results shown above reveal that there is no significant deterministic or short-run relationship between the profitability ratios (ROA & ROE) and liquidity (TL/TA). The F-Stats are well below the recommended figure of 4 and also the p-values are way above the threshold of 0.05.

4.3 Unit root tests

The data sets of three variables (liquid assets, ROE and ROA) were tested for stationarity using Phillip-Perron and Augmented Dickey Fuller tests before they were tested for cointergration – using ARDL-bounds approach. The results of the stationarity tests on differenced variables are presented in table 1.

Table 1. Stationarity tests of variables on first difference – Augmented Dickey Fuller (ADF) test and Phillips-Perron (PP) test

Variable	No trend	Trend	Intercept
Stationary tests of variables on fist difference – **Augmented Dickey Fuller (ADF) test**			
DLiquidity (TL/TA)	-4.6347***	-4.7165***	-4.8941***
DROA	-5.0000***	-4.6731***	-4.8305***
DROE	-6.2459***	-5.9924***	-6.0370***
Stationary tests of variables on fist difference – **Phillips – Perron (PP) test**			
DLiquidity (TL/TA)	-4.6245***	-4.6999***	-4.8739***
DROA	-4.9740***	-4.6553***	-4.8085***
DROE	-6.1310***	-5.9025***	-5.9309***

**** Denotes 1% level of significance*

Given the result in the table above the hypothesis that first difference of ROA, ROE, and Liquidity has unit roots can be rejected.

4.4 Cointergration test- ARDL – bounds testing procedure

To establish a long-run cointergration relationship between liquidity and profitability the auto regressive distributed lag (ARDL) - bounds testing approach by Perasan et al. (2001) model was adapted. The ARDL approach is unique and superior in that it does not require all the variables under investigation to be integrated at the same order. Thus, the ARDL approach can be used in situation even if the regressors are integrated in any order that is order one (I (1)), order zero (I (0)) or partially integrated (Pesaran and Pesaran, 1997). Laurenceson (2003) argue that using the ARDL approach avoids problems resulting from non-stationary time series data.

The ARDL framework for equation 5, 6, 7 and 8 are as follows:

$$\Delta ROA_t = \mu_0 + \sum_{i=1}^{n} \gamma_{1i} \Delta ROA_{t-i} + \sum_{i=1}^{n} \gamma_{2i} \Delta Liquidity_{t-i} + \gamma_3 ROA_{t-1} + \gamma_4 Liquidity_{t-1} + \varepsilon_t \quad (5)$$

$$\Delta Liquidity_t = \kappa_0 + \sum_{i=1}^{n} \phi_{1i} \Delta Liquidity_{t-i} + \sum_{i=1}^{n} \phi_{2i} \Delta ROA_{t-i} + \phi_3 Liquidity_{t-1} + \phi_4 ROA_{t-1} + \varepsilon_t \quad (6)$$

$$\Delta ROE_t = \alpha_0 + \sum_{i=1}^{n} \beta_{1i} \Delta ROE_{t-i} + \sum_{i=1}^{n} \beta_{2i} \Delta Liquidity_{t-i} + \beta_3 ROE_{t-1} + \beta_4 Liquidity_{t-1} + \varepsilon_t \quad (7)$$

$$\Delta Liquidity_t = \varphi_0 + \sum_{i=1}^{n} \rho_{1i} \Delta Liquidity_{t-i} + \sum_{i=1}^{n} \rho_{2i} \Delta ROE_{t-i} + \rho_3 Liquidity_{t-1} + \rho_4 ROE_{t-1} + \varepsilon_t \quad (8)$$

Where Δ - first difference operator, ROA – Return on Assets, ROE- Return on Equity and Liquidity – Liquid Assets divided by Total Assets (TL/TA). In the above equations, the terms with the summation signs represent the error correction dynamics while the second part (terms with γ in equation (5), ϕ in equation (6), β in equation (7), and with ρ in equation (8)) correspond to the long run relationship. The null hypotheses in 5, 6, 7 and 8 are

$$\gamma_3 = \gamma_4 = 0, \quad \phi_3 = \phi_4 = 0, \quad \beta_3 = \beta_4 = 0, and \quad \rho_3 = \rho_4 = 0,$$

respectively, which indicate the non-existence of the long run relationship. The first step of the ARDL-bounds testing requires examining the order of lags on the first differenced variables in equation 5, 6, 7, and 8 using the Akaike information criterion (AIC) and the Schwartz-Bayesian criterion (SBC). The results of the AIC and the SBC suggest that optimal lag of ROA and liquidity is 3, while the optimal lag for ROE and liquidity is 3. The second step requires us to apply the bounds F-test to equation 5, 6, 7, and 8 in order to determine whether any long run relationship between South African Bank profitability and liquidity.

Dependent variable	Function	F-Test statistic
ROA	ROA(Liquidity)	1.6900
Liquidity	Liquidity(ROA)	1.1876
ROE	ROE(Liquidity)	2.5532
Liquidity	Liquidity(ROE)	5.1227**

*** Denotes 5% level of significance*

Our results show that there is no evidence of long run relationship between profitability and liquidity. All other things being equal ROA and ROE are not in influenced by liquidity in the long run. To determine whether liquidity is driven by ROE in the long run we used Table CI (v) on p.301 of Pesaran et al. (2001) to determine the asymptotic critical value bounds for the F-statistic since the models had unconstrained intercept and unrestricted trend. The lower and upper bounds for the F-test statistic at the 10%, 5%, and 1% significance levels are [5.59 , 6.26], [6.56 , 7.30], and [8.74 , 9.63] respectively. As the value of our F-statistic is blow the lower bound at the 5% significance level, we can also conclude that there is no evidence of a long-run relationship between the two time-series at this level of significance or greater.

5 Summary and Conclusion

In context of Basel lll framework, released in December 2010 that calls for significant changes in liquidity requirements as a mitigating dynamic to the damage that resulted from 2009/10 financial crisis this paper attempted to determine empirically the relationship between bank profitability and liquidity. This was done with the aim to establish the impact of changes in liquidity on the performance of banks. The results reported in this paper are consistent with the view that there is no significant relationship between profitability and liquidity. This could be an indication that performance of banks can be attributed to other macro-economic factors and other firm specific characteristics besides the composition of its assets. Our findings are consistent with the findings of Naceur et al. (2009) who found out that Banks' liquidity does not determine returns on assets or equity significantly.

These results came as a surprise especially for the banking system whose business and competitive edge is centred on the size and composition of their balance sheet. By nature of their business banks act as intermediaries between deficit units and surplus units, where the take mostly short term (highly liquid) money from surplus units and pass it on to the deficit unit at a price making a positive interest rate spread, consequently making the liquidity of bank assets a focal point of investigation. The liquidity issue outside capital adequacy is the most important fundamental assumed to be directly attributed to the performance of banks in the recent past, particularly during the global financial crises.

Finally, liquidity seems to be quite persistent all over the world, which probably signals need for new, efficient and effective management of assets and liabilities. An analysis of assets only without reference to liabilities could have been the major drawback of this study hence for future studies emphasis should be within a framework of asset liability management (ALM).

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CORPORATE SUSTAINABILITY REPORTING BY PHARMACEUTICAL COMPANIES: IS IT WHAT IT SEEMS TO BE?

Mohammad Istiaq Azim*, Saiful Azam**

Abstract

A well-functioning pharmaceutical industry can contribute directly to social wellbeing. Corporate sustainability is an important precondition for the further development and growth of the industry. In this research multi methods are used to provide a complete, holistic and contextual portrait of the level of CSR by pharmaceutical companies in a developing country - Bangladesh. Firstly, we used content analysis to investigate corporate social reporting by listed pharmaceutical companies. Secondly, we conducted surveys to document management responses. Thirdly, we sought stakeholders' views on the extent to which they believe CSR is being implemented in the industry. Analysis of annual reports published in 2009- 2010 shows that only 26.67% of listed pharmaceutical companies made some CSR disclosure. However, more than seventy-five per cent of these disclosures are sweeping qualitative statements without any attempt at quantification. Most managers believe social reporting should strike a balance between meeting stakeholders' reasonable expectations and running a successful business. The majority of stakeholders appear to favour mandatory requirements for CSR disclosure.

Keywords: Corporate Social Responsibility (CSR), Pharmaceutical Companies, Management, Stakeholder

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1. Introduction

There is a growing interest in Corporate Social Disclosure (CSR) by the pharmaceuticals industry. An international survey of corporate sustainability reporting conducted by KPMG in 2011 found that for the 100 largest pharmaceuticals companies in each of the 34 countries in the survey, CSR reporting had more than doubled since KPMG's last survey in 2008 (KPMG, 2011). Over the last decade, pharmaceutical companies have come under increasing scrutiny to ensure that their operations provide social benefits and that the firms clearly disclose the social impact of their activities. At the present time there is growing pressure from various agencies for pharmaceutical companies to act responsibly and be liable for the impacts they have on the social, political and ecological environment (Azim, Ahmed and Islam, 2009). Pharmaceutical companies in developing countries cannot avoid being caught up in the discussion of this issues.

Pharmaceutical companies have a moral obligation to act ethically, responsibly and transparently. Pharmaceutical companies need to be ethical and transparent in the development of their products which are essential for effective healthcare strategies and services in both developing and developed countries. There has been some research focusing on the social and environmental impact of the pharmaceutical industry in developed countries. However not much research has been undertaken in the context of developing countries where the pharmaceutical industry plays a major role in economic development and social policy.

Bangladesh is a least developed country which has emerged as one of the fastest growing pharmaceutical exporting nations. The retail market size is estimated to be around U.S 700 million. This grew by 6.9% in 2008 and 16.8% in 2009 (Chowdhury, 2010). Bangladesh has been granted permission by the World Trade Organization to reproduce patented products up to the year 2015. The pharmaceutical industry is the second largest revenue generating industry in Bangladesh, and the country looks well set to become a global hub for quality medicines. The recent crisis in the ready-made garments sector, (i.e., the collapse of the building in Saver in 2013 and the fire in the Tazreen Fashion factory) has shifted the focus to the pharmaceutical sector as a foreign exchange earner. The industry established over 50 new factories in the last three years and almost all of them comply with the World Health Organization's *Good Manufacturing Practice standards*. In 2009 the UN Global Compact Local Network was launched in Bangladesh and some local companies have participated in the initiative. All the above factors create new challenges for increasing and improving corporate social disclosure.

Historically, most early CSR studies used the content analysis method to examine the motivations and determinants of CSR adoption. While this trend still continues, recently, CSR researchers have moved on to examine managerial and other stakeholders' perceptions of CSR more directly by using methods such as in-depth interviews. Previous studies, within the context of emerging economy, reviews CSR practice under three categories: (i) studies related to the extent of CSR, (ii) managerial perceptions studies, and (iii) stakeholder perception studies. The overwhelming majority of studies belong to the first category, that is, they use the content analysis method to determine the volume and extent of CSR. Emerging country researchers (Belal and Roberts, 2010) have only recently commenced undertaking managerial and stakeholder perceptions studies based on in-depth interviews.

Most previous CSR studies in developing countires are descriptive in nature, mainly measuring the volume of disclosures (Belal, 2000, 2001; Imam, 1999, 2000). Previous research has not examined managerial or stakeholder perceptions along with the industry's disclosure practices. This research uses both quantitative (content analysis based on secondary information, i.e., annual reports) and qualitative analysis (survey to managers and interviews with stakeholders) to provide an in-depth knowledge of CSR practices in the pharmaceutical industry in Bangladesh.

The rest of this paper is organized as follows. Section 2 provides a brief overview of the pharmaceutical sector in Bangladesh. Section 3 discusses the literature on corporate social responsibility. Section 4 outlines the data and research design. The results are presented in Section 5. Finally, Section 6 discusses the implications of the results obtained.

2. A brief overview of the pharmaceutical sector in Bangladesh

The pharmaceutical sector is the most developed of the manufacturing industries in Bangladesh. It is the third largest tax paying industry in the country (Chowdhury, 2010). Bangladeshi pharmaceutical firms focus primarily on branded generic final formulations using imported Active Pharmaceutical Ingredients (APIs). About 80% of the drugs sold in Bangladesh are generics and 20% are patented drugs. The country manufactures about 450 generic drugs for 5,300 registered brands which have 8,300 different forms of dosages and strengths (Chowdhury, 2010). These include a wide range of products from anti-ulcerants, flouroquinolones, anti-rheumatic non-steroid drugs, non-narcotic analgesics, antihistamines, and oral anti-diabetic drugs. Some larger firms are also starting to produce anti-cancer and anti-retroviral drugs.

Bangladeshi companies including the locally based MNCs produce 95%-97% of the drugs consumed in Bangladesh and the rest are imported. The domestic market is highly concentrated and competitive but local manufacturers dominate the industry as they enjoy approximately 87% of market share, while multinationals hold a 13% share. Another notable feature of this sector is the concentration of sales among a very small number of top companies. The top 10 players control around two-thirds of the industry revenue while the top 15 companies covering 77% of the market (Chowdhury, 2010). In comparison, the top ten Japanese firms generated approximately 45% of domestic industry revenue, while the top ten UK firms generated about 50%, while the top ten German firms generated nearly 60%. Square Pharmaceuticals is the stand-out market leader with a market share of 19.3%. Their nearest competitors are Incepta Pharmaceuticals and Beximco Pharmaceuticals with market shares of 8.5% and 7.6% respectively (Chowdhury, 2010). Although a number of MNCs are operating in the Bangladeshi market, no MNCs are in the top ten in terms of domestic sales.

The main disadvantage of Bangladeshi pharmaceutical companies is that they are not backward-integrated. Most APIs have to be imported and even if the API is manufactured in Bangladesh, raw materials have to be imported. This generates higher factor costs, especially in cases where the provider of the API is a competitor in selling the finished product. Establishing backwards-integration for all relevant APIs is not a realistic option: scale disadvantages and infrastructure constraints are more relevant in the early stages of the value chain, where the products have a strong commodity character. The second biggest challenge concerns administrative barriers to exports, such as import quotas, special licenses, bureaucratic delays at customs, export restrictions, technical barriers to trade etc. According to executives of leading Bangladeshi drug exporters, this problem can be eliminated by better cooperation between the pharmaceutical industry and the drug administration authorities.

3. Literature review

The CSR literature has grown over the past three decades (Deegan, 2002; Gray, 2001; Gray, 2002; Mathews, 1993). The need for companies to undertake socially responsible activities has been discussed in the literature and has been a topic for academic study for decades. However, CSR is still a subjective concept that relies on interpretations of how business activities are perceived in terms of social value generation.

There are many theoretical frameworks (such as political economy, legitimacy and stakeholder theories) which may explain why companies engage in social responsibility reporting. This study focuses on two important theories that explain the extent of corporate social disclosure: legitimacy theory and stakeholder theory. Previous studies have used either legitimacy theory or stakeholder theory to develop themes of disclosure measurement and to analyze the extent to which companies disclose their corporate social responsibility.

Legitimacy theory has been used by several researchers to examine corporate social disclosure practices. Deegan (2002) suggests that organizations need to take community expectations into account if they want to be successful. Organizations will be penalized if they do not operate in a manner consistent with community expectations.

Stakeholders are the central focus of stakeholder theory. Stakeholders include a wide range of people and interest groups who are involved in some capacity with organizations (Price, 2004). The contemporary stakeholder literature can be traced back to the seminal work of Freeman (1984). He drew attention to the role of external stakeholders who were defined as "any group who can affect, or is affected by, the accomplishment of organisational purpose" (p. 25). From an analytical perspective, a stakeholder approach can assist managers by promoting an analysis of how the company fits into its larger environment or social context, how its standard operating procedures affect stakeholders in the company (employees, managers, stockholders) and stakeholders beyond the company (customers, suppliers, financiers).

There are a set of normative stakeholder principles that potentially increase a corporation's obligations to their stakeholder groups. Increased obligations for a corporation doing business in a developing country may include determining appropriate standards for the compensation and working conditions of employees, respecting workers' rights to organize, implementing measures to incorporate marginalized groups, determining appropriate standards for externalities and emergency responses, refraining from anticompetitive practices, and providing space for acts of public autonomy (Reed, 2002, p. 195).

In this research, stakeholder groups include: the activist groups, suppliers, governments, political groups, customers, unions, employees, trade associations, and competitors. A rational manager in a pharmaceutical company would not make major corporate disclosure decisions for his or her organization without considering the impact on each of these specific stakeholders. Stakeholder theory has become important for companies wanting to secure their relationship with stakeholders through corporate social disclosure (Carroll, 1999). Wilson (2001) argues that consideration of stakeholders is a major reason why companies integrate social and environmental information in their business operations.

Research on voluntary disclosure has examined the nature and patterns of CSR and investigated the determinants of CSR such as company size, profit level, and industry affiliation (Cormier and Magnan, 2003). Reed (2002) argued that corporations also need to be sensitive to historical and cultural differences that may be present in developing countries. The literature recognizes that CSR practices differ from country to country (Adams and Harte, 1998) and between developed and developing countries (Imam, 2000). Furthermore the nature and patterns of CSR vary between types of industry (Gray et al., 2001). Surveys of CSR practices in Western countries reveal that companies place the greatest emphasis on disclosing human resources such as employee numbers and remuneration, equal opportunities, employee share ownership, disability policies, and employee training (Gray et al., 2001).

3.1 CSR Disclosure Research in Developing Countries

CSR studies in developing countries have been mainly descriptive and quantitative in character. Most use content analysis to measure the extent of CSR. Singh and Ahuja's study (1983) is considered as the first investigation of CSR practices in an emerging economy context. They developed a social disclosure index consisting of 33 items and analysed forty annual reports of public sector companies for the period 1975 - 1996. Their study found that approximately 40% of sample companies in India disclosed CSR.

Andrew, Gul, Guthrie, and Teoh (1989) examined the annual reports of 119 companies based in Malaysia and Singapore for the year 1983. They found that only 31 (26%) companies made social disclosures and the main category was related to human resources. Kin's study of 100 public companies in Malaysia (Kin, 1990) showed that 66% of companies undertook some kind of social reporting; of these, 64 companies reported human resource issues and 22 companies disclosed community involvement issues. Lynn's examination of Hong Kong companies (Lynn, 1992) revealed that 6% of companies disclosed social activities with an emphasis on staff development and community relations. The number of pages dedicated to such disclosures ranged from 0.25 to 3 pages. Ng (2000) found that 9% of 200 Hong Kong listed companies reported environmental information in published accounts. Disclosures appeared in the director's report or chairperson's statement. Haniffa and Cooke (2005) examined the association between CSR and culture and corporate governance in Malaysia. They used the content analysis method to measure the extent and level of CSR and found corporate governance influences corporate disclosure practice either positively or negatively, depending on the country of origin. Ratanajongkol et al. (2006) examined CSR practices in Thailand. They analyzed the extent and nature of corporate social reporting of 40 Thai companies over a 3-year period. Overall, they found that the level of corporate social reporting is increasing, with Thai companies increasing the information they provide particularly in relation to human resources.

Gray and Kouhy (1993) argued that CSR issues in developing countries need to be carefully identified due to the particular socio-cultural and political contexts prevailing in these countries. Current content analysis–based studies in developing countries will not necessarily be able to explain reasons for companies undertaking or not undertaking CSR. For example, Kuasirikun and Sherer (2004) analysed 63 Thai listed companies' annual reports in 1993 and 84 in 1999. They used content analysis to measure the context of disclosure and the quality of disclosures from a critical perspective (Gallhofer and Haslam, 1997). Tsang (1998) conducted a longitudinal study of CSR in 33 listed companies in Singapore from 1986 to 1995 and found that 17 (52%) made social disclosures. They contended that the socio-economic context of Singapore explained the pattern of disclosure in that country. Bravo, Matute and Pina (2012) explored the relevance of corporate social responsibility (CSR) as an element of the corporate identity of Spanish financial institutions. Their findings show that, most organizations disclose CSR information to construct communicated identities and legitimate behaviours.

In the Bangladeshi context, several CSR studies have been undertaken. However, none of them look at a specific industry and explore practices within that industry. For example, Imam (1999) shows that out of 34 companies from all sectors surveyed, those disclosing environmental information increased from four in 1992–1993 to seven in 1996–1997. Imam (2000) conducted a further survey of CSR practices in Bangladesh. The study found all 40 companies surveyed made some form of human resource disclosure. Also, 25% of companies reported on community issues, 22.5% on environmental matters and 10% undertook consumer disclosures. Hossain, Islam and Andrew (2006) examined the annual reports of 107 non-finance companies, for the financial year 2002-2003.. They found that 8.33% of Bangladeshi companies disclose social and environmental information in their corporate annual report (Hossain et al., 2006, p. 10). Azim et al (2009) analysed annual reports published in 2007 – 2008 and report that only 15.45% of listed companies in Bangladesh made CSR disclosures. Khan, Muttakin and Siddiqui (2012) found that pressures exerted by external shareholder groups and corporate governance mechanisms involving independent outsiders may allay some concerns relating to family influence on CSR disclosure practices.

Like many other countries of the world, corporate social reporting is not mandatory in Bangladesh. However, the Companies Act, 1994 and the Securities and Exchange Rules, 1987, require certain disclosures which may be classified as social disclosures. Schedule XI, Part II of the Companies Act, 1994 requires certain social disclosures which are to be shown in the profit and loss account or in notes to the financial statements. The Act requires that expenditures incurred on the following items should be shown separately in the profit and loss account: (i) power and fuel (energy), (ii) salaries, wages and bonuses, (iii) contributions to provident and other funds, and (iv) staff welfare expenses. The Securities and Exchange Rules, 1987 require similar social disclosures (Belal, 1999).

3.2 'Managerial Perceptions' Research in Developing Countries

One of the first studies to examine managerial perception was Teoh and Thong (1984). They interviewed the chief executive officers of 100 companies operating in Malaysia and examined three aspects of social performance: (i) social awareness, (ii) social involvement and (iii) social reporting. They found that the three most important factors behind social awareness were: (i) senior management philosophy, (ii) legislation and (iii) alignment with the parent company. In the areas of social involvement and social reporting, they concluded that companies are more active in reporting human resources and products/services to customers, compared to community involvement and the physical environment. This finding is similar to Andrew et al. (1989). Jaggi and Zhao (1996) examined the perceptions of managers and accountants regarding environmental reporting practices in Hong Kong. They found that although managers were concerned about the protection of the environment in Hong Kong, such concern was not reflected through voluntary environmental disclosures.

Belal and Owen (2007) examined managerial perceptions of Bangladeshi companies in respect to CSR through 23 semi-structured interviews. Their findings indicate that motivation for CSR disclosure in Bangladesh mainly comes from a desire to manage powerful stakeholder groups, and 'outside forces', and from pressure from international buyers. Islam and Deegan (2008) re-examined this motivation by using interviews and content analyses of the Bangladesh Garments Manufacturer and Exports Association (BGMEA). They concluded that BGMEA faced pressure from particular stakeholders (such as international buyers) since the early 1990s in terms of their social performance and this shaped their social policy and disclosure. One major limitation of Islam and Deegan (2008) is that BGMEA - as an industrial association is a powerful stakeholder for all garment companies in Bangladesh - may influence social policy and disclosures being made at the individual company level. However, this interesting link was not explored in their research.

3.3 'Stakeholders' Perceptions' Research in Developing Countries

Only a few studies have explored stakeholders' perceptions of CSR in an emerging economy. Naser and Baker (1999) explored the perceptions of relevant user groups such as public accountants, academics and government officials in addition to finance managers in Jordan. They found that the lack of mandatory requirements is the major reason of why most companies do not make social disclosures. Two other studies (Kuasirikun, 2005; Lodhia, 2003) have examined perceptions of professionals towards social and environmental accounting. Lodhia (2003), using semi-structured interviews, examined the potential role of accountants in the development of environmental accounting in Fiji. This study noted that accountants were less motivated to engage with environmental accounting and reporting activities mainly due to a lack of competence on their part and the voluntary nature of these disclosures. These findings are consistent with earlier studies conducted in the United Kingdom (Bebbington, Gray, Thomson, and Walters, 1994) and Australia (Deegan, Geddes, and Staunton, 1995).

4. Methodology and data collection

This research uses the mixed method to examine CSR disclosure – a powerful technique that facilitates validation of data and cross verification through the combination of quantitative and qualitative research methods (Bryman 2012; Tashakkori & Creswell 2007). This approach is relatively new and has been used increasingly since early 1980s in social research. The mixed method involves collecting both quantitative and qualitative data either simultaneously or sequentially to best understand the research problems (Creswell & Clarke 2011; Tashakkori & Creswell 2007). The mixed method enhances the understanding of the research problem and confirms the findings from different sources of data (Creswell & Clarke 2011). This research uses data from three sources - content analysis of annual reports, a questionnaire survey and interviews to get a clear picture of CSR practices in the pharmaceutical industry.

4.1 Content Analysis

This study undertakes content analysis of annual reports of pharmaceutical companies. The annual report is a common, popular and credible means of communication to stakeholders (Guthrie and Parker, 1990; Singh and Ahuja, 1983; Adams, 2004; Gray et al., 1995a, 1995b; Raman, 2006). Separate corporate social disclosure reports by publicly listed limited companies in the pharmaceutical sector published between 1 July 2009 and 30 June 2010 were also reviewed. Taking 2009-2010 as the target year, we consider all the pharmaceutical companies (thirty) that were listed on the Dhaka Stock Exchange (see the Appendix for full list). The year 2009-2010 is chosen as this is the period just after the start of Global Financial Crisis (GFC).

The results show that eight companies out of thirty or 26.67% made disclosures relating to corporate social performance. These eight reporting companies were systematically analyzed using content analysis. This technique is defined 'as a method of copying the text (or content) of a piece of written work into various categories on the basis of selection criteria' (Krippendorf, 1980, p. 21). This technique has been used in other studies (Guthrie and Parker, 1990; Raman, 2006). Content analysis employs a three-step process (Raman, 2006). First, an appropriate document is chosen. For this study, directors' reports, chairpersons' reports, separate sections of annual reports and separate sustainability reports were selected.

The second step is to determine the unit for measuring content. Different researchers use different units of measure. For example, Zeghal and Ahmed (1990) used the number of words, Hackston and Milne (1996) the number of sentences, and Gray et al. (1995b) the number of pages. Indeed there has been considerable debate about these different measures (Gray et al., 1995a; Milne and Adler, 1999; Unerman, 2000). For example, in relation to measurement of pages, some researchers do not consider font size, line spacing, and page margins. Others argue that words would have no meaning unless they are part of a sentence (see Raman, 2006). Raman (2006) argues that pages are preferred since they can be easily counted and involve less judgment. Since different companies use various page sizes,, line spacing, and page margins, to be consistent in the measurements we typed the CSR content from each report in a separate Word file and measured the number of pages used. Previous CSR studies (Imam, 2000; Belal, 2000, 2001; Hossain, Islam, and Andrew, 2006) did not take this fact into consideration.

The third step in content analysis involves identifying themes or categories into which blocks of content can be classified. The earlier work of Ernst and Ernst (1978), Guthrie and Parker (1990), and Gray et al. (1995a) is used to organize information into four categories: *Theme*, *Form*, *Amount* and *Location*. *Theme* was based on variables such as environment, energy, human resources, products, community involvement, and miscellaneous. The *form* of disclosure includes quantified data, either monetary or non-monetary, and qualitative or declarative data. *Amount* measures the proportion of pages devoted to social responsibility issues. *Location* refers to directors' and/or chairpersons' reports, separate sections of annual reports and separate or stand-alone reports.

4.2 Questionnaire Survey on Management perceptions

Initial contact with all twenty four pharmaceutical companies on the Dhaka Stock Exchange was made through formal letters. The letter was addressed to company secretaries and resulted in 15 favourable responses (six of them are from companies who disclosed CSR). Company secretaries (who in many cases also held the post of Chief Accountant or Finance Director) formed the initial point of contact with the selected organisations. One hundred and twenty one survey instruments were sent to the nominated person of each company to complete. The survey instrument started with a brief introduction of the project, together with an outline of the survey's objectives. A promise of anonymity was given that neither the person involved nor their respective organisation would be identified. Following general introductory questions relating to demographic information about the organisation and the person's role in it, subsequent questions broadly focused on the key issues identified from our review of the CSR literature and knowledge of the Bangladeshi environment. After several reminders, we received 34 questionnaires, a response rate of 28%.

4.3 Interview on Stakeholders' Perceptions

To analyse stakeholder perceptions, this paper examines why and how stakeeholders' points of view are held and the context in which they are maintained. In order to conduct this study, eleven individuals were interviewed. All of them are Bangladeshi and are from various non-managerial stakeholder groups. The author's tacit knowledge of Bangladesh aided the selection of these interviewees. Initial contact was made by e-mail where possible. However, the majority were contacted personally by telephone during a field visit to Bangladesh. Most of the interviewees were fairly independent of any business affiliations and collectively they formed part of the civil society that is influencing the socio-cultural development of Bangladesh.

The duration of the interviews ranged from 20 to 25 minutes. All interviews started with a brief introduction of the research and an outline of the objectives of the interview. With the permission of the interviewees a tape recorder was used to record their comments and all recorded interviews were transcribed. It was agreed that neither the interviewees nor their respective organizations would be identified. The interviews are analysed according to the matter they discussed. The following table provides the interviewees' employment positions.

Following a semi-structured interview protocol, interview questions encouraged open-ended responses that allowed interviewees to comment from their particular perspective. Topics covered in the interviews were stakeholder perceptions in respect to: (i) the degree of understanding of the concept of CSR (ii) current trends on CSR practice and disclosure (iii) the role of CSR disclosure in the Bangladesh economy, (iv) companies' motives to report on CSR and (v) arguments for and against mandatory regulation regarding CSR disclosure.

The above interviews generated over sixty pages of data. A summary of each interview was prepared and analysed. These summaries helped to identify the differing comments and beliefs of stakeholder groups and the most commonly occurring themes and viewpoints.

5. Empirical findings of the study

5.1 *First Research Dimension*

As none of the listed companies implemented GRI G3 it was difficult to prepare a CSR worksheet according to a standard breakdown. Lack of a widely accepted definition of 'social responsibility' creates the problem of multiple interpretations. Probably the most well-known studies in this area are by Ernst and Ernst (1978), Guthrie and Parker (1990), and Gray et al. (1995a). Ernst and Ernst's (1978) analysis of annual reports of *Fortune 500* companies revealed specific indicators of different categories of social involvement.

In answering the first research question, a corporate social responsibility worksheet was used with the following headings: (i) environment (ii) human resources (iii) community involvement, and (iv) product safety. Most information disclosed in annual reports relates to prevention or repair of environmental damage, employee health and safety, employee training, community activities, health-related activities, education and arts, and safety. For example, in Beximco Pharmaceutical Ltd.'s annual report the company disclosed at length:

We donate and make available a large quantity of medicines to the victims of natural disasters, both national and international. Medicines for the victims of earthquake and cyclone…responding to the needs of thousands of AIDS patients in the country, we are proud to be associated with the initiatives to provide treatment for these patients. Since 2005, Beximco Pharma has been supplying ARV drugs through Dutch Bangla Bank, a leading local bank, for treating the AIDS patients in Bangladesh. These ARV drugs are distributed through Ashar Alo, Mukto Akash, and Confidential Approach to AIDS Prevention (CAAP) - NGOs working for the HIV/AIDS patients…

Content analysis revealed that 87.5% of disclosures are generalized qualitative statements without supporting evidence. Twelve and a half percent of companies used both monetary and non-monetary quantification. For example, Glaxo SmithKline in its annual report disclosed:

Our community investment programs, such as Work Global Help Local provide an additional resource for addressing healthcare challenges around the world. They support under-served communities through funding, education, practical support and product donations.

Yet this company did not try to include any quantified evidence to support this claim.

Our analysis also reveals the location of disclosures. Alternative formats include a separate report (director's report, chairperson's report, separate section of annual report and separate or stand-alone report) or a combination of different formats. The most popular places for locating social responsibility disclosures are the director's report (37.5%), and separate section of the annual report (37.5%), while 25% used the chairpersons' report.

The mean amount of disclosure varied between one quarter of a page and half a page, with 61.11% of companies disclosing less than one quarter of a page, and 11.11% disclosing more than one page. To be consistent for the purpose of comparison we typed all the social and environmental disclosure sections from the annual report into a separate Word file using an A4 format, 12pt *Times New Roman*, margins: top -2.5 cm, bottom, left and right - 2 cm each. Given this standard paper size the measurement of 'pages' attributed to a particular form of disclosure should be reasonably constant.

Companies operating in the pharmaceutical sector in Bangladesh are expected to acknowledge their wider obligations to investors and other stakeholders such as employees, the government, consumers and the wider community. Owing to the presence of a unionized labor force and emphasis on a well trained workforce, employee disclosures do occur much more in Bangladesh compared to other developing countries. Moreover, pressure groups in recent times are putting pressure on industries for more social disclosure to benefit consumers (Belal, 2001). Again the government of Bangladesh appears to be more committed to protecting the environment, which is evident in the creation of the Environment Protection Act, 1995. With a re-activated capital market, rising foreign investment, increased public awareness and the government's emphasis on social welfare, pharmaceutical companies are increasingly expected to provide more social disclosure.

5.2 *Second Research Question*

To discover the motives for CSR disclosure and non-disclosure the survey questionnaire was sent to the executives of 15 pharmaceutical companies who were disclosing CSR information. Respondents were asked to discuss the reasons for making such disclosures. On the other hand, respondents from the non-disclosing companies were asked to comment on the reasons for avoiding CSR disclosures in their annual reports.

The analysis reveals that major reasons for reporting on CSR are corporate accountability to employees and society which will, in turn, help companies ensure sustainable development. CSR provides companies with an opportunity to meet their objectives of being good corporate citizens by engaging with all their stakeholders in an open, honest and constructive dialogue. Improving corporate image and relationships with stakeholders is one of the major reasons, cited by the majority (60 per cent) of respondents, for reporting corporate social performance. Forty per cent of the respondents reporting on CSR consider it to be a relatively new requirement aimed at responding to increasing demands in society for accountability and transparency. The Survey provides a number of examples in the 'other reasons' category. These examples include meeting buyers' or creditors' requirements, meeting the principles of AA 1000, following the GRI guidelines, achieving ISO 14000 certification, observance of the World Bank guidelines and obtaining awards for CSR . However, none of the respondents mention any of these factors. Although some banks and financial institutions check for any potential social and environmental hazards before advancing loans and credit to new projects, they do not require any formal CSR from the clients.

In contrast, all the respondents of non-disclosing companies indicated that there is neither any legislative requirement nor any pressure from stakeholders for such a report. It appears that the absence of mandatory requirements for CSR provides them with a convenient pretext for avoiding any action in this area (Belal 2007). Only 10 percent of the respondents contended that some of the reasons for non-disclosure may be attributable to lack of awareness and knowledge amongst corporate managers regarding CSR and related disclosures. Some respondents raised the issue of additional cost burden and several companies refrained from such reporting because they did not undertake enough social activities and additional disclosures could increase the risk of adverse publicity, particularly if the disclosures are not positive. As found in this study, 40 percent of the respondents do not undertake CSR disclosure due to the fear of bad publicity at home and abroad (for example, foreign buyers). In addition, 30 per cent of the non-disclosing respondents find no need for disclosures as they do not create any social or environmental hazard. An inherent danger is that such disclosures may result in unsolicited invitations to participate in charity or community projects requiring huge financial commitment on the corporation's part.

The companies making CSR disclosures were also asked about the procedure of preparing the CSR reports, the importance of making such reports, and measurement and recording of costs related to corporate social performance. With respect to procedures for preparing the CSR report, most of the respondents answered anonymously that they did not follow any standard format. Similar reporting by peer companies was the major factor motivating them to follow their style of reporting. Establishing a dialogue with key stakeholders is central to their approach and the social report is structured around the main topics raised in dialogue with stakeholders.

5.3 Third Research Question:

Based on the literature review and analysis of the interview data, this research observed two recurring themes that are salient to the discussion of corporate stakeholder responsibilities and CSR. The first theme relates to how stakeholders perceive the role of corporations within the ongoing economic, political and social development of their country. The second theme relates to stakeholders' evaluations of companies willingness and ability to adopt CSR standards. It is important to point out that these two themes are complementary to each other. This research concluded that, in a developing country like Bangladesh, the successful application of CSR may require a recognition and understanding of the willingness and ability of the developing country to accept and internalize this practice. As our first theme acknowledges, there can be tension between Western notions of normative stakeholder principles and existing economic, political and social cultures.

The interview results indicate that a large majority of interviewees (10 of 11) are in favour of CSR in Bangladesh. From a normative stakeholder perspective interviewees argued that the overriding purpose of social accounting and auditing should be to discharge accountability to all relevant stakeholder groups in a democratic and transparent manner (Belal and Roberts, 2010). According to them, the CSR process should be based on stakeholder engagement. However, the current practice of CSR in Bangladesh is viewed as being far from satisfactory and one that does not promote the desired levels of transparency and accountability. Furthermore interviewees in this study were highly sceptical about the corporate motives behind CSR reporting. In their opinion, public relations concerns appear to be the primary motive. Questions were raised about the genuine intentions of corporations with regard to CSR, especially in relation to the intentions of locally owned corporations that are thinly capitalized.

Interviewees expressed their concerns with profit oriented arguments against CSR, often viewing political pressure and government regulation as the most likely way to effect positive change. Tsoi (2010) reached similar conclusions when she examined Chinese stakeholders' perceptions of CSR. This is also consistent with the findings of Belal and Owen (2007). Given this high level of corruption, it is also hard to anticipate the consequences that may be generated from any stakeholder-oriented legislative reforms. In other words, when regulatory changes are implemented, stakeholders may face new forms of risk.

A number of the interviewees believe that pressure on corporations operating in Bangladesh to engage in CSR would come from global market participants as the country becomes more integrated into the global economy. This could also encourage an adoption of global CSR standards such as the SA8000 social accountability standards that are supported by International Labour Organization (ILO) conventions. However, views on the relevance of SA standards to developing countries like Bangladesh were mixed. The principal argument in their favour is that corporations are interested in adopting SA standards mainly for economic reasons.

The CSR agenda in Bangladesh, as in other developing countries, will be driven by 'outside' forces such as international market participants. As explained in interview 1:

"…There are two reasons why companies in Bangladesh do CSR: First, there is pressure. For example, pharmaceutical industry. The foreign buyers provide the pressure. The pharmaceutical companies are doing the minimum compliance to secure their market. Pressure from the stakeholders is minimum. Secondly, doing charities. This becomes a matter of prestige in Bangladesh's socio-context."

(Interviewee 1)

This stands in sharp contrast to the situation in developed countries where the pressures for CSR appear to be generated by the media (Brown and Deegan, 1999), NGO/pressure groups (Tilt, 1994), ethical investors (Friedman and Miles, 2001) and regulation (Larrinaga et al., 2002).

Secondly, Western CSR standards should be applied in the developing countries after due consideration of the local context.

"Many companies believe that they don't need to do any CSR. In Bangladesh nobody cares whether you are paying the wages properly, discharge the factory waste properly, ect. You get away with everything with providing bribe."(Interviewee 5)

Eighty precent of respondents also complain that there is no real benefit of voluntary disclosure of CSR in the annual report. Companies are reluctant to incur this extra cost of disclosure unless there is pressure from a buyer group:

'……But there are no direct incentives from CSR disclosure. In other countries the CSR expenditure is tax deductible. But in Bangladesh that is not the case. There is no such thing so far. Some countries provide tax holiday for CSR activities. There is no such thing introduced by the govt." (Interviewee 3)

Thirdly and finally, some respondents indicated that at least the core provisions of CSR should be made mandatory. However, it is important to establish proper monitoring mechanisms for effectively implementing legislation. Relevant enforcement agencies must be strengthened and adequately resourced:

'In recent time some local 'watchdogs' are developing in Bangladesh. They are working for changing the perception of the general public. A CSR center is established by Bangladesh Enterprise Institute (BEI). Centre for Policy Dialogue (*CPD*) *D.Net's and others are also doing projects. Some awards are introduced for CSR activities. Some knowledge sharing is taking place. Even a newspaper called 'Prothom Alo' is doing some CSR.' (Interviewee 11).*

The overall impression that we glean from this analysis is that there are concerns regarding the imposition of international standards in Bangladesh. Nonetheless these concerns appear to be related to the process of implementing the standards and what they actually achieve rather than the content of the standards. As mentioned by one of Interviewee:

"I believe the role and impact of CSR is more important in developing nations than developed country. In developed country, it is used to enhance leisure affair. It means cleaning the beach or reducing pornography. CSR is more about commercial intent in developed countries. May be a lot of social problems and issues are looked after by the state or government in developed countries so that the companies do not worry about those". (Interviewee 10)

CSR is often performed strategically as a way to manage impressions regarding corporate social responsibility. It is therefore reasonable to assume that interviewees fear that these standards might not necessarily lead to the desired change in corporate behaviour.

6. Conclusion

In Bangladesh, social and environmental disclosure trends have improved over the last few years. As far as the pharmaceutical industry is concerned, it is still only undertaking a minimum level of CSR reporting compared to other sectors. Without question, pharmaceutical companies have a moral obligation to society to provide people, especially the poor, with affordable medication. Presently, pharmaceutical giants have disregarded this responsibility and have ignored their CSR obligations. The need for pharmaceutical industries to conduct sustainable development in Bangladesh is urgent - they can help by playing a meaningful and practical role.

It has been demonstrated that more than one third of the total number of pharmaceutical companies in Bangladesh provide social disclosure. However, most corporate social disclosures are qualitative in nature. These conclusions are similar to Azim et al. (2009) and Belal (2010) who find that quantification of CSR disclosure by selected listed companies in Bangladesh is limited. Even where CSR disclosures are made, there is no independent verification of this information, so the credibility of the information is questionable. More than two thirds of CSR is located in the director's report and in a separate section of the annual report and the average length of disclosures amounts to less than quarter of a page. Pharmaceutical companies in Bangladesh emphasize the disclosure of prevention of or repair of environmental damage, employee health and safety, employee training, community activities, health related activities, education and arts, and safety. In addition to following a socially responsible business model, pharmaceutical companies undertake many activities related to better healthcare of the community.

The research has found that the major reasons for undertaking CSR reporting are corporate accountability to employees and society which will, in turn, help ensure sustainable development. On the other hand, all the respondents of non-disclosing companies indicated that there is no legislative requirement and no pressure from stakeholders for such reporting.

The research indicates that current disclosure practices have largely failed to meet stakeholders' expectations. The interviews revealed that many stakeholders wanted a mandatory requirement for corporate social disclosure. Given the level of corruption and bribery in Bangladesh, it is likely that any mandatory requirements relating to CSR reporting will have unintended consequences of breeding further corruption as pointed out by some of the interviewees. Unless the problems of corruption and bribery are removed from the bureaucracy the danger remains that CSR laws will not be enforced. Therefore, whilst mandatory requirement for CSR reporting are desirable, law enforcement agencies should be strengthened at the same time in order to effectively monitor CSR reporting practices and assist in their implementation. This is an understandably complex issue and needs further research.

In this paper we briefly discussed Bangladesh's Global Compact launch in 2009. In future research it might be worth seeing whether the Global Compact has had an impact on CSR disclosure (for example, by considering disclosures over the period 2009-2012).

Another possibility is to look at the industry guidelines and understand whether disclosure is in line with the guidelines over time.

Given the presence of widespread corruption, an unstable political situation, deteriorating law enforcement and the influence wielded by the country's social elite, non-compliance with the law often encourages companies to not engage in social and environmental commitments or at least disclose them very inadequately. CSR is still a 'hard pill to swallow' for pharmaceutical companies in Bangladesh.

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